BUDDLE FINDLAY

BOOM OR BUST?

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With the restructuring industry's annual Corporate and Restructuring Conference taking place this week, it is timely to look back at recent issues in the restructuring market in New Zealand.

If we project back 10 years, the story was all about finance companies. Today, it is all about the construction industry. A common refrain is: How can a building firm go bust while at the same time we're experiencing a record construction sector boom?

The list of collapses makes for sorry reading with established names leaving mountains of debt and trails of unpaid creditors. This in an industry which is clearly suffering from structural issues of its own. Names like Mainzeal, Stonewood, Ebert and most recently Arrow are all in or will shortly be in liquidation. A number of wider market issues such as the recent litigation involving the directors of Mainzeal have and will continue to flow from these collapses - the simple truth being that none of the business rehabilitation principles sitting behind our voluntary administration regime will ever assist a construction firm once it is completely on its knees.

On any large scale project, the first question financiers are now asking is around capability of the builder. Once upon a time, that first question may have focused on equity in the project and therein would appear to lie an important aspect of the current problems we have been seeing.

Many of the construction firm collapses show firms had been operating on 'fixed price' contracts. Couple that with ever compressed margins resulting from price escalation and firms have been found to have very little margin for error. When those margins are at their slimmest is the time when directors may be asked to face into the most difficult decisions of their boardroom careers. The cry for increased vigilance around construction board tables has never been more acute than now.

In response to various market failures, the Ministry of Business, Innovation and Employment (MBIE) is to be congratulated for releasing its building sector reform paper inviting consultation in the building sector - with a key aim being of ensuring that if things do happen to go wrong, there are 'fairer outcomes'. The paper however fails to adequately address what most of us know and that is that all parts of the building and construction market be they construction firms, principals, subcontractors or end purchasers, are in almost every case funded by banks and other funders. While a general invitation to join the conversation has been extended by MBIE, given that key decisions around construction industry failures are very often driven by the funders, it is imperative that they are afforded a prominent voice in the consultation process. A lot of 'rear view mirror' knowledge can also be passed on from the experiences of those insolvency professionals and lawyers who, as the ambulances at the bottom of the construction pile, are there to undertake the investigation and clean up.

The MBIE discussion paper notes that the major changes made to the Construction Contracts Act in March 2017 were broadly designed to strengthen protections for subcontractors. The changes were thought at the time to be the optimal legislative response for addressing unfairness in the handling of subcontractor retentions in particular, but regrettably that legislation appears to have missed its mark.

While the concept of a 'trust' is well understood, the trust actually formed upon a retention being made (or to be made) seems to have largely fallen into a 'no-man's land'. Funders initially reacted by amending covenant packages requiring that principals and contractors covenant that they will comply with the amended legislation - an attempt not to get drawn in to the bowels of the regime, and who could blame them. More recently, as the number of collapses in the market has increased, financiers have been more inclined to insist on seeing the establishment of retention trusts in separate retentions trust accounts. It is regrettable that the legislation did not provide for this at the outset. The result has been to force parties into costly court applications for determining things like how retentions monies are to be dealt with and distributed and in the case of Ebert, how the legitimate cost of managing such a process was to have been properly borne.

While a tidy up of the retentions regime will be a big step forward in providing some additional level of confidence for the industry, a wider conversation aimed at understanding what a 'fairer' market might look like would also be of ultimate benefit for all industry stakeholders.

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