Regulatory Impact Statement

Review of the Construction Contracts Act 2002: Proposals for change

Agency disclosure statement

1. This Regulatory Impact Statement has been prepared by the former Department of Building and Housing.
2. It provides an analysis of options to improve the adjudication process under the Construction Contracts Act 2002.
3. The Department undertook a literature review, two consultations and commissioned market research to determine the nature and scope of residential construction disputes. As a result three significant gaps in dispute resolution services were identified:
    - a central source of advice on dispute resolution services
    - an 'early intervention' service to help parties resolve any disagreement as early as possible through negotiation or mediation
    - a fast and cost-effective adjudication service which people are aware of and which is clearly available for general building disputes.
4. Feedback from key stakeholders and submissions received through public consultation suggests making minor amendments to the Act will improve efficiency and effectiveness.
5. The changes to the adjudication process will help parties hold each other to account in line with the wider Building Act reforms, especially relating to the consumer protection and remedy measures.
6. The purpose of the policy is to make the existing adjudication process faster, more efficient and cost effective.
7. The preferred policy option will not:
    - impose additional compliance costs on businesses
    - impair private property rights, market competition or incentives on businesses to innovate or invest
    - override fundamental common law principles.

Dave Kelly
Deputy Chief Executive Building Quality, Department of Building and Housing
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Status quo and problem definition

8. Disputes frequently arise under construction contracts. Market research commissioned by the Department of Building and Housing in 2010 indicated 19% of residential consumers felt they had a major dispute with their building practitioner, either before, during or after building work was carried out.
9. The Construction Contracts Act 2002 (the Act) regulates default progress payment provisions for construction contracts, provides an adjudication framework for people with disputes under construction contracts and provides remedies for recovering unreasonable non-payment under construction contracts.
10. The adjudication process under the Act is optional. It is one of several dispute resolution services consumers and contractors can choose to resolve disputes. The Disputes Tribunal and the Courts are the two other primary options – the low-cost Disputes Tribunal being appropriate for lower value and straightforward disputes, and the high-cost Courts for higher value and complex disputes.
11. The benefit of adjudication under the Act is that disputes are heard by adjudicators who have in-depth knowledge and experience of disputes under construction contract (as opposed to Dispute Tribunal referees or judges, who have a more general knowledge of the law), meaning adjudication can be a better option for construction contract disputes.
12. Since the Act came into force, Authorised Nominating Authorities (private organisations that nominate adjudicators to hear disputes) have heard approximately 700 claims under the Act. The number of claims that have been heard by adjudicators not nominated by Authorised Nominating Authorities is unknown.
13. Submissions from the Building Act Review in 2010 supported the adjudication process under the Act, but a number of discreet issues were identified as making it difficult for some parties to resolve disputes. A number of the issues relate more to residential building contract disputes than to commercial.
14. The prescribed process provides little incentive for some parties to use the Act, particularly due to the limited scope of the Act to residential contracts. This can result in court action used as a first resort to resolving a dispute rather than as a last resort. The current Act is unclear about what residential construction contracts can be resolved at adjudication. As a result, consumers perceive there is no low cost alternative to court action.
15. If the Act remains unchanged there will still be:
    - unequal treatment between residential and commercial construction contracts
    - unequal enforcement options for different kinds of disputes
    - time and cost barriers to enforcing adjudication determinations
    - unclear rights to appeal or contest adjudication determinations

- fewer options for disputes resolution with professional service providers (in particular, those who do design, engineering or quantity surveying work).

Objectives

16. The review's objective is to create a fast, cost-effective and efficient adjudication option for people with building disputes under contract.
17. This will be achieved by:
    - clarifying the types of building dispute that can be, and should be resolved using the adjudication process
    - ensuring adjudication determinations are expert, accurate and enforceable so that building work can continue, compensation obtained or outstanding payments recovered
    - the fair treatment of the parties involved in the building dispute.

Regulatory impact analysis

Option one: Repeal

18. Repealing the Act is not a viable option. Between 1987 and 2002 there was no regulation of construction payments, which increased construction company insolvencies and building debt. The group most affected by insolvency action were the sub-contracting trades.

Option two: Increase consumer education about the Act in its current form

19. Market research conducted for the Department showed almost all commercial construction is preceded by a written contract setting out expectations and deliverables. One-third of residential construction is undertaken without a formal written contract relying on verbal agreements. It is much harder for parties bound by a verbal contract to resolve disputes.
20. Even if the Department increased its education and promotion of the current Act, the barriers caused by the Act's limited scope would continue to exist, which could lead to more confusion – especially when describing which disputes are eligible for adjudication and which are not. Our main concern is some contractors may argue the dispute is outside of the scope of adjudication, creating delays and unnecessarily drawn-out dispute resolution.

Option three: Modify existing adjudication models (for example: tribunals)

21. The Department could create a new tribunal (or even extend an existing tribunal's jurisdiction). These options are expensive and would cut across existing market provision.

22. The Department considered alternative dispute resolution models, such as the Financial Service Providers (Registration and Dispute Resolution) Act 2008, where registration with a dispute resolution provider is mandatory. This model type was discounted as it would place a high compliance cost for the person or company required to register. The costs would be disproportionate on sole and small traders who make up a large proportion of the construction industry.

Option four: Amend the existing Act (preferred option)

23. The preferred option is for an amendment Bill, which if passed would:

- contribute to a fast, cost-effective and efficient adjudication option for people with building disputes under contract. The key proposals for amendment include:
- removing the distinction between how the Act applies to residential and commercial construction contracts
- removing the distinction between enforcement of payment disputes and rights and obligations disputes
- speed up enforcement processes by reducing the amount of time a defendant has to oppose an application to have a determination entered as a judgement
- clarify procedural matters, such as how to seek time extensions to respond to adjudication claims
- clarify how determinations can be appealed, contested and reviewed.
- enable consumers to use existing options of private mediation services, the Disputes Tribunal and court action. The decision to use either the Disputes Tribunal or courts may be based on the financial size of the dispute
- retain the status quo of passing the cost of resolution onto disputing parties.

Costs and benefits of the preferred option

Government	
Costs	**Benefits**
• Developing and maintaining an education programme (as part of the wider education programme agreed to under the Building Act Review and future work on alternative dispute resolution in the building sector). This is subject to further work and costs are unable to be quantified at this stage.	• Adjudication is provided privately and is an existing and established market. • Limited ongoing Government involvement. • Few, if any, financial or administrative costs.

Industry/Sector: Construction

Costs

- Up-skilling of workforce and investment in ongoing training (tempered with fewer disputes and overall savings).
- Cost of filing a claim when disputes arise:
- Dispute tribunal: $30.67 to $102.22.
- Private mediation: $400 to $800.
- Construction Contracts Act adjudication: $500 to $3,000.
- Courts: from $143 to $4000 plus
- All figures exclude legal costs

Benefits

- Potential for expansion of the market (adjudication services) and possibly lower adjudication rates.
- Improvement of existing system that industry knows and already uses.
- Faster dispute resolution, including payment.

Industry/Sector: Adjudication

Costs

- Potential expansion of the market – increased competition.

Benefits

- Increased business through wider range of building disputes that can be resolved through adjudication.

Society: consumers

Costs

Cost of filing a claim when disputes arise:

- Dispute tribunal: $30.67 to $102.22.
- Private mediation: $400 to $800.
- Construction Contracts Act adjudication: $500 to $3,000.
- Courts: from $143 to $4000 plus

Benefits

- Increased information.
- Wider choice of options for dispute resolution.
- Faster dispute resolution, including compensation.

- All figures exclude legal costs

Consultation

24. The public was invited to participate in the Building Act Review between February and April 2010. Consultation on the Construction Contracts Act took place in November and December 2010. During the development of the consumer protection work stream for the Building Act Review, a reference group consisting of consumer groups, construction groups, territorial authorities and lawyers were involved in developing the dispute resolution model.
25. A targeted consultation followed public consultation, comprising representatives from the Construction Industry Council, the Adjudicators' and Mediators' Institute of New Zealand, the Building Disputes Tribunal and the Adjudicators' Association of New Zealand.
26. The following government agencies were consulted: the Treasury, the Ministry of Economic Development, the Ministry of Consumer Affairs and the Ministry of Justice. The Department of the Prime Minister and Cabinet was informed.
27. With the exceptions of two suggestions (strengthening the remedies for non-payment and security of payment measures), the Department incorporated all other substantive suggestions into the preferred option. For those that were not incorporated:
    - the current remedies for non-payment will be strengthened by faster and less-costly enforcement measures. Additional measures to strengthen remedies for non-payment are not considered necessary at this time
    - security of payment measures are already available in the market. Mandating or promoting use of security of payment measures in legislation is not warranted, given parties to a contract are already free to decide on their use when contracting.

Conclusions and recommendations

28. The purpose and principles of the Construction Contracts Act are still relevant and necessary. The distinction within the Act between commercial and residential contracts has led to poor outcomes for residential consumers and contractors. Parties to a construction contract need clear routes to engender the early resolution of disputes. This is especially important if a dispute arises during the building phase, as disputes can cause delays and increase costs.
29. Our recommendation is to make a discreet package of amendments to the Construction Contracts Act to enable commercial and residential construction consumers to access an appropriate, market-driven dispute resolution service. This will be supported by increased consumer information and education about the Act and people's rights and responsibilities.

30. Taken with the other amendments to the Building Act, the introduction of better and more information to residential consumers before they enter into a construction contract, increased take up of the licensed building practitioner scheme (to raise construction standards), there may be a decline in the need for dispute resolution services.

Implementation

31. Implementation of an amended Act will be by the private sector, as it is now. This is not expected to present any risks.
32. To support the implementation, the Department will work with existing providers, key consumer groups and others to ensure the transition stage is as smooth as possible.
33. The Department will raise awareness of the Act and how adjudication under the Act works through consumer information and education.

Monitoring, evaluation and review

34. The preferred option does not introduce a monitoring, evaluation and review cycle to the Act.
35. It is anticipated the Department will continue to work with the Construction Industry Council, and Productivity Partnership to monitor the effects of the Act to determine if further amendments are needed once all of the Building Act review changes have been implemented.