

# TRADIE LAW FACT SHEET #28

## DEALING WITH CONTRACTORS OR SUBCONTRACTORS



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## Retentions under the Construction Contracts Act 2002 (“the Act”)

### OVERVIEW

Retention money is an amount withheld by a party to a construction contract (**party A**) from an amount payable to another party to the contract (**party B**). The purpose of withholding this money is to provide security for party A over the performance of party B, ensuring that the work is carried out to an appropriate standard and that all obligations under the contract are met. In most situations where the retention regime is engaged, party A is the head contractor and party B the subcontractor. The retention funds are then paid out once the liability period has expired.

The Construction Contracts (Retention Money) Amendment Act 2023 (“**the Amendment Act**”) comes into effect on 5 October 2023. The Amendment Act strengthens the retention money regime and helps to clarify the protections in place for subcontractors retention money.

It is important to note that the Amendment Act only applies to commercial contracts created (or renewed) after 5 October 2023 and does not apply to contracts with homeowners/residential occupiers.

### MANAGING RETENTION FUNDS

The Amendment Act introduces a number of new requirements around how retention funds are held, reported on and paid out.

- **Funds held on trust**

A trust is a financial tool that allows a person or organisation to put aside money and other assets that will later be distributed to the beneficiary named in the trust.

From 5 October 2023, retention money must be held on trust, for the benefit of the subcontractor from whom it was withheld.

Retention money will become trust property whether or not the contractor complies with the Act. As trust money, retentions will be legally separated from the company assets and, therefore, protected in the event of the contractor’s liquidation.

The retention money may be held in cash, other liquid assets that are readily converted into cash, or a financial instrument such as insurance or a payment bond.

- **Separate bank accounts**

Contractors must place retention funds into a separate bank account and retain that money until it ceases to be trust property.

A separate bank account established for retention monies must comply with the Act. In particular:

- the account holder is the head contractor in their capacity as trustee of the retention money;
- the account is used solely for the purpose of holding retention money that is held by the head contractor; and
- the head contractor has informed the bank that the account is for the purpose of holding retention funds on trust under the Act.

Retentions may also be held by organisations in trust accounts on behalf of the head contractor and subcontractor, for example, law firms, trustee companies or other solutions such as [iPromise](#).

- **When does retention money cease to be trust property?**

Retention money will only cease to be trust property in limited situations which are:

- funds are paid out to the subcontractor; or
- the subcontractor gives up any claim to the funds in writing; or
- funds are used to remedy defects in the performance of the subcontractor under the construction contract - but only if:
  - the use of that money is permitted by the contract; and
  - provisions of the contract relating to the use of the retention money are complied with; and
  - at least 10 working days before using the money, the head contractor gives written notice of:
    - its intention to use the retention money for that purpose; and
    - details of the defects to be remedied.

- **Retention money not available for other purposes**

Retention money held on trust is not available for the payment of other debts to any of the head contractors' creditors (other than the party from whom the money was withheld) and is not liable to be attached or taken in execution under the order or process of any court at the instance of any of your creditors (other than the subcontractor from whom the money was withheld).

- **Accounts and Records**

Proper accounting records for all retention money received, held and paid out, and proper and readily verifiable records of all instruments issued for these purposes must be maintained.

If retention money is held in a bank account, the records must:

- identify the bank account as an account the retention money is held; and
- identify the construction contract under which that money is retained; and
- Include details of all payments into and out of that account.

All accounting and other records required to be maintained under the Act in relation to retention money must be made available for inspection by a subcontractor at all reasonable times and without charge.

- **Reporting on retention money**

Party A (most commonly the head contractor) must report on retention monies held at least once every 3 months until the trust ends.

The information Party A must report on is:

- each amount retained (for example, from each progress payment); and
  - the construction contract under which it is retained; and
  - and the date of retention; and
  - the total amount held as retention; and
  - the bank account details in which the money is held; and
  - if Party A is relying on a complying instrument, the details of that complying instrument; and
  - a statement that the subcontractor may inspect the accounts and records referred to above.
- **Penalties**

The penalties under the Act for a failure to keep retention money as required and a failure to maintain accounting and other records have been increased with penalties ranging from convictions and fines not exceeding \$200,000 for a company and \$50,000 for directors of those companies or individuals. The definition of “director” under the Act is deliberately wide.

## **SUMMARY**

The protections afforded to subcontractors and obligations placed on head contractors under the Act, as amended, are wide-reaching and are designed to improve the retention regime by preventing the misuse of retention funds by head contractors as working capital, delaying payments or holding retention amounts which are disproportionate to contract prices. The retention money regime under the Act recognises the importance of cash flow in the construction industry. Many of the issues that arose in well known liquidations that adversely impacted subcontractors, such as the *Ebert Construction Ltd* and *Mainzeal Liquidations* should be avoided.

In short, there are a number of stronger mechanisms available to subcontractors under the Amendment Act to ensure their retentions are protected, accounted for and used for their intended purpose.

**If you would like further advice on the retentions regime under the Act, get in touch as we can help.**

**Contact:**

E [helpdesk@tradielaw.co.nz](mailto:helpdesk@tradielaw.co.nz)  
W [www.tradielaw.co.nz/tradie-law/contact/](http://www.tradielaw.co.nz/tradie-law/contact/)

**One of our team will be in touch to assist you within 24 hours.**