IN THE HIGH COURT OF NEW ZEALAND
PALMERSTON NORTH REGISTRY

I TE KŌTI MATUA O AOTEAROA
TE PAPAIOEA ROHE

CIV-2023-454-100
[2024] NZHC 2415

UNDER	the Construction Contracts Act 2002
BETWEEN	STEVENSONS STRUCTURAL ENGINEERS 1978 LIMITED (In liquidation) Plaintiff
AND	MCMILLAN & LOCKWOOD (PN) LIMITED First Defendant
	MCMILLAN & LOCKWOOD CENTRAL LIMITED Second Defendant

Hearing:	21 May 2024 Further affidavit evidence: 5 June 2024
Appearances:	F B Collins for Plaintiff M Holland and S Poh for First and Second Defendants
Judgment:	27 August 2024

JUDGMENT OF ASSOCIATE JUDGE SKELTON

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[1] This is an application by the plaintiff for summary judgment against the defendants in respect of monies retained under subcontracts which are construction contracts under the Construction Contracts Act 2002 (Act).

[2] Retentions are a portion of the contract price withheld as security for performance. Retentions are usually released in two tranches: the first tranche is released once the works have been completed, and the balance once the works are found to be free of defects after a defects liability period.

[3] The plaintiff, which is now in liquidation, and has disclaimed the subcontracts pursuant to s 269 of the Companies Act 1993, seeks:

(a) a declaration that all or part of the retention provisions in the subcontract agreements are unlawful and the retentions must be released, and judgment in the sum of the retentions; or alternatively,

(b) a declaration that the retentions can only be applied towards actual physical defects within the works carried out by the plaintiff prior to it being placed into liquidation (with the validity and cost of any such defects to be determined at a substantive hearing).

[4] The defendants oppose the application for summary judgment on the basis that they have an arguable defence to the plaintiff's claims. The defendants contend that the relevant retention provision is not prohibited by the Act and, even if it is, it would be replaced by an implied term providing for payment of retentions when the plaintiff has performed all of its obligations under the subcontracts. The defendants contend that, in any event, the retention monies have ceased to be payable to the plaintiff and the retention trust has ended, and there are no limitations on the use of the retention money. Alternatively, if the retention monies are payable, the defendants are entitled to set off losses suffered by them against the retention monies under s 310 of the Companies Act. The defendants also contend that the plaintiff's position that retention monies can only be applied towards actual physical defects takes an unduly narrow view of the word "defect". Finally, the defendants contend that, if the retention monies are payable, the Court should exercise its discretion against granting summary judgment because the plaintiff is in liquidation and there is a risk of injustice.

What happened?

[5] The plaintiff was subcontracted in 2020 and 2021 to carry out steel fabrication and installation works on two projects:

(a) the Sarjeant Gallery in Whanganui for the first defendant building company; and

(b) a military project known as Project Cannon in Linton for the second defendant building company.

[6] There were in fact three subcontracts. This was due to the Sarjeant Gallery project works being staged, with stage one being an extension with a new modern wing added to the gallery, and stage two being the refurbishment and strengthening of the existing building. Each of these stages involved a separate subcontract between the plaintiff and the first defendant.

[7] The plaintiff was put into liquidation on 3 March 2023. At that time its obligations under the three subcontracts were only partially performed. Retentions had been deducted under the subcontracts by the defendants and these monies were held on trust by the defendants under sub-pt 2A of the Act. The following amounts are held (exclusive of GST):

(a)	Sarjeant Gallery – stage one (74% complete)	$60,423.23
(b)	Sarjeant Gallery – stage two (66% complete)	$40,394.55
(c)	Project Cannon (99% complete)	$125,897.39

[8] On 22 March 2023, the liquidators of the plaintiff disclaimed the subcontract agreements under s 269 of the Companies Act. The liquidators reserved the plaintiff's rights regarding the retentions held on trust by the defendants.

[9] On 2 July 2023, the defendants confirmed cancellation of the subcontract agreements in respect of both projects on the basis that the plaintiff had committed an act of insolvency.

[10] On 28 July 2023, the liquidators issued a letter of demand to the defendants for release of the retentions held in respect of both projects. The defendants have declined to release the retentions.

Legal principles — summary judgment

[11] The plaintiff's application for summary judgment is made under r 12.2(1) of the High Court Rules 2016 which provides:

> **12.2 Judgment when there is no defence or when no cause of action can succeed**
>
> (1) The court may give judgment against a defendant if the plaintiff satisfies the court that the defendant has no defence to a cause of action in the statement of claim or to a particular part of any such cause of action.

[12] The application is also made under r 12.3, which provides that:

> **12.3 Summary judgment on liability**
>
> The court may give judgment on the issue of liability, and direct a trial of the issue of amount (at the time and place it thinks just), if the party applying for summary judgment satisfies the court that the only issue to be tried is one about the amount claimed.

[13] The principles that govern summary judgment are now very well settled. In *Krukziener v Hanover Finance Ltd*, the Court of Appeal summarised the principles as follows:[1]

> The question on a summary judgment application is whether the defendant has no defence to the claim; that is, that there is no real question to be tried: *Pemberton v Chappell* [1987] 1 NZLR 1 at 3 (CA). The Court must be left without any real doubt or uncertainty. The onus is on the plaintiff, but where its evidence is sufficient to show there is no defence, the defendant will have to respond if the application is to be defeated: *MacLean v Stewart* (1997) 11 PRNZ 66 (CA). The Court will not normally resolve material conflicts of evidence or assess the credibility of deponents. But it need not accept uncritically evidence that is inherently lacking in credibility, as for example where the evidence is inconsistent with undisputed contemporary documents or other statements by the same deponent, or is inherently improbable: *Eng Mee Yong v Letchumanan* [1980] AC 331 at 341 (PC). In the end the Court's assessment of the evidence is a matter of judgment. The Court may take a robust and realistic approach where the facts warrant it: *Bilbie Dymock Corp Ltd v Patel* (1987) 1 PRNZ 84 (CA).

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[1] *Krukziener v Hanover Finance Ltd* [2008] NZCA 187, [2010] NZAR 307 at [26]–[27].

> Under r 141A [of the High Court Rules] the defendant need not file a statement of defence. The onus remains on the plaintiff, and summary judgment will be denied if on the hearing of the application it appears that there is an issue worthy of trial.

[14] Other ways of expressing the notion of "no defence" are: no bona fide defence, no reasonable ground of defence, and no fairly arguable defence.[2]

[15] The Court will deal with questions of law on a summary judgment application,[3] and this includes issues of contractual interpretation.[4] This is so even where the question of law is difficult and requires argument, including reference to authority.[5]

[16] Further, summary judgment may be given where the interpretation of a contract is an issue. In *Jowada Holdings Ltd v Cullen Investments Ltd*, the Court of Appeal stated:[6]

> [29] This present appeal is concerned with a contract based claim in circumstances where both parties seek to rely on evidence of circumstances said to form part of the relevant context in which the contract is to be interpreted. Their evidence is in conflict. That, however, does not preclude the Court from giving summary judgment in a contract claim if it is satisfied that resolution of the factual matters in dispute is not necessary to provide the Court with such contextual background as is necessary to resolve the claim. This is simply an application of the principle that where, despite differences on factual matters, the lack of a tenable defence to a cause of action is plain on the material before the Court, and the Court is sure on that point, summary judgment will normally be entered. In such circumstances there is no reason why a contract should not be interpreted and applied in summary judgment proceedings…

[17] Further, in *Tegel Foods Ltd v Neal*, the High Court stated:[7]

> [40] I have noted Mr Thompson's submission that unless a contractual interpretation advanced by a party is clearly without merit, the Court should be extremely cautious about resolving disputes about interpretation by way of summary judgment, particularly when the words of the contract do not clearly support one meaning over another. However, I consider that submission is not consistent with the observations of the Court of Appeal in *Jowada Holdings* that there is no reason why a contract should not be interpreted and applied in

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2 *Pemberton v Chappell* [1987] 1 NZLR 1 (CA) at 3.
3 At 4.
4 *Zurich Australian Insurance Ltd v Cognition Education Ltd* [2014] NZSC 188, [2015] 1 NZLR 383 at [37].
5 At [37], citing *International Ore & Fertilizer Corp v East Coast Fertiliser Co Ltd* [1987] 1 NZLR 9 (CA) at 16.
6 *Jowada Holdings Ltd v Cullen Investments Ltd* CA 248/02, 5 June 2003 at [29].
7 *Tegel Foods Ltd v Neal* [2018] NZHC 1921 at [40] (footnotes omitted).

> summary judgment proceedings where the lack of a tenable defence is plain on the material before the Court, and the Court is sure on that point. … The key question is not whether there is an issue of contractual interpretation but whether the Court is left with any real doubt or uncertainty about whether the defendant has a defence.

Issues to be considered

[18] The following issues arise for consideration:

(a) A preliminary issue raised by the defendants as to whether the proceedings are contrary to r 4.3 of the High Court Rules and therefore the plaintiff should not be entitled to summary judgment.

(b) Are the relevant provisions of the retention clauses in the subcontracts prohibited under the Act?

(c) If the provisions are prohibited, what is the consequence?

(d) Has the retention money trust ended?

(e) If the retention money is payable to the plaintiff, are the defendants entitled to set off alleged losses suffered by them against the retention money under s 310 of the Companies Act?

(f) Is the proper construction of s 18E(1) of the Act that retention money can only be applied to remedying actual physical defects in the works including departures from the design or specifications?

(g) If the retention money is payable to the plaintiff, should the Court exercise its discretion against granting summary judgment because the plaintiff is in liquidation and there is a risk of injustice?

Parties to the proceedings

[19] Mr Holland, for the defendants, submits that the plaintiff has "rolled-up" what should be separate proceedings into a single proceeding. Mr Holland submits that the

defendants are separate entities and the subcontracts in issue are not the "same transaction" as required by r 4.3(1) of the High Court Rules which provides:

> **4.3 Defendants**
>
> (1) Persons may be joined jointly, individually, or in the alternative as defendants against whom it is alleged there is a right to relief in respect of, or arising out of, the same transaction, matter, event, instrument, document, series of documents, enactment, or bylaw.

[20] I do not consider that there is any issue with the plaintiff issuing these proceedings against both the first and second defendants in respect of separate projects. As submitted by Mr Collins, for the plaintiff, the relief claimed in this case arguably arises out of the same series of documents, or enactment, being the Act.

[21] Further, the claims against each defendant raise common questions of law and, if the claims were not already being heard together in one proceeding, then it may be appropriate for separate proceedings to be consolidated in any event.[8]

Are the relevant provisions in the subcontracts prohibited?

[22] It is accepted by the parties that the subcontracts are materially in the same form.

[23] Clause 12.4 of the subcontract general conditions provides that:

> **12.4 Retentions**
>
> 12.4.1 Payments will be subject to retentions as specified in the Subcontract Specific Conditions.
>
> 12.4.2 Retentions may be released in two stages. Part of the retention amount may be held after Practical Completion to cover maintenance and rectification of defects. The dates for release of retentions are given in the Subcontract Specific Conditions.

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8 High Court Rules 2016, r 10.12.

[24] The Subcontract Specific Conditions provide:

12.4.1	Percentage of total amount certified to be held as retention (only if retention bond not provided see 3.2.1)	Up until practical completion. 10. % of first $200,000.00 5. % of next $800,000.00 1.75 % of remainder

[25] The parties agree that the release of the retentions is not governed by the Subcontract Specific Conditions but by clauses in the plaintiff's quotations for the subcontract works which provide:

> Stevenson's standard conditions of contract covering retentions, as per SCNZ Industry Standard; 50% of retentions are to be released within 30 days of completion of the Structural Steel contract works, the provision of QA documentation and PS3 Producer Statement(s) if required, with the balance of retentions due within 30 days of the issue of a Certificate of Practical Completion, or earlier, as detailed in the Head Conditions Contract. Contractor must make records of retentions available for inspection upon SSE's request at all reasonable times without any cost; …

[26] Therefore, the retentions withheld under the subcontracts were to be released in two tranches:

(a) 50 per cent of the retentions were to be released within 30 days of the completion of the structural steel contract works under the subcontracts and the provision of quality assurance documentation and a PS3 producer statement, if required; and

(b) the balance of the retentions, were to be released within 30 days of the issue of a certificate of practical completion, or earlier, as detailed in the head contract.[9]

[27] The plaintiff contends that the second part of the clause (the impugned provision) is prohibited under s 18I of the Act.[10] Section 18I provides that:

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[9] The head contracts for the projects do not provide for payment of retentions any earlier than payment as part of the first progress payment after issue of the certificates of practical completion under the head contracts.

[10] References in this judgment to the retention money sections in sub-pt 2A of the Construction Contracts Act 2002 are, unless otherwise stated, to those sections prior to the amendments introduced by the Construction Contracts (Retention Money) Amendment Act 2023. That is

18I Prohibited provisions

(1) Any term in a construction contract is void that purports to—

(a) make the payment of retention money conditional on anything other than the performance of party B's obligations under the contract; or

(b) make the date on which payment of retention money is payable later than the date on which party B has performed all of its obligations under the contract to the standard agreed under the contract; or

…

(2) Any provision in a construction contract is void if the purpose, or one of the purposes, of the provision is to avoid the application of any of the provisions of this subpart.

[28] The plaintiff contends that the impugned provision is prohibited under s 18I(1)(a) and (b). The argument is that because the payment of the balance of retentions is linked to practical completion of the works under the head contract it is: (a) conditional on the performance of other parties in addition to the plaintiff, for example, performance by the head contractors (defendants) and other subcontractors; and (b) payable later than the date on which the plaintiff has completed all its obligations under the subcontracts to the agreed standard.

[29] The plaintiffs also contend that the impugned provision is a conditional payment provision under s 13(2)(ca) of the Act. Section 13 provides:

Subpart 1—Prohibition of conditional payment provisions of construction contracts

13 Conditional payment provisions ineffective

(1) A conditional payment provision of a construction contract has no legal effect and accordingly—

(a) is not enforceable in any civil proceedings; and

(b) may not be used as a basis for withholding payments that are due and payable under the contract.

(2) In this section,—

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because the subcontracts which are the subject of this case were entered into before the 2023 Act commenced.

> **amount owed**, in relation to a construction contract, means either the whole or part of any amount of money owing for construction work that has already been carried out under the contract.
>
> **conditional payment provision of a construction contract** means a provision of the contract—
>
> (a) that makes the obligation of one party (**party A**) to pay an amount owed to another party (**party B**) conditional on party A receiving payment from a further party (**party C**); or
>
> (b) that makes the due date for payment of an amount owed by party A to party B contingent on the date on which party A receives payment from party C; or
>
> (c) that is commonly referred to in the construction industry as a "pay when paid" or "pay if paid" clause of a construction contract; or
>
> *(ca) that is of a kind described in section 18I(1)(a)*; or
>
> …
>
> (Emphasis added)

[30] The plaintiff submits that there is support for its position in the decision of the High Court of Australia in *Maxcon Constructions Pty Ltd v Vadasz*.[11] In that case, the appellant, Maxcon Constructions Pty Ltd (Maxcon), was a builder. It entered into a subcontract with the first respondent, Vadasz, who was a piling subcontractor. Under the terms of subcontract, Vadasz was required to provide security in the form of cash retentions. Clause 11 of the subcontract provided for security to be given by Vadasz in the form of retention by Maxcon of five per cent of the subcontract sum to ensure due and proper performance. Clause 11(e) provided:

> Subject to [Maxcon's] rights to any deductions made or pending any deductions which are likely to be made under the [subcontract], retention shall be released:
>
> (a) 50% of retention within the time nominated in Schedule E.
>
> (b) Remaining 50% within the time nominated in Schedule E.

[31] Schedule E provided for 50 per cent of retentions to be released "90 days after CFO is achieved", with the remaining 50 per cent to be released "365 days after date of CFO". The "CFO" was defined to mean "the certificate of occupancy and any other

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[11] *Maxcon Constructions Pty Ltd v Vadasz* [2018] HCA 5.

Approval(s) required under Building Legislation which are required to enable the Works lawfully to be used for their respective purposes in accordance with [Maxcon's] Project Requirements".

[32] Section 12 of the Building and Construction Industry Security of Payment Act 2009 (South Australia) defined a "pay when paid provision" and provided that such a provision is ineffective:

> (1) A pay when paid provision of a construction contract has no effect in relation to any payment for construction work carried out or undertaken to be carried out (or for related goods and services supplied or undertaken to be supplied) under the contract.
>
> (2) In this section—
>
> ***money owing***, in relation to a construction contract, means money owing for construction work carried out or undertaken to be carried out (or for related goods and services supplied or undertaken to be supplied) under the contract;
>
> ***pay when paid provision*** of a construction contract means a provision of the contract—
>
> (a) that makes a liability of 1 party (the *first party*) to pay money owing to another party (the *second party*) contingent on payment to the first party by a further party (the *third party*) of the whole or a part of that money; or
>
> (b) that makes the due date for payment of money owing by the first party to the second party dependent on the date on which payment of the whole or a part of that money is made to the first party by the third party; or
>
> (c) that otherwise makes the liability to pay money owing, or the due date for payment of money owing, contingent or dependent on the operation of another contract.

[33] The High Court of Australia was required to determine whether the retention provisions, in particular cl 11(e) of the subcontract, was a "pay when paid provision" under s 12. The Court held:

> [23] Under the subcontract, the release of the retention sum was contingent or dependent on "CFO" being "achieved". The retention provisions expressly provided that the due dates for the release of the retention sum were tied to the provision of a "certificate of occupancy and any other Approval(s) required under Building Legislation which [were] required to enable the Works lawfully to be used for their respective purposes in accordance with [Maxcon's] Project Requirements". That is, before the due dates for the

> release of the retention sum could be calculated under the retention provisions, a certificate of occupancy had to be issued under s 67 of the Development Act.
>
> [24] The issue of that certificate of occupancy was dependent upon certification by the builder, Maxcon, that the building work had been performed in accordance with the issued documents, including the head contract between Maxcon and the owner of the land. It necessarily follows that the issue of the certificate depended on completion of the whole project in accordance with the provisions of the head contract. Until that certificate was issued on completion of the project, the retention sum was not to be released.
>
> [25] And that certificate had not been, and could not have been, issued on 25 February 2016 when Mr Vadasz served on Maxcon a payment claim pursuant to s 13 of the Security of Payment Act. *The due dates for payment of the retention sum were dependent on something unrelated to Mr Vadasz's performance. They were dependent on the operation of another contract — namely, the completion of the head contract, which in turn would have enabled a certificate of occupancy to be issued.* Accordingly, the retention provisions were pay when paid provisions within the meaning of s 12(2)(c) of the Security of Payment Act and Maxcon was not entitled to deduct the retention sum from the progress payment.
>
> …
>
> [27] As the proceeding analysis demonstrates, s 12(2)(c) focuses on a provision of a contract and asks whether, on its proper construction, the provision "makes the liability to pay money owing, or the due date for payment of money owing, contingent or dependent on the operation of another contract". Here, the retention provisions did just that: they made the due dates for payment contingent or dependent on "CFO". And for "CFO" to be achieved, there had to be issued a certificate of occupancy and "any other Approval(s) required under Building Legislation which [were] required to enable the Works lawfully to be used for their respective purposes in accordance with [Maxcon's] Project Requirements". Those Project Requirements were to be ascertained from the head contract. "CFO" required satisfactory completion of the head contract before the dates for the release of the retention sum could be calculated, let alone for the retention sum to be released. …
>
> (Emphasis added; footnotes omitted)

[34] In the present case, the plaintiff does not contend that the impugned provision is a "pay when paid" or "pay if paid" clause under the Act. However, the plaintiffs submit that *Maxcon Constructions Pty Ltd* is relevant because, albeit in the context of considering whether a retention provision was a "pay when paid provision" under the relevant South Australian legislation, the High Court of Australia recognised that linking the payment of subcontractor retentions to the completion of the head contract meant that payment of retentions was dependent on a matter unrelated to the subcontractor's performance. The plaintiff contends that this analysis can be applied

in the present case, meaning that the impugned provision is prohibited under s 18I(1)(a) and (b) of the Act.

[35] The defendants submit that the impugned provision is not prohibited under the Act. The defendants rely on the decision in *Federal Commercial Construction Ltd v Leading Edge Fabrication Ltd*.[12] In that case, the Court considered a retention clause which provided:

> **RETENTIONS**
>
> Retentions are 5% of the subcontract price.
>
> Retentions will be released as follows:
>
> (a) 2% of the total retained 31 days after Practical Completion of the main contract or release of retentions to Federal Commercial Limited.
>
> (b) 3% of the total retained 12 months after Practical Completion of the main contract or release of Maintenance Retentions to Federal Commercial Limited.
>
> Or, as amended on the Subcontract Agreement.
>
> Release will only be made after receipt by the company [that is, Federal Commercial Ltd] of a separate GST invoice for each subcontract for the appropriate sum and once all outstanding requirements on the subcontract have been completed and upon release of the retentions held by the client.

[36] The Court found that:

> [25] The parties are agreed that there are a series of cumulative steps that must occur under the Subcontract before the date for release passes. They are expressly provided for in cl 1.16 of the Subcontract and include the following:
>
> (a) Federal must receive a GST invoice for the appropriate sum; and
>
> (b) All "outstanding requirements" of the Subcontract must have been completed.
>
> [26] On the face of cl 1.16, there was a further and third requirement, namely that there be a release of retentions "held by the client", (that is, the Principal/Head Contractor). However, both parties agree that that requirement is void pursuant to s 18I of the Act That section renders void any term that purports to make the payment of retention money conditional on anything other than the performance of the subcontractor's obligations under the contract.

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12 *Federal Commercial Construction Ltd v Leading Edge Fabrication Ltd* [2020] NZHC 2352.

> [27] The parties are in agreement that the date 12 months after practical completion (that is, the date contemplated by cl 1.16(b)) was 21 January 2020. They are therefore in agreement that the "defects liability period" (DLP) under the Subcontract expired on 21 January 2020.

[37] Mr Holland, for the defendants, submits that the provision providing for subcontractor retentions to be withheld for 12 months after head contract practical completion was not criticised by the Court. He submits that, therefore, in the present case, the provision providing for retentions to be released within 30 days of the certificate of practical completion does not contravene the Act. He submits that it is simply the parties agreeing an objective milestone for payment, a point in time.

[38] However, in *Federal Commercial Construction Ltd*, the issue was whether there was a genuine and substantial dispute that retentions were not owing because the date for release had not passed on the date a statutory demand was issued. The issue as to whether the provisions relating to the release of retentions after practical completion were prohibited provisions under the Act did not arise. There was no argument on this issue recorded in the judgment and no findings made. The case is not authority for the proposition that such provisions are not prohibited under the Act.

[39] In considering whether the impugned provision contravenes s 18I, it is relevant to consider the provisions of the subcontract agreements relating to defects. Section 11 of the Subcontract General Conditions provides:

> **SECTION 11 DEFECTS**
>
> …
>
> 11.1.2 Any defects or faults which appear in the Subcontract Works prior to practical completion of the Head Contract Works, or during the defects liability period stipulated in the Head Contract, must, upon notification in writing by the Contractor, be remedied by the Subcontractor at their own cost.
>
> …

[40] With regard to the head contract, cl 4 of the Subcontract Agreement provides:

> 4. The following items constitute the Subcontract ("Subcontract Documents")
>
> a) This Subcontract Agreement;

b) The Subcontract Specific Conditions including Additional Documents and Special Conditions;

c) The Subcontract General Conditions;

d) The contract documents (as defined under the Head Contract), which relate to the Subcontract Works.

[41] Clause 2 of the Subcontract Specific Conditions provides:

> **2. THE CONTRACT**
>
> The general conditions of the Head Contract are NZS 3910:2013 as may have been modified by other documents in the Head Contract.

[42] Section 2.1 of the Subcontract General Conditions provides:

> **2.1 Head Contract**
>
> 2.1.1 The Subcontractor agrees to comply with all the provisions of the Head Contract that apply to the Subcontract Works, except as specifically varied by this Subcontract. All the powers and obligations of the Principal and Engineer, under the Head Contract, extend to this Subcontract and must be exercised by the Contractor. In the event of ambiguity or conflict, the terms of this Subcontract take precedence over the terms of the Head Contract.

[43] Therefore, based on cl 11.1.2 of the subcontracts referred to above, the defects liability period under the subcontracts was the period from completion of the subcontract works through until the end of the defects liability period stipulated in the head contracts. The defects liability periods under the head contracts run from the date of practical completion of the works for a period of 12 months.

[44] In my view the impugned provision is a prohibited provision under s 18I(1)(a) of the Act. The provision provides for release of the balance of retentions within 30 days of the issue of the certificate of practical completion, or earlier, as provided in the head contract. The issue of the certificate of practical completion for the head contract works is dependent on things other than the performance by the plaintiff of its obligations under the subcontracts; it is also dependent on performance by other subcontractors and on performance by the head contractor under the head contract (the defendants). Therefore, the impugned provisions purport to make the payment of the balance of the retentions conditional on "anything other" than performance by the plaintiff of its obligations under the subcontracts.

[45] However, I do not consider that the impugned provision contravenes s 18I(1)(b) of the Act. As discussed above, the defects liability period under the subcontracts extends until 12 months after practical completion under the head contracts. During this period, the plaintiff remains under an obligation to remedy defects notified by the defendants at its own cost. The balance of the retentions is to be released within 30 days of the issue of the certificate of practical completion under the head contract. This is not a date which is later than the date on which the plaintiff has performed all of its obligations under the subcontracts to the agreed standard. The plaintiff is under an obligation to remedy notified defects at its own cost for a period of 12 months after the issue of the certificate of practical completion.

If the impugned provision is prohibited, what is the consequence?

[46] I have found that the impugned provision is a prohibited provision under s 18I(1)(a) of the Act and therefore also a conditional payment provision under s 13(2)(ca) of the Act. Section 18I(1) provides that a prohibited term is "void" and s 13 provides that a conditional payment provision has "no legal effect" and is therefore not enforceable in any civil proceeding and may not be used as a basis for withholding payments that are due and payable under the contract.

[47] The plaintiff's position is that the effect of the impugned provision being a prohibited provision is that retention funds must be released in their entirety as property wrongfully taken. The basis for this submission seems to be that the impugned provision is an "illegal provision" and therefore the subcontracts are illegal contracts under s 71(1)(b) of the Contract and Commercial Law Act 2017 (CCLA). Mr Collins refers to ss 71–73 of the CCLA.[13] Section 71 provides:

> **71 Illegal contract defined**
>
> (1) In this subpart, **illegal contract**—
>
> (a) means a contract governed by New Zealand law that is illegal at law or in equity, whether the illegality arises from the creation or the performance of the contract; and
>
> (b) includes a contract that contains an illegal provision, whether that provision is severable or not.

[13] See Stephen Todd and Matthew Barber *Burrows, Finn and Todd on the Law of Contract in New Zealand* (7th ed, LexisNexis, Wellington, 2022) at [13.5].

…

[48] Section 72 provides:

> **72 Breach of enactment**
>
> A contract lawfully entered into does not become illegal or unenforceable by any party because its performance is in breach of an enactment, unless the enactment expressly so provides or its object clearly so requires.

[49] Section 73 then provides that an illegal contract is of no effect:

> **73 Illegal contracts have no effect**
>
> (1) Every illegal contract is of no effect.
>
> (2) No person is entitled to any property under a disposition made by or under an illegal contract.
>
> (3) This section and section 74 apply—
>
> (a) despite any rule of law or equity to the contrary; but
>
> (b) subject to the provisions of this subpart and of any other enactment.

[50] This raises an issue as to whether prohibited provisions and/or conditional payment provisions under the Act are "illegal provisions" under s 71(1)(b) of the CCLA. Sections 10(1) and (2) of the Legislation Act 2019 read:

> **10 How to ascertain meaning of legislation**
>
> (1) The meaning of legislation must be ascertained from its text and in the light of its purpose and its context.
>
> (2) Subsection (1) applies whether or not the legislation's purpose is stated in the legislation.
>
> …

[51] As noted above, the Act does not expressly provide that a prohibited provision under s 18I or a conditional payment provision under s 13 is illegal or that the illegal contracts provisions of the CCLA will apply. Rather as noted above, the Act provides only that offending provisions are "void" and/or of "no legal effect".

[52] The purpose of the Act includes to facilitate regular and timely payments between the parties to construction contracts, and to provide speedy resolution of

disputes arising under construction contracts, and to provide remedies for the recovery of payments under a construction contract.[14] The purpose of the retention provisions in sub-pt 2A of the Act is to attempt to ensure that the retentions regime under construction contracts is not misused by using retentions as working capital, delaying payment of retentions for unduly long periods or holding retention amounts which are disproportionate to contract prices.[15] In my view, this is achieved by making an offending provision under s 18I "void" which I consider simply means that the offending provision is invalid and ineffective. And if the prohibited provision is also a conditional payment provision under s 13 then that section provides that it is of "no legal effect" meaning it is unenforceable and unable to be used as a basis for withholding payments that are due and payable. I do not consider that it is consistent with the purposes of the Act, and nor can it have been the intention of Parliament, that the inclusion of a prohibited provision under s 18I and/or a conditional payment provision under s 13 in a construction contract would render the construction contract illegal. Under s 73 of the CCLA, the construction contract would be of no effect; "title or property to the subject-matter of the contract, or the consideration for it, cannot pass".[16] The parties would have to seek discretionary relief under s 76 of the CCLA. There would be significant disruption and uncertainty for parties to construction contracts.

[53] Mr Holland, for the defendants, submits that if the impugned provision is found to be prohibited and therefore "void", the outcome is not that there was never any entitlement to withhold retentions. He submits that there are four parts making up the retention money provision in this case:

(a) the term providing for withholding of retention money;

(b) the term providing for calculation of the sum to be withheld;

(c) the term providing for the first release of retentions; and

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14 Construction Contracts Act, s 3.

15 Construction Contracts Amendment Bill 2013 (71-2) (select committee report); (20 October 2015) 709 NZPD 7347–7348; and *Bennett v Ebert Construction Ltd* [2018] NZHC 2934 at [60]–[79].

16 Todd and Barber, above n 13, at [13.6].

(d) the term providing for the second release of retentions.

[54] He submits that it is a strained interpretation of s 18I that, if one term relating to the release of retention money is void, then the entire contractual right to withhold retention money is ineffective. Mr Holland again refers to the decision in *Federal Commercial Construction Ltd*.[17] In that case, retentions were only to be released to the subcontractor after "release of retentions held by the client". The parties agreed that this provision was void under s 18I. Mr Holland submits that this did not lead to a finding that there was never any entitlement to withhold retentions. Rather, the parties simply ignored the void provision. However, the consequence of the relevant provision being "void" does not seem to have been raised or in issue between the parties. The judgment does not record any submissions on the issue and nor are any findings made.

[55] Mr Holland also submits that effect of a term being void may create a "lacuna", for example, if the term providing for the second release of retentions is void. He submits that, in the present case, the lacuna should be filled by implying a term to give business efficacy to the subcontract; the implied term would provide for release of the balance of retentions no later than the date the plaintiff has completed all of its obligations under the subcontract to the agreed standard.[18] However, in the circumstances I do not consider that it is appropriate to imply a term with regard to release of retentions. This is not a situation where the parties have left an obvious gap in their agreement and there is a need to fill in the detail to give business efficacy to the contract, or to give effect to the obvious but unexpressed intention of the parties.[19] Here, the parties have included a provision in their contract which is prohibited by the Act and "void"; the legal consequence of that needs to be determined.

[56] I consider that the decision of the High Court of Australia in *Maxcon Constructions Pty Ltd* is instructive. In that case, as here, the retentions regime consisted of a series of provisions dealing with: the requirement to provide security in

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17 *Federal Commercial Construction Ltd v Leading Edge Fabrication Ltd*, above n 12.
18 See Todd and Barber, above n 13, at [6.4.4(f)].
19 At [6.4.4(f)].

the form of a cash retention; the calculation of that retention at five per cent of the subcontract sum; and the release of the retention in two tranches. The High Court of Australia found that the provisions dealing with the release of retentions were dependent on the operation of another contract (the head contract) and therefore a "pay when paid provision" within the meaning of s 12(2)(c) of the Building and Construction Industry Security of Payment Act (South Australia) and of "no effect in relation to any payment for construction work". The Court held that the consequence was that Maxcon, the head contractor, was not entitled to deduct retentions nor retain retentions that had been deducted. The finding that the provision providing for release of the retentions was of no effect under the relevant legislation meant that the entire retentions regime was invalidated. There is no suggestion otherwise in the judgment.

[57] In the present case, it is not contended that the relevant provisions are "pay when paid" or "pay if paid" clauses. However, I consider the same result follows as found in *Maxcon Constructions Pty Ltd*. In my view, the retention regime under the subcontracts is an indivisible whole. The provisions providing for release of retentions are an integral part of the regime. The provision providing for release of the balance of the retentions (50 per cent) after the issue of the practical completion certificate cannot be ignored or severed.[20]

[58] Therefore, the consequence of the impugned provision being found to be prohibited under s 18I(1)(a) the Act, and a conditional payment provision under s 13, is that the entire retention regime is rendered void and of no legal effect. This means that the retention regimes under the subcontracts may not be used as the basis for withholding payments that are due and payable under the subcontracts.[21] As a result, the defendants were not contractually entitled to withhold retentions under the subcontracts nor retain the retention money. The plaintiff had an accrued right under the subcontracts to payment of the retention money prior to the liquidation and prior to the disclaimers and any cancellation of the subcontracts.

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[20] See the approach taken by the Supreme Court to severance of invalid contractual provisions in *Carr v Gallaway Cook Allan* [2014] NZSC 75 at [47]–[62].

[21] Construction Contracts Act 2002, s 13(1)(b).

Has the retention money trust ended?

[59] The defendants accept that the retention money withheld under the subcontracts was initially held on trust by them as trustees for the benefit of the plaintiff under s 18C(1) of the Act.

[60] In my view that remains so even though I have found that the consequence of the impugned provision being prohibited is that the defendants were not contractually entitled to deduct retentions. Section 18A of the Act defines "retention money" as "an amount withheld by a party to a construction contract (party A) from an amount payable to another party to the contract (party B) as security for the performance of party B's obligations under the contract". The definition does not specify that there must be an entitlement to withhold an amount as security under the construction contract. However, any amount that is withheld as security must be held on trust under sub-part 2A.[22]

[61] However, the defendants contend that the retention money trusts have now ended under s 18C(3) of the Act and there are no limitations on the use of the money held.

[62] First, Mr Holland submits that the trusts are an end under s 18C(3)(b) of the Act because the plaintiff agreed to give up any claim to the money in writing by disclaiming the subcontracts. Mr Holland submits that the liquidators cannot, in disclaiming the subcontracts, reserve all rights in relation to the retentions held on trust because no right to be paid the retentions had accrued at the time of the disclaimer.

[63] Mr Holland refers to s 269(3)(a) of the Companies Act which provides that a disclaimer "brings to an end on and from the date of the disclaimer the rights, interests, and liabilities of the company in relation to the property disclaimed". Mr Holland also refers to *Smartt Holdings Ltd v DK Yeoman Ltd (in liq)*,[23] where Whata J in

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22 I note that, although it does not apply to the subcontracts in this case, s 18B(5) of the Construction Contracts Act (introduced by the Construction Contracts (Retention Money) Amendment Act 2023) provides that the sub-pt 2 of the Construction Contracts Act applies even though the contract does not provide for the withholding of retentions.

23 *Smartt Holdings Ltd v DK Yeoman Ltd (in liq)* [2017] NZHC 1545 at [23].

considering s 269(3) of the Companies Act referred to the comments of Lord Nicholls in *Hindcastle Ltd v Barbara Attenborough Associates Ltd*, including:[24]

> Equally clear is the essential scheme by which the statute seeks to achieve these purposes. Unprofitable contracts can be ended, and property burdened with onerous obligations disowned. The company is to be freed from all liabilities in respect of the property. Conversely, and hardly surprisingly, the company is no longer to have any rights in respect of the property. The company could not fairly keep the property and yet be freed from its liabilities.

[64] Mr Holland submits that, as a result of the disclaimers, the plaintiff is freed of its prospective obligations under the subcontracts but cannot fairly keep prospective rights. Mr Holland submits that the rights to be paid the retention monies were prospective rights which have now been disclaimed.

[65] However, as I have found above, the defendants were not contractually entitled to withhold any retention money from progress payment claims made by the plaintiff under the subcontracts, and were not entitled to retain the money withheld. Therefore, the plaintiff had accrued contractual rights under the subcontracts to be paid the retention money withheld prior to being put into liquidation and prior to the disclaimers and any cancellation of the subcontracts by the defendants.

[66] Secondly, Mr Holland submits that the retention trusts have ended because, pursuant to s 18C(3)(c) of the Act, the retention money has ceased to be payable under the subcontracts. He submits that this is because the plaintiff has not completed its obligations under the subcontracts and the conditions for payment will never be satisfied, and the plaintiff has disclaimed all rights under the subcontracts. However, as discussed above, I have found that the plaintiff had accrued contractual rights under the subcontracts to be paid the retention money withheld prior to the disclaimers and any cancellation of the subcontracts by the defendants.

[67] Mr Holland also contends that the monies have ceased to be payable by operation of law under the mutual credit and set-off provisions of s 310 of the Companies Act. I address this issue below. I find that s 310 does not apply as there is no mutuality.

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[24] *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1996] 1 All ER 737 (HL) at 745–746.

[68] Finally, Mr Holland submits that the trusts end when the money held on trust is paid under s 18C(3)(a) of the Act. He contends that it is common practice in the construction industry to do a "final wash-up" or final account at the end of the contract and the subcontracts contain final account provisions. Mr Holland submits that at the time of the final account, the parties consider the amounts owed both ways, and the retention money is paid out accordingly. However, the difficulty with this argument is that no retention money withheld by the defendants has yet been paid out to the plaintiff under any "final wash-up", so the retention trusts cannot have ended under s 18C(3)(a).

[69] For these reasons set out above, I find that retention money withheld by the defendants under the subcontracts is held on trust by the defendants as trustees for the benefit of the plaintiff.

Mutual credit and set-off under s 310 of the Companies Act

[70] Mr Holland submits that if retention money is due and payable to the plaintiff then the defendants' claims as creditors must be accounted for in accordance with s 310 of the Companies Act. Section 310(1) provides:

> **310 Mutual credit and set-off**
>
> (1) Where there have been mutual credits, mutual debts, or other mutual dealings between a company and a person who seeks or, but for the operation of this section, would seek to have a claim admitted in the liquidation of the company,—
>
> (a) an account must be taken of what is due from the one party to the other in respect of those credits, debts, or dealings; and
>
> (b) an amount due from one party must be set off against an amount due from the other party; and
>
> (c) only the balance of the account may be claimed in the liquidation, or is payable to the company, as the case may be.

[71] Mr Holland submits that the defendants have significant losses arising out of the disclaimer of the subcontracts and the cancellation of the subcontracts. The defendants have adduced evidence of the alleged losses. The defendants contend that the losses in respect of both projects extinguish the retention money amounts held for the plaintiff after applying the mandatory set-off under s 310 of the Companies Act.

[72] Mr Holland refers to *N F Global v Sky Capital Management Ltd* where the Court held with regard to s 310 of the Companies Act:[25]

> It is helpful to compare this with the application of insolvency set-off under s 310 of the Companies Act 1993. Insolvency set-off arises when there have been mutual dealings between a person and a company. The set-off is substantive, not procedural. It is self-executing and mandatory. Contracting out is not permitted. The set-off establishes a new net balance, which replaces the earlier claim and cross-claim. It applies to all claims that may be made in a liquidation, including contingent claims. A creditor's claim will be extinguished if the company's cross claim against it is for a greater sum.

[73] Mr Holland also refers to *Trans Otway Ltd v Shephard*.[26] In that case the Supreme Court stated:[27]

> It is regarded as unfair that someone who owes an amount to an insolvent person should have to pay it in full whilst exposed to the peril of receiving only a dividend, or nothing at all, from the estate in respect of an amount owed by the insolvent. It is this policy which is recognised in s 310(1), in the requirement that in a company liquidation the balance between the company and its creditor must be taken on a net basis after set-off has occurred.

[74] However, as submitted by Mr Collins, the difficulty for the defendants in this regard is that s 310 of the Companies Act makes it clear that insolvency set-off is allowed in a liquidation only if there has been mutual credits, mutual debts and other mutual dealings. The credits, debts or claims arising from the dealings must be between the same persons, and the benefit or burden of the credits, debts or other dealings must lie in the same interest or in the same capacity.[28]

[75] As the retention money is held on trust, there is no mutuality. While the defendants may have a personal claim against the plaintiff in respect of losses suffered as a result of the disclaimers and/or cancellations of the subcontracts, the plaintiff has a proprietary interest in the trust assets and a claim against the defendants as trustees.[29]

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25 *N F Global Ltd v Sky Capital Management Ltd* [2020] NZHC 2196 at [40].
26 *Trans Otway Ltd v Shephard* [2005] NZSC 76, [2006] 2 NZLR 289 at [15].
27 At [15].
28 *Finnigan v He* HC Auckland CIV-2009-404-753, 1 December 2009 at [24]; and Robyn Merrett and Stephen Revill *Insolvency Law and Practice* (looseleaf ed, Thomson Reuters, 2022) at [CA310.07].
29 Rory Derham *Derham on the Law of Set-Off* (4th ed, Oxford University Press, Oxford, 2010) at 10.02.

[76] Therefore, s 310 does not apply to require set-off of any claims for losses suffered by the defendants against the retention money held on trust by the defendants as trustees.

[77] Further, in the circumstances of this case, I note that if set-off operated to extinguish the retention money, that would essentially allow the defendants the benefit of the retention money as security for performance in circumstances where there was no contractual entitlement to withhold and retain the money as security for performance.

Summary in respect of plaintiff's first cause of action

[78] For the reasons set out above, I find that the impugned provision is prohibited under s 18I(1)(a) of the Act and therefore void, and also a conditional payment provision under s 13 of the Act. The consequence is that the retention regimes under the subcontracts are rendered void and of no legal effect. This means that the retention regimes may not be used as the basis for withholding payments that are due and payable under the subcontracts. The defendants had no contractual entitlement to withhold the retention money or retain the retention money. The plaintiff had an accrued right to payment of the retention money under the subcontracts prior to being put into liquidation and prior to the disclaimers or any cancellation of the subcontracts.

[79] The retention money remains held on trust by the defendants as trustees for the benefit of the plaintiff. There is no set-off of the defendants' claims for losses or damages against the retention money because there is no mutuality. Therefore, the plaintiff is entitled to immediate payment of the retention money held on trust, and it must be released by the defendants.

[80] I am satisfied that the defendants do not have an arguable defence to the plaintiff's claim for a declaration to the effect that the retentions must be released.

Is the proper construction of s 18E(1) that retention money can only be applied to remedying actual physical defects in the works including departures from the design or specifications?

[81] Given the conclusion I have reached above with regard to the plaintiff's first cause of action, I do not need to deal with the alternative claim for a declaration regarding the scope of s 18E(1) of the Act.

[82] Even if I had found that the impugned provision is not prohibited under the Act or that the consequence of prohibition is not as set out above, I do not consider that the scope of s 18E(1) would necessarily be in issue. That is because, if the impugned provision was not prohibited, or if the consequence of prohibition was not as I have found above, then it seems to me to be arguable in the circumstances of this case that the retention money trust would have ended under s 18C(3)(b) or (c) of the Act and s 18E(1) would no longer apply.

Should I exercise my discretion not to grant summary judgment?

[83] Mr Holland also submits that the relief sought by the plaintiffs in this case involves a transfer of the risk of insolvency which is not the policy of the Act.[30]

[84] Mr Holland referred me to the decision in *Rintoul Group Ltd v Far North District Council*,[31] in which Moore J referred with approval to the decision of the District Court in *Williams Investment Group Ltd v Kingsview Developments Ltd*.[32] In that case, the plaintiff applied for summary judgment in respect of a debt owed under the provisions of the Act. The Court found, after considering the payment schedule served by the defendant, that the plaintiff had failed to satisfy the Court that there was no arguable defence to the plaintiff's claim and therefore the application for summary judgment failed. However, the Court also stated:

> [22] I respectfully disagree with the plaintiff's submission. I accept that the Construction Contracts Act 2002 was predicated on a statutory purpose of prioritising cashflow, on the basis that cashflow is the lifeblood of the industry. But in this case we are dealing with a statutory corpse, a liquidated company,

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30 Mr Holland refers to *Kariiti Ltd v Donovan Drainage and Earthmoving Ltd* [2010] NZHC 2146 at [6]–[15].

31 *Rintoul Group Ltd v Far North District Council* [2019] NZHC 2577 at [37]–[39].

32 *Williams Investment Group Ltd v Kingsview Developments Ltd* DC Tauranga CIV-2007-070-1323, 4 September 2008.

> a corpse which claims disputed retention sums where there is at least prima facie evidence of inadequate performance of the contract. Here any flow of funds can only be in one direction if summary judgment is granted. While the defendant can indeed file fresh proceedings to advance its own claim, I accept that liquidation would likely render such proceedings financially nugatory in terms of recovery.
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> [23] In my view it would clearly be unjust if the defendant were prevented from obtaining practical justiciable access to its offsetting claims to the retentions sum; claims which had been notified to the plaintiff before liquidation, notified to the liquidators prior to the issue of the payment claim, and which are clearly set out in the correspondence relied upon by the defendant as the payment schedule.
>
> …
>
> [29] For those reasons, I am satisfied that this would in any event be an appropriate case for the exercise of the Court's discretion to refuse summary judgment. On that ground also, the plaintiff's application for summary judgment is dismissed.

[85] Mr Holland submits that these cases recognise that the "pay now argue later" policy of the Act presumes there will be a "later". He submits that to give effect to the plaintiff's position in this case would create an injustice because the plaintiff is in liquidation and defendants are unlikely to be able to recover their losses.

[86] However, in the circumstances of this case, I do not consider it is necessary to exercise the residual discretion to refuse the entry of summary judgment to avoid an injustice. In my view, this case can be distinguished from the decisions relied on by Mr Holland. The key distinguishing features follow.

[87] First, this is not a case involving a debt due and interim payment based on ss 23, 24 or 59 of the Act. Here, retentions have been withheld by the defendants when there was no contractual entitlement to do so. The defendants are not entitled to retain the retention money as security for performance. The plaintiff has had an accrued right under the subcontracts to payment of the retention money throughout.

[88] Second, the retentions are held on trust by the defendants as trustees for the benefit of the plaintiff. The defendants are not able to set-off their claims against the retention money for the reasons set out above.

Result

[89] By way of summary judgment, a declaration is made that the retention regimes (all retention provisions) in the subcontract agreements between the plaintiff and the first and second defendants for the Sarjeant Gallery and Project Cannon are void and of no legal effect, and the retention money withheld by the first and second defendants under those subcontract agreements is due and payable to the plaintiff.

[90] At this stage, summary judgment is not given for the specific sums to be paid by the first and second defendants to the plaintiff under the respective subcontracts including interest on those amounts. Counsel for the parties are to confer to attempt to agree on the specific amounts in respect of which summary judgment is to be given including interest. If the parties are unable to agree, then then either party may request that a telephone conference be scheduled for any outstanding issues to be determined, and the parties are to file memoranda in advance of the conference setting out their respective positions. If agreement can be reached, the parties are to file a joint memorandum setting out the agreed amounts and interest and summary judgment will then be entered for those amounts.

[91] With regards to costs, my preliminary view is that the plaintiff has been successful and is entitled to costs on a 2B basis and reasonable disbursements. The parties should endeavour to agree costs. However, if they are unable to do so then memoranda may be filed (not exceeding three pages, excluding costs schedules) and costs will be determined on the papers.

Associate Judge Skelton

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Hazelton Law, Wellington for First and Second Defendants