

BELL GULLY

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Building Performance Team

Ministry of Business, Innovation and
Employment

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Construction Contracts Amendment Act 2015

1. We thank the Ministry of Business, Innovation and Employment (**MBIE**) for the opportunity to make submissions on the potential regulations under the Construction Contracts Amendment Act 2015, which creates a new regime for retention monies under the Construction Contracts Act 2002 (**CCA**).
2. MBIE has asked stakeholders to address three questions:
 - (a) Should there be a minimum amount of retention money to which the trust obligation applies, and if so, how much?
 - (b) What (if any) methods of accounting should be included in regulations to describe "liquid assets"?
 - (c) What (if any) methods of accounting should be included in regulations to cater for situations where retention money is mixed with other money?
3. We have limited our submissions to the specific questions raised by MBIE. We have broader concerns about the implications of the new regime. In our view, the new regime is inconsistent with the established treatment of secured and preferential creditors under other legislation and will create uncertainty for insolvency practitioners. Nevertheless, we acknowledge that the present process does not provide an opportunity to revisit those policy decisions.

Minimum threshold

4. The new section 18B of the CCA provides that the retention monies regime applies to:
 - (a) commercial construction contracts;
 - (b) where the amount of retention money is more than the *de minimis* amount to be specified by regulation.
5. In our view, three principles should guide MBIE's determination of the *de minimis* amount:
 - (a) the objectives of the new regime;
 - (b) the public interest in regulatory certainty; and
 - (c) fairness between construction companies of different sizes.

6. We consider that these principles suggest that the threshold should be modest.
7. The purpose of the new regime is to ensure that retention monies are available to contractors in the event that the party holding the retentions becomes insolvent. As noted above, we have serious reservations about the desirability and practicality of the new regime. However, there is no principled reason for the scope of the regime to be restricted.
8. We consider that setting a modest threshold would provide greater regulatory certainty for the industry. It would avoid there being a regulatory advantage for small and medium size construction companies. It would also be undesirable for contractual variations to cause parties to enter or exit the ambit of the regulatory regime as the contract price rises or falls.
9. Given the key differences between the new CCA regime and the New South Wales regime, we do not consider that it is necessary or desirable for New Zealand to be guided by the New South Wales threshold. The New South Wales regime has a threshold that the total consideration for the construction works must be at least \$20 million.¹ That threshold reflects the more onerous regime under which the monies must be held in a trust account.
10. Taking the above considerations into account, we consider that a threshold of \$100,000 would be suitable for the purposes of section 18B. This threshold is based on an assumption that a construction project in the \$1-2 million price range might be subject to retentions of about 5%. We think that such a project is sufficiently modest to represent the lower boundary of the regulatory regime. Taking that into account, we consider that \$100,000 would represent a reasonable threshold.

Liquid assets

11. The new section 18C(2) provides that retention monies must be held in the form of cash or other liquid assets that are readily converted into cash.
12. We consider that two principles should guide MBIE's approach to regulations on this issue, i.e:
 - (a) the need for the retention monies to be available in the event of insolvency, which is the purpose of the regime; and
 - (b) the desirability of ensuring that the regulations align with generally accepted accounting practice.
13. In our view, MBIE should apply a definition based on the concepts of "cash" and "cash equivalents" in IAS-7, i.e.:
 - (a) cash comprises cash on hand and demand deposits; and
 - (b) cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

¹ Building and Construction Industry Security of Payment Amendment (Retention Money Trust Account) Regulation 2015 (NSW).

Accounting methods

14. New section 18D(1) provides that the party holding retentions must keep proper accounting records of all retention money held that:
 - (a) correctly record all dealings and transactions in relation to the money; and
 - (b) comply with generally accepted accounting principles; and
 - (c) are readily and properly auditable.
15. New section 18D(2) further provides that the party holding the retentions must make the accounting records of retention money available for inspection to the contractor at all reasonable times and without charge.
16. Our view is that these provisions are sufficient. While we have serious concerns about the practical consequences of allowing retention funds to be commingled with other monies (section 18E)(2)), that is not an issue that can be addressed by way of regulations.

Next steps

17. It would be helpful if an exposure draft of the regulations could be made available to stakeholders for submissions before any new regulations are promulgated.
18. Please contact us if you have any queries in relation to this submission.

Yours faithfully
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