



COVERSHEET

Minister	Hon Poto Williams	Portfolio	Building and Construction
Title of Cabinet paper	Construction Contracts Act 2002: Further Amendments to Retention Money Regime	Date to be published	5 May 2021

List of documents that have been proactively released		
Date	Title	Author
17 March 2021	Construction Contracts Act 2002: Further Amendments to Retention Money Regime	Office of Hon Poto Williams
22 March 2021	Construction Contracts Act 2002: Further Amendments to Retention Money Regime – Minute of Decision	Cabinet Office

Information redacted

YES

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld to protect the confidentiality of advice tendered by ministers and officials..

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Office of the Minister for Building and Construction

Cabinet Economic Development Committee

Further Amendments to the Construction Contracts Act 2002 (Retention Money Regime)

Proposal

- 1 This paper seeks approval for further policy changes to the retention money regime in the Construction Contracts Act 2002 (CCA), following feedback from stakeholders on an exposure draft of the Construction Contracts (Retention Money) Amendment Bill (the Bill).

Relation to government priorities

- 2 Government and the construction industry are working together to transform the building and construction sector through the Construction Sector Accord [DEV-19-MIN-0335 and CAB-19-MIN-0652 refer]. As part of the Accord Transformation Plan, Government and industry have considered changes to retention money.
- 3 The protection and transparency of retention money supports economic recovery efforts underway in the building and construction sector due to COVID-19. New requirements for withholding retention money align with current priorities to maintain a steady cash-flow and business confidence within the building and construction sector.

Executive Summary

Previous Cabinet decisions

- 4 Cabinet has approved legislative changes to the retention money regime to clarify and strengthen existing requirements [CAB-20-MIN-0239 refers]. Following consultation on an exposure draft of the Bill, I seek approval for further policy changes that support the Government's goal for better protection of retention money.

Retention money regime

- 5 Retention money is an amount withheld by a party to a construction contract (party A, a 'payer' who may be a head contractor) from an amount payable to another party to the contract (party B, a 'payee' who may be a subcontractor) as security for the performance of party B's obligations under the contract.
- 6 The CCA regulates retention money for construction companies that decide to hold retention money. Holding retentions is voluntary. The amount withheld as retention money is set in the construction contract, and typically ranges

IN CONFIDENCE

between five and ten per cent of the contract value. Retention money is usually paid 12 months after the completion of a contract.

- 7 While retention money forms part of the security to ensure that a subcontractor fixes any defects with their work, there have been instances where head contractors have used retention money as working capital. The use of retention money as working capital can add additional financial risk for businesses. For example, if a head contractor becomes insolvent before paying retention money, there can be substantive financial loss for subcontractors. This can be seen following the separate collapse of Arrow International (NZ) Limited, Ebert Construction Limited, Stanley Group and Tallwood Holdings.

Consultation on an exposure draft of the Bill

- 8 Since Cabinet's decision to make legislative changes to the retention money regime, the Ministry of Business, Innovation and Employment (MBIE) has sought feedback from the building and construction sector on an exposure draft of the Bill. Stakeholders were broadly supportive of the changes.
- 9 A number of issues raised by stakeholders as part of consultation require further Cabinet approval to address. Addressing these issues ensures the operability of the Bill, and the durability of changes.
- 10 I seek approval for the following changes to:
- 10.1 further clarify the trust requirement for retention money by removing the use of liquid assets as a way to hold retention money;
 - 10.2 agree that retention money held as cash may be held aside separately in a bank account with prescribed ledger accounts
 - 10.3 further improve the transparency of retention money held by introducing regular reporting requirements and confirmation of retention money held;
 - 10.4 introduce an additional new offence and penalty in the CCA to deter the provision of false information on retention money; and
 - 10.5 avoid the duplication of existing legislation by clarifying the interaction between the Public Finance Act 1989 and the CCA.

11

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Background

- 12 Subcontractors can face significant business risk and loss in profits if retention money is not paid when due. The issues with the treatment of retention money have become apparent following the collapse of major construction

I N C O N F I D E N C E

companies since 2013. Amending the CCA will provide additional protections for subcontractors in relation to retention money.

Cabinet decisions in May 2020

- 13 On 25 May 2020, Cabinet agreed to a package of legislative changes to the retention money regime in the CCA [CAB-20-MIN-0239 refers]. This includes:
 - 13.1 Clarifying the existing trust requirement and removing the ability to co-mingle retention money with other money and assets held by the head contractor. This clarification will ensure greater protection for subcontractors' retention money in the event of insolvency, as the money will be clearly identifiable and separate from other assets held by the head contractor.
 - 13.2 Requiring the payment schedule (a form of invoice) to include information on the amount of retention money held. This is intended to notify subcontractors of the retention money held and provide greater transparency.
 - 13.3 Introducing offences, penalties and defences for companies (e.g. head contractors) and their directors for failure to comply with the requirement to hold retention money on trust. The strict liability offence will improve compliance, and personal liability for directors will cover instances where a breach is discovered at the point of company insolvency.
 - 13.4 Allowing the receiver or liquidator appointed to administer retention money and charge reasonable fees, in the event the head contractor becomes insolvent. This change has the effect of allowing subcontractors access to retention money without a court order, which would add further costs, time and complexity.

Feedback on the exposure draft of the Construction Contracts (Retention Money) Amendment Bill

- 14 An exposure draft of the Bill was released to selected stakeholders in August 2020 to seek feedback on the workability and durability of the changes to the retention money regime. The process allowed opinions to be heard from the building and construction sector, and for any changes to be incorporated in the Bill prior to introduction.
- 15 MBIE received feedback from a variety of stakeholders in the building and construction sector on an exposure draft of the Bill. Stakeholders included subcontractors, head contractors, accountancy firms, legal firms, and insolvency practitioners.
- 16 Stakeholders were broadly supportive of the changes. Feedback from the exposure draft included a number of suggestions to:
 - 16.1 allow retention money for different subcontractors to be held in separate ledger accounts of a bank account;

I N C O N F I D E N C E

- 16.2 remove the use of liquid assets as a way of holding retention money;
- 16.3 provide further information and reporting on retention money; and
- 16.4 create an additional offence and penalty for providing false information on retention money.

Details of the proposed additional changes to strengthen and clarify the retention money regime in the CCA

Safeguarding retention money while balancing costs to industry

- 17 I heard concerns from submitters during the exposure draft process about the additional cost and administrative burden created by requiring a head contractor to set up separate bank accounts for retention money for each subcontractor or construction project. As a way of balancing costs while better protecting subcontractors, stakeholders suggested enabling the creation of separate ledger accounts for retention money held in one (still separate) bank account.
- 18 I propose that for retention money held as cash, money may be held separately in a bank account with prescribed ledger accounts. This aligns with existing Cabinet decisions and ensures further transparency and assurance for subcontractors.
- 19 Under this proposal, each ledger account would represent a separate trust arrangement. A potential result of these separate arrangements would mean that, in the event of insolvency, retention money would be paid out to the individual subcontractor, in accordance with the trust arrangement. The use of separate ledgers will also result in transparency of accounting records.

Removing liquid assets

- 20 I received feedback regarding the use of liquid assets as retention money being a cause of confusion and insecurity in the building and construction sector, undermining the intent of the trust arrangement.
- 21 Liquid assets include shares, bonds, and property. The introduction of the ability to hold retention money in liquid assets in 2015 was intended to support the use of retention money across the contracting chain to provide additional options for parties. However, it has transpired that in practice liquid assets are unlikely to be recoverable in the case of insolvency.
- 22 I propose to remove liquid assets as an available option for holding retention money from the CCA. This will further clarify the trust obligation by ensuring that retention money is available in the event of insolvency.

Improving the transparency of retention money held

- 23 Stakeholders have provided feedback calling for the prompt confirmation of the retention money held through a receipt, and for more regular reporting of retention money held. Existing requirements under the CCA allow

IN CONFIDENCE

subcontractors the right to request and inspect accounting records from head contractors at reasonable times and without charge.

24 I have considered the frequency of reporting requirements and the need to strike a balance between the benefits of assurance and transparency to the subcontractor and the administrative costs imposed. I propose that the following new reporting requirements be created:

24.1 Confirmation of retention money held be provided on the transfer of retention money into a separate account. When retention money is held as a complying financial instrument, this can be in the form a receipt; and

24.2 Information on the status of any retention money held be provided regularly, at least every three months. For retention money held as cash, information can be provided in the form of a bank statement or a copy of a ledger account.

Additional offences and penalties to supporting new transparency measures

25 A failure by head contractors to provide transparent records of retention money held can create uncertainty and undermine business confidence within the building and construction sector. Feedback during the exposure draft process included suggestions of introducing an additional offence for providing false information on retention money held.

26 An additional new offence would deter head contractors from providing false information, which undermines subcontractors' ability to inspect records for retention money held on their behalf. The offence would encourage compliance with reporting requirements, and improve the accuracy of information provided before a company becomes insolvent.

27 I propose to introduce an additional offence to cover parties providing false information on retention money held under the CCA. This will be an intention based offence and not subject to strict liability.

28 I propose that a maximum penalty amount of \$50,000 apply for the additional offence described in paragraph 26. This amount aligns with the wider retention money regime, and similar requirements under the Companies Act 1993 and the Lawyers and Conveyancers Act 2006.

Interface between the CCA and Public Finance Act 1989

29 During consultation on the exposure draft of the Bill, a number of legal and technical questions were raised by government departments (core Crown) and Crown entities, in particular the effect of the new trust requirement on the Crown.

30 The requirement to establish a separate bank account for retention money under the CCA is very similar to existing requirements under the Public Finance Act 1989 (PFA). Part 7 of the PFA regulates the use of trust money by the core Crown. This includes requirements for: how trust money is

IN CONFIDENCE

accounted for, interest, investment, payment, and the holding of trust money aside from other public money in a separate bank account.

- 31 The changes to the retention money regime are intended to further protect retention money and ensure that retention money is held in a bank account on trust separate from other funds. These new provisions will duplicate existing legislative requirements for the core Crown under the PFA. The core Crown is also held to account for trust money through the existing parliamentary process, providing additional scrutiny and transparency of trust money.
- 32 As part of the exposure draft process, I heard from Construction Sector Accord Steering group members on the impact of using the existing PFA provisions, compared to the proposed new requirements. Members of the Accord Steering Group did not have any issues or raise any concerns regarding the Crown's use of part 7 of the PFA for retention money that is trust money.
- 33 MBIE officials have also engaged with departments and Crown entities on the effect of the new provisions. Departments expressed a preference for utilising existing requirements to avoid additional compliance and administrative costs with limited benefit to subcontractors.
- 34 Crown entities are not subject to part 7 of the PFA, and are therefore currently subject to the CCA. I do not propose any changes to requirements for retention money for Crown entities.
- 35 I propose that, where there is a duplication of existing legislation with similar outcomes, the core Crown:
- 35.1 be held to account through the existing mechanisms under the PFA;
 - 35.2 utilise existing interest and investment provisions under the PFA; and
 - 35.3 account for retention money, as trust money in accordance with the PFA.
- 36 Where there is no duplication, the core Crown would continue to be subject to other aspects of the retention money regime, including the proposed changes. More broadly, the core Crown would continue to be subject to the provisions under the CCA.

Next Steps

37

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Financial Implications

- 38 There are no direct financial implications to the Crown under this package.
- 39 Based on analysis provided by MBIE officials for previous Cabinet decisions on changes to the retention money regime, initial administrative costs to the

building and construction sector are approximately \$55 million. However, once established, administration costs will diminish to approximately \$16 million per annum across the building and construction sector [CAB-20-MIN-0239 refers]. The benefits are expected to be between \$50 and \$100 million per annum in avoided financing and insolvency costs.

Legislative Implications

40 In order to strengthen and clarify the retention money regime, the CCA will need to be amended. Part 2 of the CCA outlines provisions for holding retention money.

41 The CCA binds the Crown. The proposed amendments will also bind the Crown.

42

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Impact Analysis

Regulatory Impact Statement

43 The Regulatory Quality Team at the Treasury has determined that the regulatory proposals in this paper are exempt from the requirement to provide a Regulatory Impact Statement on the basis that the substantive issues have been addressed by previous impact analysis titled "Proposed Amendments to the Construction Contracts Act 2002 (Retention Money Regime)", available at <https://www.treasury.govt.nz/sites/default/files/2020-07/ria-mbie-cons-mar20.pdf>.

Climate implications of policy assessment

44 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

45 The proposals in this paper are not expected to have significant implications for population groups.

Human Rights

46 The proposals in this paper are not inconsistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

47 The following agencies and Crown entities were consulted on the proposals in this paper: Ministry of Housing and Urban Development, Treasury, Te Puni Kōkiri, Kāinga Ora, Department of Internal Affairs, Ministry for the Environment, Ministry of Health; Ministry of Education, Department of Corrections, Ministry of Justice, Waka Kotahi NZ Transport Agency,

IN CONFIDENCE

Department of the Prime Minister and Cabinet, Inland Revenue Department, Financial Markets Authority, Infrastructure Commission, and WorkSafe.

Communications

48 A media statement will be issued once Cabinet decisions have been made.

Proactive Release

49 This Cabinet paper and associated minute will be published on MBIE's website subject to any necessary redactions.

Recommendations

The Minister for Building and Construction recommends that the Committee:

1 **note** that additional changes to strengthen and clarify the retention money regime will support a high-performing building and construction sector and align with previous Cabinet decisions to amend the retention money regime in May 2020 [CAB-20-MIN-0239-refers];

Safeguarding retention money while balancing costs to industry

2 **note** that the amended Construction Contracts Act 2002 will clarify that retention money be held separately on trust;

3 **note** that the use of liquid assets as retention money creates additional risk and uncertainty to subcontractors;

4 **agree** that retention money held as cash may be held aside separately in a bank account with prescribed ledger accounts;

5 **agree** to amend the Construction Contracts Act 2002 to remove the use of liquid assets as a way of holding retention money;

Improving the transparency of retention money

6 **note** that regular reporting and confirmation of retention money held will provide greater assurance to subcontractors;

7 **agree** to amend the Construction Contracts Act 2002 to require that a confirmation of retention money held be provided on the transfer of retention money into a separate account or when retention money is held as a complying financial instrument;

8 **agree** to amend the Construction Contracts Act 2002 to require information on the status of any retention money held be provided at least every three months;

Offences and penalties

- 9 **agree** to amend the Construction Contracts Act 2002 to introduce an offence for providing false information on retention money under the Construction Contracts Act 2002;
- 10 **agree** to a maximum penalty amount of \$50,000 for providing false information on retention money held under the Construction Contracts Act 2002;

Interface between the Construction Contracts Act 2002 and Public Finance Act 1989

- 11 **note** that the core Crown is subject to provisions for trust money under part 7 of the Public Finance Act 1989;
- 12 **agree** that where there is a duplication of provisions for trust money for the core Crown under the Public Finance Act 1989 and the retention money regime under the Construction Contracts Act 2002, the Crown be subject to the existing provisions under the Public Finance Act 1989;

Commencement

- 13 **note** that the new requirements will come into force six months after Royal Assent and will apply to new construction contracts, and renewed or new construction contracts entered into for an existing project;

Drafting instructions

- 14 **note** that the proposals will be given effect through a Construction Contracts (Retention Money) Amendment Bill;
- 15 **invite** the Minister for Building and Construction to issue drafting instructions to the Parliamentary Counsel Office to give effect to the proposals in this Cabinet paper;
- 16 **authorise** the Minister for Building and Construction to make decisions consistent with the proposals in this Cabinet paper on any issues which arise during the drafting process;

Communications

- 17 **note** that a media statement will be issued once Cabinet decisions have been made.

Authorised for lodgement

Hon Poto Williams

Minister for Building and Construction