



# IS IT TIME TO END RETENTION PAYMENTS?

**FINOLA MCCARTHY**, Partner, Ronan Daly Jermyn, examines alternative means to retention of providing protection for clients, and questions what real value retention brings to projects.

**R**etention is a longstanding feature of construction and engineering projects whereby a percentage of the contract price is withheld by the client as a safeguard against remedying defects. Half is released at project completion, and the other half is released following the expiry of a defects liability period. In preparing contracts, the debate is generally focused on the percentage of retention that is to be applied, and the question of whether or not retention is appropriate is not considered.

Is the time now right to review this practice?

## THE ISSUES

The retention of money has a considerable impact on cash flow for contractors and subcontractors, and many have experienced delays in the release of retention monies at the end of a project without justification. Research carried out in the United Kingdom in 2017 found that 71% of contractors surveyed experienced delays in



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receiving retention monies over a three-year period, with over half of those surveyed reporting that they had experienced non-payment of retention (Department

for Business, Energy & Industrial Strategy BEIS Research Paper 17 'Retentions in the Construction Industry', October 2017).

The extent of the delay is more pronounced for tier 1 and 2 subcontractors than for main contractors. Statistics on the total amount of retention held in Ireland are not published. In England, it is estimated that the total amount held in retentions in the construction sector over the course of a given year could be £3.2bn to £5.9bn.

The collapse of Carillion and other company failures has highlighted again the difficulties that arise with the loss of retention in the event of insolvency.

Other impacts throughout the construction sector supply chain identified in the UK research paper include:

- Higher business overheads
- Administrative time incurred in obtaining payments
- Costs of construction sector works are deemed generally higher
- Weakened relationships with clients and the rest of the supply chain

- The amounts withheld can add aged debt to balance sheets which can affect the capacity of contractors to borrow.

### ELIMINATION OF RETENTION

Given the difficulties that arise, there is a growing call for the elimination of the use of retention. The CIF, in its 'Medium-Term Strategy' in 2017 called for the practice of retention to be done away with completely, as there is little evidence to show that retention helps to avoid defects. In June 2019, Build UK (a leading representative organisation for the construction industry), as part of its campaign to eliminate the use of retention by 2023, published a guide on minimum standards on retention, with the aim of changing the current practice, together with a 'Roadmap to Zero Retentions'. It advocates that achieving zero retentions is a vital part of becoming a more collaborative and efficient sector.

The 'Minimum Standards Guide' sets out a number of policy principles, together with suggested contract wording, to address these principles (by way of amendments to the JCT Design and Build contract and the NEC4 Engineering and Construction Contract). These key principles are:

- No more onerous conditions – The retention in any subcontract should not be more onerous than in the main contract, to ensure fairness and transparency throughout the supply chain.
- No retention on temporary works – Retention should only be deducted from payments made in respect of permanent works. This is because the risk of defects in temporary works such as scaffolding is low enough not to require security by way of retention.
- Only one retention deduction – To improve cashflow, retention should only be deducted as a single sum towards the end of the project rather than from interim payments throughout.
- Lower percentage – The retention amount should be 1.5% on the basis of a single sum payment, reducing to 1% from 2021.
- Separate release – In subcontracts, the release of retention should not be linked to release of retention under the main contract.
- Minimum threshold – There should be no retention for contracts at any tier with a starting value of less than £50,000 (increasing to £100,000 from 2021).

While implementing these suggestions might seem radical, some of the ideas could be workable in Irish projects with limited complication. For example, the application of one single reduced percentage of retention to the payment at practical



completion should still provide adequate protection to employers to address any defects during the defects liability period. During the construction phase, usually interim payments can be adjusted to address any workmanship issues anyway. The suggestion of not applying retention to temporary works might be less attractive, depending on the level of the supply chain involved. It could give rise to administrative difficulties and uncertainties in assessing separately the elements of the works that are not permanent, and applying a zero rate to these.

### ALTERNATIVES TO RETENTION

There are a number of other mechanisms which potentially can be used to provide protection as an alternative to retention, such as retention bonds, performance bonds, parent company guarantees, project bank accounts, escrow stakeholder accounts and retention held in trust funds.

The advantages and disadvantages of each of these alternatives are set out in the UK's research paper. The main finding was that there is limited evidence of widespread use of the alternative mechanisms in the United Kingdom. The main disadvantage of a number of the mechanisms is the administrative cost and time required to implement them. While retention bonds are frequently used, the costs of bonds are high and could be a barrier for smaller subcontractors. The research paper identified two mechanisms that warrant further investigation as viable alternatives to retention, namely retentions held in trust and a retention deposit scheme.

Retention held in trust involves keeping the retention amount in a separate account, which keeps the monies ring-fenced from the outset of the project. It is protected in the event of an insolvency. The monies cannot be used for any other purpose by the employer.

In relation to the retention deposit scheme, it is suggested that the contract would be registered with a Government-approved retention deposit scheme (essentially a mechanism for protecting the retention monies) and then the retention

monies would be paid over to the scheme, where it would be held in trust. The scheme would also need to provide for the release of retention. Draft legislation to provide for the scheme has been prepared as a private member's bill, (The Construction (Retention Deposit Schemes) Bill), but its progress has stalled currently. Other jurisdictions such as New Zealand, Canada and Australia have introduced protections for the release of retention.

### WHAT NEXT?

The main forms of contract used in Ireland (RIAI, GCCC, FIDIC and NEC) all provide for retention, and in general, the process is similar in each. If the policy principles set out in the Build UK Minimum Standards are to be implemented, some limited amendments to these contracts would be necessary.

The RIAI Yellow and Blue forms already provide for retention held in trust, for a joint account retention fund, and for a mandatory retention bond at practical completion. However, in most private sector projects, it is common for employers to amend these provisions (mostly driven by funder requirements).

Implementing changes to established practice can be slow, and buy-in from all stakeholders (including funders and investors) will be needed. Introducing policy changes on retention practices through revised guidance on the GCCC contracts would provide an effective lead, as in general, this would likely persuade the private sector to follow. Additional legislative support might be necessary, and this could be done through amendments to the Construction Contracts Act.

Either way, there is no better time than the present to progress the review of current retention practices with the objective of improving much-needed cashflow in the Irish construction industry. **C**

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