BUILDING PERFORMANCE

Construction Contracts Amendment Act 2015

Retention money withheld under commercial construction contracts

The Construction Contracts Amendment Act 2015 and the Regulatory Systems (Commercial Matters) Amendment Act 2017 amend the Construction Contracts Act 2002 (CCA), providing that payment of retention money withheld under commercial construction contracts must be held on trust or via a complying instrument from 31 March 2017. This requirement only applies to contracts entered into, or renewed, on or after 31 March 2017.

The new retention money provisions provide greater protection of payment for contractors and sub-contractors owed retention money for work done and ensure the money held in retentions is responsibly managed.

Definition
Retention money is defined as: "an amount withheld by a party to a construction contract (party A) from an amount payable to another party to the contract (party B) as security for the performance of Party B's obligation under the contract."

How does it work?

Where payers withhold retention money under a commercial construction contract, the payers must either:

1) hold retention money on trust in the form of cash or other liquid assets readily converted into cash – the default option, or
2) obtain a financial instrument (a 'complying instrument'), such as insurance or a payment bond, to provide third party protection of payment of retention money.

1) Retention money held on trust

When payers choose to hold retention money on trust, the payer becomes a trustee and the payee becomes the beneficiary.

The obligations of the payer holding retention money on trust end when:

- retention money is paid;
- the payee to whom the money is payable agrees to give up their claim; or
- the money ceases to be payable by law, i.e. the money ceases to be payable under the construction contract.

Retention money:

- does not need to be held in a separate trust account
- may be mixed with other money, ie, it can be held in the same bank account as other money
- may be held in the form of cash or other liquid assets
- may be invested and interest earned can be kept provided the investment is in accordance with the Trustee Act 1956.

2) Obtaining a complying instrument

This option allows payers to obtain a complying instrument as an alternative to holding retention money on trust. If a financial instrument is purchased that does not meet the requirements set out in the CCA, then it will not be considered a complying instrument and retention money must be held on trust.

For a financial instrument to be a 'complying instrument' for the purposes of the CCA it must:

- be issued by a licensed insurer or registered bank;
- be issued in favour of the payee or endorsed with the payee's interest;
- require the issuer to pay the retention money to the payee if the payer fails to make payment when it is payable under the construction contract; and
- enable the payer to enforce the promise to pay against the issuer.

The payer is also responsible for ensuring the premium or other money that is payable for the instrument is fully paid and all terms and conditions are satisfied so that the instrument remains in effect.

What can't you do?

Prohibited contract provisions

You cannot include in a contract any terms designed to delay payment of retention money. Any such terms in a contract will be void.

Similarly you cannot include any conditional payment provisions for retention money in a construction contract (known as pay-when-paid provisions). Conditional payment provisions have been banned since the Act came into force in 2003. The amendments make it clear that this ban also applies to provisions for payment of retention money.

NOTE: Payment of retention money, including the promise to pay set out in complying instruments, cannot be conditional on anything other than the performance of the payee's obligations under the contract.

Use of retention money

Retention money that is held on trust cannot be used for any purpose other than to remedy a payee's breach of their obligations under the contract, such as fixing defective work.

What records must be kept?

Parties holding retention money must keep proper accounts that correctly record:

- all retention money held on trust;
- all amounts of retention money protected by complying instruments; and
- all dealings and transactions in relation to the retention money or complying instruments.

In relation to complying instruments payers must keep records of:

- each payer's interest in each instrument;
- the liability limit of each instrument;
- evidence that the premium or other money that is payable has been paid;
- any failure to comply with the terms and conditions of the instrument.

All records that relate to a payee must be made readily available without charge to those parties owed retention money.

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Late payments, interest and fees in relation to retention money

Interest must now be paid on late payments of retentions at the rate agreed under the contract.

In the event of a payer’s insolvency, retention money will be protected. Retention money is not available for the payment of debts of any creditor of a payer and cannot be taken by a court order at the insistence of any creditor of a payer.