

# RELEASE OF THE RETENTION AND MATTERS OF TRUST

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- ▶ Cash retentions are becoming increasingly controversial.
- ▶ Public sector behaviours may be changing.
- ▶ Alternative protective steps are readily available.

## What is going on?

Cash retentions are becoming increasingly controversial in the construction industry. Huge amounts annually are said to go either unpaid or unclaimed, with recent studies suggesting the UK's top dozen contractors were owed £1bn of retention cash. For SME's, non-payment of retentions can be critical – affecting cashflow, and ultimately, jobs.

At its most basic, a contractual retention is an issue of trust – can the “employer” trust the contractor to return to site to rectify defects, snagging, or other faults? Widespread construction practice suggests not – cash must be retained in order to “incentivise” the contractor to return to site.

## What is happening now?

Public and industry awareness of the issue is high. A ten-minute rule bill was introduced into the UK Parliament before the last election (ironically by a Scottish MP, given the issue is devolved to the Scottish Parliament). The bill fell with the dissolution of the last session of Parliament. However, key industry figures continue to lobby for change.

Without legislation, contractual solutions in the current market can vary.

Firstly, the use of project bank accounts on larger developments is relatively common in order to improve payment flow, although retention sums do not ‘sit’ in the PBA until they become due for payment. If the PBA were to be used as a repository for the retention (giving greater visibility to the contractor, and protecting the retention from the effects of upstream insolvency), this would require a change to current practice and careful drafting.

Secondly, retention bonds can obviate the need for a cash retention, but can be expensive.

Thirdly, more commonplace are drafting amendments on a payer's behalf deployed to permit the retention holder complete and unfettered ownership of the retention sum – the contractor's entitlement to receive the retention on satisfactory performance under the contract is simply a further tranche of the contract sum.

## What is wrong with the current system?

Anecdotal and survey evidence suggests retentions do not operate as they should. Cashflow in the construction industry has improved hugely since Latham, but retentions remain stubbornly problematic whether that be due to intransigence, contract breach, or the difficulties caused by insolvency.

Recent public sector guidance suggests a move away from cash retentions. The Scottish Government's Procurement Manual confirms that cash retentions are not prescribed, noting:

- ▶ *“performance assurance mechanisms should be proportionate... and should be applied consistently along the supply chain.”*

With innovations in construction procurement often beginning in the public sector, large contractors may soon demand that private sector developers update their thinking in terms of cash retentions.

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## A ready solution – a display of trust

A workable drafting solution is readily available. JCT and SBCC contracts already provide for retention monies to be held “as trustee” on a fiduciary basis – however, this drafting is often deleted.

In Scots law, it is generally accepted that SBCC drafting (SBC/DB c4.16.1) does not work – however, to satisfy the Scots law on constitution of a trust, the requirement for constructive delivery can be met with straightforward drafting and delivery of a straightforward trust document. While “divestiture” and “constructive delivery” sound complex, for an industry not averse to additional paperwork it is not beyond clients and their lawyers to issue a clear declaration to their contractors at the outset that the retention is held in trust, payable either to the contractor on certification of making good defects or to the client on breach of specific defect rectification provisions by the contractor.

In English law, the matter is more straightforward still – the standard form (JCT DB c4.16.1) functions to give the contractor basic protection from employer insolvency, and the more concrete right to payment of the retention which trust status would bring.

NEC3 is silent on the issue, leaving the retention as a simply contractual matter. If contractors move toward requiring additional security, Z-clause drafting will be required.

Employers do not necessarily lose out in adopting this method. If the Employer must “spend” retention sums correcting defects on its own, the trust mechanism will allow for that, if properly drafted.

## What now?

Contractors and subcontractors will continue to push to reduce the role of cash retentions. Payers under construction contracts should be mindful that protective drafting already exists. The concept of a trust may seem archaic, but is workable and readily available, and represents a good compromise between payer and payee.

## Who to contact

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