

## **What you need to know about Payment Retentions**

You may already be all over the new rules relating to payment retentions, or you may only be vaguely aware of them, or this might be the first time you've heard of them. Regardless of your state of knowledge, if you're in the building business then you need to be on top of it, and more importantly you need to be able to separate the fact from the fiction. Here's a guide.

### **What do the new rules say?**

Under the current rules, retention money is an asset of the party that is holding it back. So if that party goes bust, as Mainzeal did, the money gets distributed to its secured and preferential creditors, and then the contractors or subcontractors who earned the money have to pick over the carcass with all the other unsecured creditors. The new rules say that all retention money must be held on trust for the contractor or subcontractor who earned it. The significance of that, is that money held on trust is not an asset of the party that is holding it back. They are merely holding it as guardian for the real owners - the contractors or subcontractors who earned the money – so the creditors of the failed company can't touch it.

### **Where do you find the new rules?**

The rules were inserted into the Construction Contracts Act 2002 (**CCA**) by the Construction Contracts Amendment Act 2015. They are Subpart 2A of Part 2 of the CCA, and they are extremely brief for such an important piece of legislation.

### **When do the new rules come into force?**

The new rules come into force on 31 March 2017, so you have time to prepare. Initially, all retentions that you happened to be holding on 31 March 2017 were going to instantly become trust assets. The Government has acknowledged that would be a bit harsh, so they have introduced a further amendment to the CCA which you can find in Part 4 of the Regulatory Systems (Commercial Matters) Amendment Bill. Assuming that Bill becomes law, the new rules will only apply to construction contracts entered into on or after 31 March 2017.

### **What projects do the rules apply to?**

The new rules only apply to commercial construction contracts, but that is a bit misleading, because some residential contracts will be caught by the new rules. For example, where the house is an investment property, or it is owned by a company (as long as it is not a trustee for the occupants). Also, all subcontracts are commercial construction contracts, regardless of whether they relate to a residential project or not, so retentions withheld by the head contractor will be trust money. In addition, only retentions above a certain amount are going to be caught, and at the time I wrote this article, the Government hadn't decided how much that was going to be.

### **What changes will you need to make?**

The first thing you will have to decide is: Do I owe money to a contractor beneath me, and have I withheld some of it as security for the performance of that contractor's obligations

under the contract? If so, you must hold it in trust. Technically it doesn't even matter if you had the right to withhold it under the construction contract or not. You have to hold the money in cash or other liquid assets that are readily converted into cash. That means you actually have to have it – you can't just hope that you will have sufficient funds by the time you're due to pay it out.

### **What are liquid assets?**

The CCA doesn't define liquid assets, but as a rule of thumb, they have to be investments like shares in blue chip companies traded on the stock exchange, or Government or local body bonds, that you can convert into money quickly. If you comply with the investment rules in the Trustee Act 1956, you're okay. The big debate is whether your accounts receivable are liquid assets, or for that matter, retentions that are being withheld from you. Although you can always sell your book debts if you have to, when everything has turned to custard they tend not to be worth very much, so you should value them very conservatively.

### **Will you need new accounting systems?**

You must keep proper accounting records of all retention money that you hold, and those records must correctly record all dealings and transactions in relation to the money, they must comply with generally accepted accounting principles, and they must be readily and properly auditable. You are going to need some professional help with that. You are supposed to make your retention accounting records available for inspection by the contractor or subcontractor who earned the money, at all reasonable times and without charge, so you might get caught out if you don't comply.

### **When do you have to pay the money out?**

You must pay the money out when your construction contract says, but that can't be any later than the date on which the contractor or subcontractor has performed all of his obligations under the contract to the standard agreed under the contract. If you're late in paying out retentions, the CCA says you have to pay interest. The only reason you can refuse to pay out retentions is to remedy defects in the performance of the contractor or subcontractor's obligations under the contract.

### **What will happen if you break the rules?**

If your company has gone bust then you might not care whether the rules have been broken or not. However people who owned or managed the company will have personal liability for the breach, as will other parties who were knowingly a party to it.

### **Will the new retentions regime work?**

The large construction companies and specialist trades will comply. The small-medium businesses will struggle. As from 31 March 2017, I wouldn't want to be a tradesman who was not able to front up with retention money by the time it was due. So get in touch and get some systems in place, before it's too late.