

Submission

to the

Transport and Infrastructure
Committee

on the

Construction Contracts (Retention
Money) Amendment Bill

23 July 2021

About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.
2. The following seventeen registered banks in New Zealand are members of NZBA:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of China (NZ) Limited
 - Bank of New Zealand
 - China Construction Bank
 - Citibank N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - Industrial and Commercial Bank of China (New Zealand) Limited
 - JPMorgan Chase Bank N.A.
 - Kiwibank Limited
 - MUFG Bank Ltd
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide feedback to the Transport and Infrastructure Committee (**Committee**) on the Construction Contracts (Retention Money) Amendment Bill (**Bill**). NZBA commends the work that has gone into developing the Bill.

Contact details

4. If you would like to discuss any aspect of this submission, please contact:

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Summary

NZBA welcomes the introduction of the Bill to amend the retention money scheme in the Construction Contracts Act 2002. We support the policy behind the Bill, to enhance the efficiency of the construction sector and strengthen and clarify the retentions regime, and the broader work the Government is doing through the Construction Sector Accord.

However, we think that the Bill, as currently drafted, may not sufficiently deter inappropriate use of retention money. Additionally, we think that some of the current drafting creates confusion, and risks frustrating the goal of achieving a clear and efficient retentions regime. Our submission addresses these points below.

The Bill may not sufficiently deter inappropriate use of retention money

We submit that the Bill in its current form may not sufficiently deter inappropriate use of retention money. Our view is that:

- Bank accounts are not necessarily an appropriate product for ring-fencing and safeguarding retention money and that third parties with expertise in holding funds (independent from the head contractor) should be permitted to administer retention money.
- Penalties alone may have an insufficient deterrent effect.
- There is no clear and accessible enforcement pathway.

Bank accounts may not adequately protect retention money

We support the Bill clarifying that retention money is held on trust, and the requirement that it is not co-mingled by the head contractor with its working capital or other funds. However, as noted in our 21 February 2020 submission on the Ministry of Business, Innovation and Employment's earlier consultation, we remain concerned that, despite these changes, using bank products as a vehicle to attempt to protect subcontractor rights may not offer appropriate safeguards for the appropriate use of retention money.

In particular, we are concerned that naming a bank account a 'trust account' will not prevent head contractors from transacting on such accounts holding retention money, and therefore the risk remains that they could misuse those funds (for example, in a distress situation to top up working capital). Banks are not set up to monitor, identify and prevent inappropriate transactions and misuse of retention funds in this context.

These concerns could in part be addressed through an amendment which expressly allows retention money to be held by third parties such as escrow agents and statutory trustee companies. Escrow agents and statutory trustee companies may be in a better position to administer retention money given that the trust arrangements contemplated by the Bill are commonplace in those environments. Furthermore, they may also be better placed to monitor transactions and, therefore, protect the interests of subcontractors.

Connected to this, to avoid confusion, we also recommend two minor amendments to the Bill to clarify that retention money does not need to be held in a formal trust account:

- In the General Policy Statement, “... requiring retention money to be held ~~in a trust account~~ on trust...”
- In section 18E(3)(a), which requires a head contractor to “ensure that the bank is informed that the account ~~is a trust account for retention money~~ is an account for retention money held on trust under this Act”

These clarifications would help to avoid confusion between the concept of money ‘held on trust’ and the trust account product. We assume that the references to ‘trust account’ are intended only to indicate to the bank that the money is held on trust, so that it is not subject to a banker’s lien or other set-off rights. We do not understand the Bill to be prescribing the product requirements for holding retention money as that could create significant unintended consequences.

Proposed fines alone will have a limited deterrent effect

We note the proposed introduction of fines as a means of deterring inappropriate use of the retention money. However, we are concerned that the existence of fines alone may not sufficiently deter a head contractor in significant financial trouble from withdrawing retention money to use as working capital, particularly without a clear prevention or enforcement pathway.

Clear and accessible enforcement pathway

We think there is merit in investigating the feasibility of establishing a separate governing body to enforce standards in the construction sector and, as with the Real Estate Authority trust account requirements, conduct audits of the funds held on trust, and provide a whistleblowing service. In our view, it is the enforcement of standards that will drive behaviour and effect change in the industry. Examples can be taken from other industries, including:

- The New Zealand Law Society enforces the Lawyers and Conveyancers Act 2006. It issues practising certificates to members, and members who do not adhere to the industry standards can be fined or suspended.
- Chartered Accountants Australia and New Zealand oversee all chartered accountants and consider complaints against members for breaches of relevant ethics, standards, and rules. Similar to the Law Society, members can be fined or suspended for failing to comply with their obligations.
- The Real Estate Authority is responsible for addressing complaints about the behaviour of agents under the Real Estate Agents Act 2008, with the ability to impose fines and suspend an agent’s licence.

We think that a central governing body would increase confidence in the Bill by setting clear expectations and driving a change in behaviour. It would also provide a cheaper and easier

pathway for subcontractors who feel their rights have been breached, but do not have the funds or appetite to take formal legal action.

Enhancing clarity and efficiency

Timing of deemed trust may create issues

As noted above, we support the policy objectives behind the Bill, being to enhance the efficiency of the construction sector and strengthen and clarify the retentions regime, but are concerned that the current drafting of the Bill may not achieve fully these aims. In particular, the Bill currently creates a statutory trust over 'retention money' as soon as an amount becomes retention money under the Bill. This trust will arise prior to the retention money being paid into a separate bank account (or to an escrow agent/statutory trustee company as per our comment above).

We think that the timing of the creation of the statutory trust could create issues if retention money is not immediately paid into a separate account. Would the statutory trust attach to the head contractor's general assets in an amount equal to the retention money? This could create uncertainty in an insolvency of a head contractor and result in costly legal proceedings to determine what assets of the head contractor (in addition to any funds sitting in separate retention money trust accounts) is 'retention money' and subject to the statutory trust.

This outcome would be contrary to the objectives of the Bill – to enhance efficiency in the construction sector and to clarify the retentions regime. It also undermines the protections provided to subcontractors, as costs incurred by receivers/liquidators in legal proceedings will be taken from the retention trust money. Our view is that subcontractors' interests would be better served if the Bill maintains its focus on head contractor compliance (refer to our comments on enforcement pathway above).

Recommendations for further clarification

There are further areas of the Bill that we think would benefit from clarification:

- Section 18E(2) sets out requirements in relation to "the account name". It is unclear whether this reference is to the bank account (section 18E(1)), or the ledger account (section 18E(4)-(6)). We would welcome clarification in the Bill as to which account sub-section 2 is intended to capture.
- The current drafting of the Bill would allow a head contractor to hold retentions in a Solicitors' Trust Account, provided the solicitor could comply with the requirements of section 18E. We think it would be helpful if the Bill was amended to expressly allow retention money to be held in a Solicitors' Trust Account given the protections and controls that exist in relation to Solicitors' Trust Accounts.