RETENTIONS UNDER THE SPOTLIGHT

- SUZY LOVELL

The Department for Business, Innovation and Skills (BIS) has recently announced a review of the practice of retentions in the construction industry. Together with other industry bodies such as the National Specialist Contractors Council, the Specialist Engineering Contractor's Group and the Scottish Futures Trust all lobbying for major change as well as the ever increasing momentum of the Fair Payment Campaign, are we finally on the brink of real reform?

The 2009 amendments to the Housing Grants, Construction and Regeneration Act 1996 (i.e. the Construction Act) brought a measure of regulation to the use of retentions through its prohibition on condition payment provisions. The Government also launched its Construction Supply Chain Payment Charter in April 2014 with a commitment to move to zero retentions by 2025. However, neither of these measures appears as yet to have stemmed the current practice of retentions.

The practice of retentions in the UK originated in the railway construction sector in the 1840's, where the rapid expansion of the railway network resulted in new construction companies forming to meet the surging demand. However, with insolvency rates high, clients were driven to deduct a "retention" from payment schedules, in some cases withholding up to 20% of the contractors' payments, in order to ensure there was a fund available to help them cover the costs of completion should the firm default. Today, a 20% retention might seem absurd but it remains commonplace for clients to withhold 5% from Contractors and for contractors in turn to withhold 3-5% from subcontractors.

So what are the problems with retentions?

- Cashflow – the contractor is denied payment for work it has already completed putting a strain on its cashflow, which only heightens down the supply chain.
- Risk lies with the Subcontractors - contractors pass down the retention to its subcontractors whose retention money is then at risk of contractor insolvency. Where profit margins are narrow, the retention can often represent the majority if not all of the profit on any given project.
- Administration – keeping records on outstanding retention, chasing release at the end of the rectification period and trying to find out who is responsible for release a year or more on from the completion of the project all create administrative hurdles.
- Increased cost for Clients – contractors may increase the price for the works in order to offset the risk of not recovering the retention at the end of the project.

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The Scottish Construction Procurement Manual which applies to the central government sector in Scotland, sets out the need for those procuring construction works to employ project assurance measures to protect the public purse from becoming liable, but it does not specify that this should necessarily be achieved by the use of cash retentions:

> *"Decisions should be project based and processes should be proportionate to the specific circumstances of the project...Cash retentions or other traditional means of assurance should not prevail purely by default".*

The manual also lists some sensible alternative project assurance measures to cash retentions which are already used on a wide range of projects, not just in public procurement – such as retention bonds, performance bonds and parent company guarantees. Retention bonds are a win-win as the contractor has the monetary protection it requires and the sub-contractor keeps hold of its cash (and with the cost of the retention bond usually being factored into the price of the works). It also suggests that lessons could be learned from the trial of project bank accounts in Scotland and questions whether similar trust accounts might be used to administer retentions.

With pressure from lobbyists increasing and the government now launching a review of this area, both legal and industry reform may well be possible.

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