



**Ministry of Business,
Innovation & Employment**

Background Report
to the

Commerce Select Committee
on the

Construction Contracts Amendment Bill

Ministry of Business, Innovation and Employment
1 August 2013

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Introduction

- 1 The construction sector is vital to our economy. It contributes about 5% of GDP and employs around 172,100 people, or one in 13 of the New Zealand workforce.
- 2 The Building Act 2004 is the primary legislation that governs the construction sector in New Zealand. A comprehensive review of the Building Act 2004 was carried out in 2009/2010. The review found the current system is not broken, but it is not creating the right incentives to improve productivity. The review also found the system is more costly than necessary and less efficient than it could be. The sector needs to be more accountable and take greater responsibility for the quality of its work.
- 3 The Government has already progressed amendments to the Building Act 2004 to address the findings of the review. The Building Amendment Act 2012 was passed in March last year and the Building Amendment Bill (No 4) completed its Second Reading on 2 July 2013.
- 4 The Construction Contracts Act 2002 (“the Act”) is a key piece of legislation supporting the construction sector. The Act prescribes default progress payment provisions and enables parties to construction contracts to use a lower cost alternative to the Courts for resolving disputes.
- 5 The Act was reviewed, as part of the suite of reforms stemming from the Building Act review, with the objectives of ensuring the Act provides:
 - a fair, balanced and appropriate payment regime
 - access to fast and cost-effective dispute resolution
 - tools that encourage self-resolution and remedy
 - cost-effective and timely enforcement of rights and obligations.
- 6 The review found the Act is generally meeting these objectives, but some parts of the adjudication process are not working as well as they could. While the adjudication process is working well (the private adjudication market is meeting the demands for formal dispute resolution in the sector), the jurisdiction of the Act is limited and unclear (particularly with regard to residential construction contracts). Also, in line with the overall direction of the Building Act reforms, the review found that greater efficiency and clearer accountability can be obtained by making some amendments to the Construction Contracts Act 2002.
- 7 This report supplements the explanatory note to the Bill, highlights major amendments to the Act, and explains the intent and purpose behind the proposed changes.

Commencement date

[Clause 2]

- 8 It is proposed the Bill will come into force on a specific date soon after it is passed. When the Bill was drafted, it was expected to be passed in late 2013 so a commencement date of 1 November 2013 was specified. This date will need to be changed during the Select Committee process to reflect the likely time for the Bill to complete its Parliamentary process.

Residential construction contracts

[Clauses 5, 8, 9 and 13]

- 9 Section 5 of the Act defines a construction contract as either a commercial construction contract or a residential construction contract.
- 10 The distinction between a commercial construction contract and a residential construction contract is based on whether a party to the contract is a residential occupier of the premises where the construction work is being carried out. A residential occupier is an individual who occupies (or intends to occupy) the premises that are the subject of a construction contract wholly or mainly as a “dwellinghouse”, i.e: their home.
- 11 The Bill proposes to remove the distinction between different types of construction contracts because:
 - the limitation on how the Act applies to residential construction contracts means there are low incentives to resolve residential contractual disputes using the processes under the Act
 - residential occupiers and contractors carrying out construction work for residential occupiers are less well placed to remedy disputes outside of the time-consuming and expensive option of going to Court
 - the distinction is not well founded – the notion that commercial consumers have sophisticated advisors does not reflect the reality of smaller businesses, commercial consumers can be just as disadvantaged as residential consumers
 - it will enable more residential contractual disputes to be resolved using the processes in the Act.
- 12 One distinction between commercial and residential construction contracts is proposed to remain in the Act. Currently, a charging order can only be obtained in relation to a commercial construction contract. A charging order is a Court order that can be registered against the title to land and prevent the land being sold until the basis of the charging order is satisfied. Under the Act, a person who has successfully obtained an adjudicator’s determination, that the owner of a construction site must pay them a sum of money, can obtain a charging order on the land. The charging order will remain in place until the relevant sum of money is paid.
- 13 If a charging order is registered against a residential property it creates a risk the owner will default on any mortgage on the property. The consumer protection considerations therefore outweigh the need for a residential construction contractor to be able to register a charging order. The Bill does not propose to change this, charging orders will still be unobtainable in relation to residential construction contracts.

Enforcement of adjudication determinations

[Clauses 18 to 28]

- 14 Under the existing provisions in the Act, enforcement of a determination about payment can be time-consuming and costly. Further, determinations about rights

and obligations disputes currently cannot be enforced at all – the entire dispute must be re-heard in Court.

15 Residential contractual disputes are more often about issues of the parties' rights and obligations than simply payment of money. Enforcing a determination about rights and obligations under the Act is currently more difficult than enforcing a decision about payment of money. The Government proposes to amend the Act to better align the enforcement processes by allowing:

- determinations to be enforced as if they were orders of the District Court
- determinations about residential contractual disputes to be enforced in the same way as commercial contractual disputes – the Act currently limits the enforcement options for determinations about residential contractual disputes
- determinations about rights and obligations disputes to be enforced in the same way as payment disputes.

Design, engineering and quantity surveying

[Clause 5(7), 6 and 7]

16 Contracts for the supply of design work, engineering work and quantity surveying are not currently covered by the Act. This means these kinds of contracts are not regulated by the payment provisions in the Act and, if disputes arise, the adjudication process is not available as an option.

17 To increase the dispute resolution options for consumers, the Government proposes to extend the scope of the Act to include contracts for design, engineering and quantity surveying work. This will also mean the default payment provisions in the Act will apply to contracts for these services (most contracts for these services already contain specific provisions about payment, the default provisions only apply if a contract is silent on the matter of payment).

18 Extending the scope of the Act will benefit both people who provide design, engineering and quantity surveying services and their customers. Initially people who provide construction-related services may incur some costs to bring their systems and processes into line with the provisions of the Act. These costs will not be significant and will be mitigated by education and guidance provided by the Ministry.

Other amendments

Chief executive power to require information

[Clause 31]

19 The Act lacks explicit powers and tools for the Government to monitor and evaluate the operation and effect of the Act. Information about the number and type of disputes resolved using the adjudication processes in the Act will contribute to the Government's understanding of:

- whether effective contracting practices are being used in the construction sector – good contracting practices are expected to exist in an efficient and productive market
- the key matters that result in disputes – an efficient and productive market has minimal disputes so, if dispute levels are not decreasing (as a result of the wider reforms the Government is making in the sector), further measures to reduce them may need to be considered by the Government.

20 In relation to the information gathering powers, the Government proposes to amend the Act as follows:

- Insert an explicit power for the chief executive of the agency that administers the Act (currently the Ministry of Business, Innovation and Employment) to require adjudicators and others exercising functions under the Act to supply relevant information to the chief executive (for example, about the number and nature of disputes).
- Limit the obligation to supply information to the chief executive to protect privacy and the confidentiality of adjudication proceedings (similar to the confidentiality provisions already in section 68 of the Act).

Pre-adjudication conferences

[Clause 15]

21 The review of the Act found there are instances when adjudication determinations are delayed because one or both of the parties misunderstands or misuses procedural steps. To ensure procedural issues do not impact on substantive decision-making, the Bill proposes to require adjudicators to convene a pre-adjudication conference to answer any questions parties have about the process. If both parties agree a pre-adjudication conference is unnecessary, then the adjudicator will not need to convene one.

Minor and technical amendments

22 The Bill contains some minor and technical amendments that will clarify the Act and reduce compliance costs.

23 The opportunity has also been taken to re-order some provisions to improve the “flow” of the Act (e.g: section 72 has been moved and re-numbered as section 24A).

24 The minor amendments most likely to be commented on in submissions to the Select Committee are summarised below.

- Clause 16: Allowing the time for lodging a response to a claim to be extended in certain circumstances to prevent “gaming” of the process and ambushing of respondents by claimants.
- Clauses 29 and 30: Reducing, to five working days, the amount of time a defendant has to oppose an application to have an adjudication decision entered as a judgement. This will speed up enforcement of adjudication decisions.

- Clause 26 (new Subpart 1AA of Part 4): Clarifying how an adjudication decision may be appealed, contested or re-heard.

Issues outside scope of Bill that may be raised in submissions

Security for payments

- 25 “Security of payment” usually refers to the consumer (or developer) setting aside the entire amount of the contract price in a neutral account, or bond, as soon as the contract is signed. Sometimes a similar result is achieved by a funder (e.g: mortgagee) providing proof or assurance the amount of the contract price can be paid.
- 26 Several submissions on the review of the Act requested the Act be amended to include mandatory security for payment provisions. The Government decided not to amend the Act because the market is currently providing sufficiently for security of payment and legislative intervention is not necessary. The methods for security of payment that already exist in the construction sector are largely effective. Parties to a construction contract are free to agree on what (if any) method is to be used to ensure payment of the contract price. The Act provides a backstop for cases where non-payment occurs. The amendments proposed in the Construction Contracts Amendment Bill will improve access to remedies for non-payment and this will help contractors to get paid.
- 27 The Bill also does not address issues in the sector with the way retentions are used. Retentions are a portion of the contract price withheld by the principal or head contractor and not paid until after the construction work is checked and found to be free of defects. Issues about payment of retentions were recently highlighted by the collapse of Mainzeal – retentions are unsecured debts and are generally not able to be recovered. The Ministry is working on advice to the Minister for Building and Construction about possible solutions to those issues. The Ministry is currently meeting with representatives of the sector to clearly define the issues and the possible solutions. In the event a legislative amendment is the preferred solution, the Construction Contracts Amendment Bill is likely to be the appropriate vehicle. The Ministry will, therefore, keep the Committee informed about the progress of this work during the Select Committee process.