

RICS Professional Guidance, UK

Retention

1st edition, guidance note



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Retention

RICS guidance note

1st edition (GN 90/2012)

Acknowledgment

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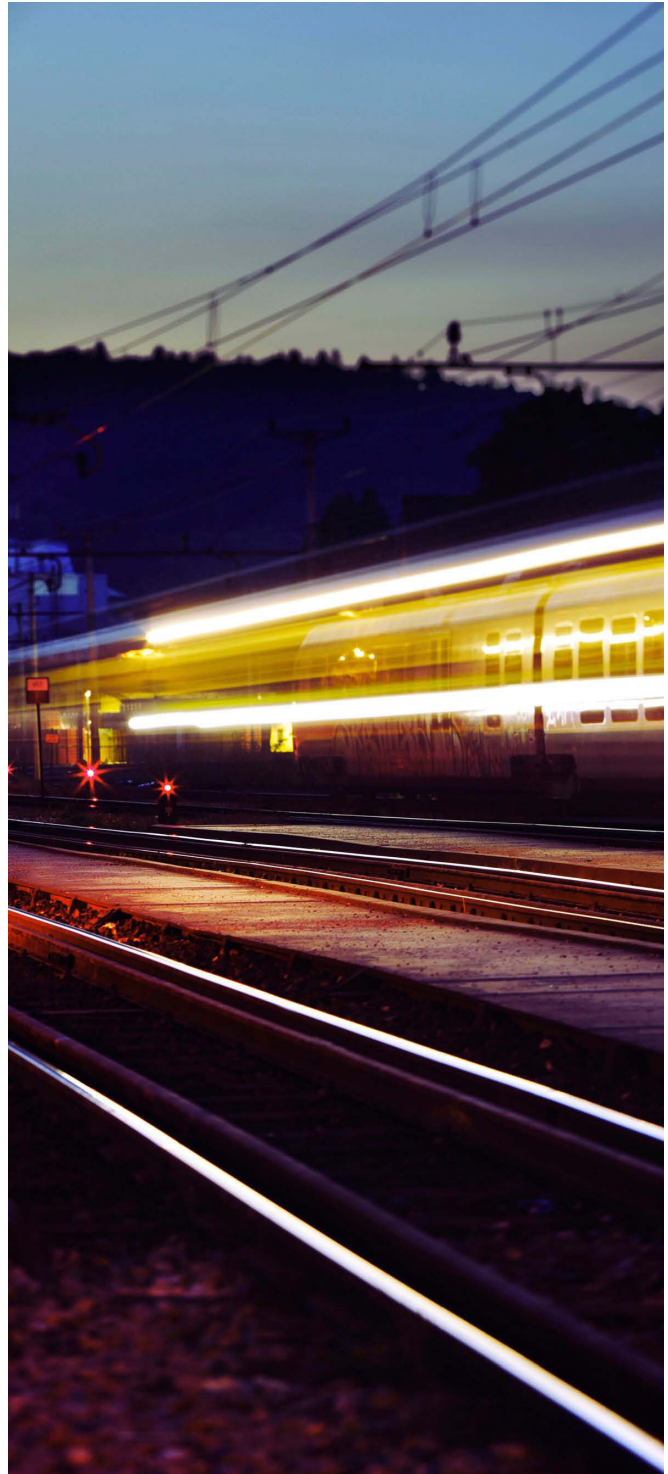
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RICS guidance notes

This is a guidance note. Where recommendations are made for specific professional tasks, these are intended to represent ‘best practice’, i.e. recommendations which in the opinion of RICS meet a high standard of professional competence.

Although members are not required to follow the recommendations contained in the note, they should take into account the following points.

When an allegation of professional negligence is made against a surveyor, a court or tribunal may take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the member had acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this note should have at least a partial defence to an allegation of negligence if they have followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance.

It is for each surveyor to decide on the appropriate procedure to follow in any professional task. However, where members do not comply with the practice recommended in this note, they should do so only for a good reason. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice. Also, if members have not followed this guidance, and their actions are questioned in an RICS disciplinary case, they will be asked to explain the actions they did take and this may be taken into account by the Panel.

In addition, guidance notes are relevant to professional competence in that each member should be up to date and should have knowledge of guidance notes within a reasonable time of their coming into effect.

Document status defined

RICS produces a range of standards products. These have been defined in the table below. This document is a guidance note.

Type of document	Definition	Status
RICS practice statement	Document that provides members with mandatory requirements under Rule 4 of the Rules of Conduct for members	Mandatory
RICS code of practice	Standard approved by RICS, and endorsed by another professional body that provides users with recommendations for accepted good practice as followed by conscientious practitioners	Mandatory or recommended good practice (will be confirmed in the document itself)
RICS guidance note	Document that provides users with recommendations for accepted good practice as followed by competent and conscientious practitioners	Recommended good practice
RICS information paper	Practice based information that provides users with the latest information and/or research	Information and/or explanatory commentary

1 Introduction

This guidance note introduces the subject by looking at the general principles of retention, including areas such as law; reasons for introduction within a contract; levels of retention, and how amounts are deducted, certified or released.

The guidance note then focuses on how the standard forms of contract deal with the issue. A list of the contracts reviewed is included within the table of contents. This paper reviews methods and limits of deduction, inclusion of the retention amount to be included within the contract, release and set off against sums held.

This guidance note concludes with a review of common issues including areas such as commonly occurring problems; financing; insolvency, and defects rectification.

Guidance is given for each of the main groups of contracts and the forms in most regular use within those groups, under the following headings, which map to the Assessment of Professional Competence (APC):

- General principles (Level 1 – Knowing)
- Practical application (Level 2 – Doing)
- Practical considerations (Level 3 – Doing/ Advising)

2 General principles (Level 1 – Knowing)

2.1 Reason for inclusion of retentions within the contract

Retention is a sum, generally deducted at each monthly payment notice, to provide the client with some security that the contractor/sub-contractor will return to correct any defects during the defects correction period, or defects liability period. If the contractor/sub-contractor does not return to correct the defects then the retention held may be used to fund the payment of others to correct the defects. It is advisable to check the contract on the ability to do this, and the relevant notices that should be given to the incumbent contractor prior to appointing others to undertake the works.

2.2 Amounts of retention and caps

The level of retention held is usually a percentage of the value of the contract works. It is generally applied to the value of the contract works, including variations and changes, not just to the contract sum. Sometimes contracts will place a cap on the maximum level of retention that can be deducted. For example, this could be three per cent of the contract price/lump sum.

Other limits or caps may be set as to the maximum amount of retention that may be deducted from payments. The FIDIC and NEC forms of contract demonstrate this and this is detailed further within this guidance note.

Some contracts also contain retention free amounts and therefore the contractor can be paid up to a certain sum prior to the retention being deducted.

Retention bonds are an alternative and these are considered elsewhere within this guidance note.

2.3 General principles of release of retentions

Generally, a portion of the retention is released upon completion of the works. The remainder is released when the rectification period or defects

liability period has expired and the relevant certification under the contract has been issued to confirm this. It is advisable to check the details of the individual contracts as release is slightly different in each. The release of retention is different if there is sectional completion, partial possession or the like under the contract. The majority of contracts allow for partial release of the retention at each sectional completion but the final release will vary between contracts. The final portion may be released either at the expiry of the defects liability period for each section or the expiry of the defects liability period for the works as a whole. The majority of contracts also allow for partial release of retention upon partial possession by the client/employer.

Sub-contractors should review contracts to determine when the release is triggered. This may be by completion of the sub-contractor's works or the main contractor's works. However, contracts entered into on or after 1 October 2011 will be subject to the *Local Democracy, Economic Development and Construction (LDEDC) Act 2009*. This has provisions which forbid payments under a contract being dependent on performance under another, so the payment of subcontract retentions cannot be linked to, e.g. practical completion of the main contract.

The contract should be reviewed for the effect upon retention in the event that the contract is terminated. Generally, clauses regarding the release of retention cease to apply in the event of termination but this may vary dependent on the reason for termination and the conditions of contract.

For quantity surveyors or project managers running multiple contracts or programmes of work, it is advisable to set up a tracking process of retention for clients and contractors/sub-contractors. This may avoid late release of retention or a surprise payment required by a client/employer. It should be noted that simple interest will become due for the late release of retention monies, once contractual prerequisites have been completed.

2.4 Alternatives, e.g. retention bonds

Rather than deduct a physical sum from a contractor's interim payment, it is possible to procure a retention bond to cover retention that would otherwise have been deducted. There are examples of suitable retention bonds in the contracts reviewed within this guidance note. Retention bonds are generally issued in favour of the client/employer who has waived his rights, under the contract, to the deduction of cash retention amounts. Bonds are generally set to the standard levels of retention which would otherwise be contained in the contract.

The contracts reviewed in this guidance note contain retention bonds appropriate to use with the same form of contract. For an example, refer to the retention guarantee which is contained within the appendices of the FIDIC Red Book conditions. This is simply a bank guarantee to pay the beneficiary (generally the client/employer), up to a limit of the guaranteed amount if the contractor (referred to as the Principal), 'has failed to carry out his obligation(s) to rectify certain defect(s) for which he is responsible under the contract'. An example is also included in the JCT Standard Building Contract.

It is recognised that there is opposition from contractors and sub-contractors to the use of retention in many areas as there is a view that this impacts upon cash flow. There has been movement from clients and employers, particularly in the public sector, to support this. The removal of retention provisions without the use of an appropriate bond is not a decision to be taken lightly and should be thoroughly reviewed with the client/employer with a clear explanation of the risks prior to pursuing this route.

3 Practical application (Level 2 – Doing)

3.1 Contract specific clauses for retention

This section contains the detail of the retention provisions within each of the contracts, but for ease of reference, this has also been summarised in the following table. Practitioners are strongly advised to always review the precise wording of the contract, especially where older or later versions of the contract may be in use and clients/employers often amend the wording of the standard forms of contract.

Contract	Retention Bond Option	Entry into Contract	Default Level	Sectional Completion Release	Completion Release	Final Release (subject to Defects Issues)	Caps or Limits	Other Comments
JCT Standard Building Contract and Design and Build Contract	Yes – see schedules.	Contract particulars	3%	Yes – proportional to value of section.	50% upon practical completion (subject also to sectional completion).	Upon Certificate of Making Good.	N/A	See notes below for minor variances between the contracts.
JCT Minor Works Building Contract	No	Contract particulars	5%	Not applicable	50% upon practical completion.	Upon Certificate of Making Good.	N/A	Retention is determined by the value of work paid rather than withheld.
JCT Intermediate Building Contract	No	Contract particulars	5%	Yes	50% upon practical completion (subject also to sectional completion).	Upon Certificate of Making Good.	N/A	Retention is determined by the value of work paid rather than withheld.
JCT Prime Cost Building Contract	No	Contract particulars	3%	Yes – proportional to value of section.	50% upon practical completion (subject also to sectional completion).	Upon Certificate of Making Good.	N/A	None

Contract	Retention Bond Option	Entry into Contract	Default Level	Sectional Completion Release	Completion Release	Final Release (subject to Defects Issues)	Caps or Limits	Other Comments
JCT Management Building Contract	For works contracts only.	Contract particulars	3%	Yes	50% upon practical completion (subject also to sectional completion).	Upon Certificate of Making Good.	N/A	Retention is determined by both the value of work paid and also an amount withheld.
JCT Management Works Contract	Yes	Works contract particulars	3%	Yes	50% upon practical completion (subject also to sectional completion).	Upon Certificate of Making Good.	N/A	Refer to detail notes below.
NEC ECC Options A & B	No	Option clause X16 in contract data	N/A	No	Half at completion or the employer taking over the whole of the works.	Upon Defects Certificate.	Retention free amount is possible. Maximum retention limit only if the contract is amended.	Not usually selected if performance bond is required.

Contract	Retention Bond Option	Entry into Contract	Default Level	Sectional Completion Release	Completion Release	Final Release (subject to Defects Issues)	Caps or Limits	Other Comments
NEC ECC Options C to E	No	Option clause X16 in contract data	N/A	No	Half at completion or the employer taking over the whole of the works.	Upon Defects Certificate.	Retention free amount is possible. Maximum retention limit only if the contract is amended.	Not usually selected if performance bond is required. Calculated on gross subcontract payments so retention is not duplicated.
NEC ECC Option F	No	Option clause X16 in contract data	N/A	No	Half at completion or the employer taking over the whole of the works.	Upon Defects Certificate.	Retention free amount is possible. Maximum retention limit only if the contract is amended.	Not usually selected if performance bond is required.

Contract	Retention Bond Option	Entry into Contract	Default Level	Sectional Completion Release	Completion Release	Final Release (subject to Defects Issues)	Caps or Limits	Other Comments
FIDIC Red Book	Yes	Appendix to Tender	N/A	Yes – 40% of the retention released for the section.	50% upon issue of Taking-Over Certificate.	A further 40% is released for sections. Expiry of defects notification period for all of the works releases the final retention.	Limit of retention entered into the Appendix to Tender.	Employer certifies the amount to be paid for nominated subcontractors. No payments are made if performance security is not in place.
FIDIC Orange Book	No	Appendix to Tender	N/A	Yes – 50% released proportional to the value of works as stated in the Appendix to Tender.	50% upon issue of Taking-Over Certificate.	Upon expiry of the contract period.	Limit of retention entered into the Appendix to Tender.	No payments are made if performance security is not in place.

3.1.1 JCT contracts

General

The Standard Building Contract is reviewed in detail. Other versions of the JCT contracts have been reviewed and brief comments are also noted. It is important to check the particular wording in a contract, especially when older or amended versions of the contract are being used.

The Standard Building Contract Without Quantities has been used in the preparation of this guidance note.

Standard Building Contract

Details of the retention requirements are to be completed in the contract particulars. The contract has the facility to enter the requirement for a retention bond and the contract particulars should be amended to indicate whether this is applicable to the particular contract. If so, the 'maximum aggregate sum' and the expiry date can be entered into the particulars.

The percentage of retention can also be entered in the particulars. In the event that this is left blank, the default retention level is three per cent. If it is not the intention to deduct retention then nil or zero should be entered.

Within the definitions section of the contract, there is no further detail on retention other than a direction to the relevant contract conditions and the contract particulars.

It should be noted that the contract does have provisions for advanced payment but this is not included in further detail in this guidance note.

The contract states that amounts to be included in interim notices shall be subject to the deduction of retention as noted elsewhere within the contract. The sum is noted as being retained by the employer. It also notes that notwithstanding the employer's interest in the retention, the employer can deduct from the notice other sums which are due from the contractor under the contract. It is recommended that appropriate notice be given for this prior to deduction.

The final notice process is also detailed but there is no retention deduction included within this.

In computing the value to be included in any notice, the value is split into two sections; the value which is subject to the deduction of retention and

that which is not. It is advisable to review the contract to understand which items fall into each category but generally, value of works executed and material on and off site are subject to retention deduction.

The contract administrator/QS prepares a statement, for the employer and the contractor, of the retention to be deducted in each interim notice.

The employer deducts retention. The contract states the following:

'...the Employer's interest in the retention is fiduciary as trustee for the Contractor (but without obligation to invest)'.

Unless the employer is a local authority, the contractor may request that the employer place the retention monies in a separate bank account to comply with the above statement. The employer will certify that this has occurred to the contractor and then the architect/contract administrator. The employer benefits from interest earned on this account.

If a retention bond is selected for the contract, retention is not deducted but the contract administrator or QS still prepares a statement of the retention that would have been deducted from the interim notice.

Prior to the 'Date of Possession' (more simply, handover of the site from the employer to the contractor), the contractor provides the bond to the employer. The bond is to be as per the format set out in the contract and should state the maximum aggregate sum and the expiry date. These are also to be inserted in the contract particulars.

If the bond is not provided or maintained, retention is deducted from interim notices thereafter as calculated in the aforementioned statement. Once delivered, retention is no longer deducted from interim notices and is therefore released to the contractor.

If the retention that would have been deducted exceeds the aggregate sum stated in the bond then the contractor can either have the bond value increased or the excess retention will be deducted from the interim notice.

If the contractor has provided both a retention and performance bond then 'the employer shall have first recourse to the retention bond'. However, it

should be noted that retention bonds and performance bonds are generally required for different purposes in that a performance bond will provide surety for non performance in general rather than failure to rectify defects.

Only half of the retention is deducted for the works, or section of the works, where practical completion has been achieved but a Certificate of Making Good Defects has not been issued. It is therefore important to understand the value of each section of works in order to accurately calculate the level of retention to be deducted, or for adjustments to the bond value.

Once the Certificate of Making Good Defects is issued, no retention is held from the following notice. Refer to the relevant contract clause regarding the final notice.

The standard wording for the retention bond is contained within the schedules of the contract.

Minor Works Building Contract

The Minor Works Building Contract has similar principles to the Standard Building Contract. The significant variances are:

- there is no sectional completion provision within the contract
- there is no facility to enter the requirement for a retention bond; and
- the level of retention is determined by the value of works that will be paid rather than the value that will be withheld.

Details of the retention requirements are to be completed in the Contract Particulars. Retention is stated as the amount to be paid rather than the amount to be withheld, i.e. a percentage of 95 per cent is entered in the Contract Particulars if the intention is to deduct five per cent retention. There is a default value of percentage of work to be paid of 95 per cent if the contract is left blank.

There is a requirement to state in the Contract Particulars the amount to be paid once Practical Completion has been certified. As an example, this would be entered into the contract as 97.5 per cent if the intention was only to deduct 2.5 per cent retention. There is a default value of percentage of work to be paid of 97.5 per cent following Practical Completion but prior to Final Certificate if the contract is left blank.

If the intention is not to deduct retention, then 100 per cent should be entered.

The contract states that amounts to be included in interim notices shall be subject to the percentage of total value of work. At Practical Completion, a revised percentage is applied as stated in the Contract Particulars. All works are subject to the percentage adjustments prior to and after Practical Completion but before final notice.

The final notice process is also detailed, once the Certificate of Making Good Defects is issued, but obviously there is no retention deduction included within this. It should also be noted that the defect rectification period is only three months in this contract unless otherwise stated in the Contract Particulars.

Intermediate Building Contract

The Intermediate Building Contract has similar principles to both the Minor Works Building Contract and the Standard Building Contract. The following points are noted:

- there is sectional completion provision within the contract
- there is no facility to enter the requirement for a retention bond; and
- the level of retention is determined by the value of works that will be paid rather than the value that will be withheld.

Details of the retention requirements are to be completed in the Contract Particulars. Retention is stated as the amount to be paid rather than the amount to be withheld, i.e. a percentage of 95 per cent is entered in the Contract Particulars if the intention is to deduct five per cent retention. There is a default value of percentage of work to be paid of 95 per cent if the contract is left blank.

There is a requirement to state in the Contract Particulars the amount to be paid once Practical Completion, for the whole of the works or a section, has been certified. As an example, this would be entered into the contract as 97.5 per cent if the intention was only to deduct 2.5 per cent retention. There is a default value of percentage of work to be paid of 97.5 per cent following Practical Completion but prior to Final Certificate if the contract is left blank.

If the intention is not to deduct retention, then 100 per cent should be entered.

The contract states that amounts to be included in interim notices shall be subject to the percentage of total value of work. At Practical Completion a revised percentage is applied as stated in the Contract Particulars. In ascertaining the value to be included in any notice, the value is split into two sections; the value which is subject to the deduction of retention and that which is not. It is advisable to review the contract to understand which items fall into each category but generally, value of works executed and material on and off site are subject to retention deduction.

The contract administrator/QS prepares a statement for the employer and the contractor, of the amount due in each interim notice. The employer should then within five days give written notice to the contractor of the payment to be made. However, this may be subject to adjustment by a withholding notice, which must be issued five days prior to the final date for payment.

Where the employer is not a local authority:

‘...the Employer’s interest shall be fiduciary as trustee for the Contractor (but without obligation to invest)’.

The final notice process is also detailed, once the notice of making good is issued, but obviously there is no retention deduction included within this. It should also be noted that the defect rectification period is only six months in this contract unless otherwise stated in the Contract Particulars.

It should be noted that the contract does have provisions for advanced payment but this is not included in further detail in this guidance note.

Design and Build Contract

The Design and Build Contract is similar to the Standard Building Contract but the variances are as follows:

- In ascertaining the value to be included in any notice, the value is split into two categories; the value which is subject to the deduction of retention and that which is not, as features in the Standard Building Contract. However, there are two methods of establishing the gross valuation and the option selected should be entered in the contract particulars; Alternative A is selected for payment by stages and Alternative B for periodic payments. It is

advisable to review the contract to understand which items fall into each category in terms of retention deduction.

- There is no reference to a contract administrator/QS and therefore the preparation of a statement, for the contractor, of the retention to be deducted in each interim notice is undertaken by the employer.
- If a retention bond is selected for the contract, there is no requirement to prepare a statement of the retention that would have been deducted from the interim notice had the bond option not been selected.

Prime Cost Building Contract

The Prime Cost Building Contract is similar to the Standard Building Contract but the variances are as follows:

- There is no facility to enter the requirement for a retention bond.
- There is no facility for advance payments.
- There are minor changes to the wording regarding the contract administrator/QS requirement to prepare a statement, for the employer and the contractor, of the retention to be deducted in each interim notice, but a statement is still required of the total amount to be included in each notice.

Management Building Contract

The Management Building Contract is different to other JCT contracts reviewed within this guidance note but has some common features with the Standard Building Contract and the Intermediate Building Contract, for example.

It should be noted that there is no provision for advance payment within the contract.

Details of the retention requirements, including the percentages, (for the management contractor’s retention only), are to be completed in the Contract Particulars. In the event that this is left blank, the default retention level is three per cent. If it is not the intention to deduct retention, then nil or zero should be entered.

Retention bonds are referred to in the contract but only in respect of the works contractors rather than the management contractor.

Within the definitions section of the contract, retention is defined as works contractors’ retention

and management contractor's retention. There is also further direction to the other clauses within the contract.

The contract states that amounts to be included in interim notices shall be subject to the deduction of retention as noted elsewhere within the contract. In any notice the amounts due are as follows:

- Amounts due under the works contracts less any retention deducted in those contracts.
- Prime cost of the management contractor excluding items in the bullet point above then subject to the deduction of retention, as per the management building contract.
- Preconstruction fee cost.
- Construction period fee subject to a maximum percentage.
- Costs associated with breaches by works contractors or alleged default by the management contractor from the works contractors. It is advisable to read the contract for further detail on this.
- Amounts deducted for previous payments, credits which the employer is entitled to recover, or credits for items such as materials recovered from the works.

The maximum percentage works in a similar way to the 'retention' within the Minor Works Building Contract and the Intermediate Building Contract. Details of this percentage are entered into the Contract Particulars but the default percentage, if left blank, is 97 per cent.

The contract notes that notwithstanding the employer's interest in the retention, the employer can deduct from the notice other sums which are due from the contractor under the contract. It is recommended that appropriate notice be given for this prior to deduction.

The final notice process is also detailed but there is no retention deduction included within this.

The architect/contract administrator/QS prepares a statement, for the employer and the contractor, of the retention to be deducted in each interim notice. This separately identifies the retention for the management contractor and each works contractor. Where the works contractor has provided a bond, the retention stated is the amount that would have been held in the absence of such bond and no retention is deducted.

The employer deducts retention following appropriate notice to the management contractor. The contract states the following:

'...the Employer's interest in the retention is fiduciary as trustee for the Management Contractor and for each relevant Works Contractor (but without obligation to invest)'.

Unless the employer is a local authority, the management contractor, or the works contractor through him, may request that the employer place the retention monies in a separate bank account to comply with the above statement. The employer will certify that this has occurred to the management contractor and then the architect/contract administrator. The employer benefits from interest earned on this account.

For the management contractor's retention, only half of the retention is deducted for the works or section of the works where Practical Completion has been achieved but a Certificate of Making Good Defects has not been issued. The works contractor's retention is also reduced but please refer to the management works contract to follow.

Once the Certificate of Making Good Defects is issued, no retention is held from the following notice. Refer to the relevant contract clause regarding the final notice.

The release of monies related to the maximum percentage applied to the construction period fee is released like the other retention but is released after Practical Completion dependent on a comparison between the final prime cost and the project cost plan. Refer to the contract for further details of this mechanism.

Management Works Contract

Details of the retention requirements are to be completed in the works Contract Particulars. The contract has the facility to enter the requirement for a retention bond and the Contract Particulars should be amended to indicate whether this is applicable to the particular contract. If so, the 'maximum aggregate sum' and the expiry date can be entered into the particulars.

The percentage of retention can also be entered in the particulars. In the event that this is left blank, the default retention level is three per cent. If it is not the intention to deduct retention, then nil or zero should be entered.

Within the definitions section of the contract, there is no further detail on retention other than a direction to the relevant contract conditions and the works Contract Particulars.

It should be noted that there is no provision for advance payment within the contract.

The contract states that amounts to be included in interim notices shall be subject to the deduction of retention as noted elsewhere within the contract and also reference to the Management Building Contract. The employer and/or management contractor can deduct from the notice other sums which are due from the works contractor under the contract. Appropriate notice shall be given for this prior to deduction.

The retention is noted to be deducted and retained by the employer rather than the management contractor. This is deducted at the rate in the works Contract Particulars unless the works, or a section of the works, have reached Practical Completion.

Only half of the retention is deducted for the works or section of the works where practical completion has been achieved, or deemed to have been achieved under the management building contract, but a Certificate of Making Good Defects has not been issued. It is therefore important to understand the value of each section of works in order to accurately calculate the level of retention to be deducted.

The contract notes that where works contractor's retention is released to the management contractor, the management contractor's interest in the retention:

'... is fiduciary as trustee for the Works Contractor, but without obligation to invest). If the Management Contractor:

-1 mortgages or otherwise charges the whole or part of the amount released or any interest in it (otherwise than by floating charge) or attempts or purports to do so; or

-2 withholds any of the Works Contractor's Retention after the final date for payment of such amount to the Works Contractor,

he shall immediately place any such unpaid retention (or an equivalent sum) in a separate banking account so designated as to make clear he is trustee for the Works Contractor of the unpaid amount.'

If there are no defects in the works or sections of the works following the rectification period under the Management Building Contract, retention is released to the works contractor in the following interim payment. If there are defects, they would be notified by the management contractor to the works contractor. Retention is retained until those defects are made good.

If a retention bond is selected for the contract, retention is not deducted.

Prior to the date of commencement of the works, the works contractor provides the bond to the management contractor but in favour of the employer. The bond is to be as per the format set out in the contract and should state the maximum aggregate sum and the expiry date. These are also to be inserted in the works Contract Particulars.

If the bond is not provided or maintained, retention is deducted from interim notices thereafter. Once delivered, retention is no longer deducted from interim notices and is therefore released to the works contractor.

If the retention that would have been deducted exceeds the aggregate sum stated in the bond then the works contractor can either have this increased or the excess retention will be deducted from the interim notice.

If the works contractor has provided both a retention and performance bond then 'recourse shall first be made to Retention Bond'. However, it should be noted that retention bonds and performance bonds are generally required for different purposes in that a performance bond will provide surety for non performance in general rather than failure to rectify defects.

The standard wording for the retention bond is contained within the schedules of the contract.

3.1.2 NEC Engineering and Construction Contract

The NEC suite of contracts contains a set of guidance notes and while individual NEC options are reviewed, a summary of the guidance notes is included as an introduction to the principles.

As well as retention provision, the ECC has provision to retain 25 per cent of any sums due until such time as the contractor submits a programme for acceptance (if a programme is not

referenced within the contract data). For the purposes of this guidance note, this has not been classed as retention and therefore is not included in any further detail.

NEC ECC guidance notes

Retention is introduced into the contract by the selection of option clause X16. In order for this clause to be included within the contract the option clause should clearly be identified in section 1 of part 1 of the contract data.

In the contract data part 1, the employer/project manager should insert the retention free amount (a sum up to which the contractor can be paid without the deduction of retention), and a percentage of retention. The figures inserted in the guidance notes are indicative only and the appropriate figures will be entered by the project manager/employer.

As previously explained, retention is deducted as security for the employer and an incentive for the contractor to complete the works. It is noted that retention will affect the contractor's cash flow and it is advisable to consider this when completing the contract data.

The employer may enter a retention free amount in the contract data. The retention free amount can be completed as nil to act as a more traditional contract. Retention is then applied in each assessment for payment to the sum (price for work done to date and not to any other sums), in excess of the retention free amount

Options C to F use gross payments to sub-contractors so that retention is not duplicated. However, it is also noted in the contract that option clause X16 is not used with the main contract Option F.

The guidance note advises that where a performance bond is required in accordance with the contract then the retention clause is not normally selected.

There is no maximum amount of retention that can be deducted although it is noted in the guidance that this can be created by amending the contract data. It is recommended that surveyors take extreme caution before amending a standard form of contract.

Half of the retention is released in the next payment assessment, four weeks after the earlier of

completion or the employer taking over the whole of the works. The remainder is released in accordance with the payment core clause contained within each of the options once the Defects Certificate has been issued. It is recommended that payment clauses are reviewed where the contractor has not corrected notified defects. Once the Defects Certificate has been issued then no amount is retained.

Options A and B

Please refer to section 3.1.2 on NEC ECC guidance notes as there are no changes to the retention provision for this option.

Option C

Please also refer to section 3.1.2 on NEC ECC guidance notes.

In this option defined cost for subcontractors is defined as:

‘...the amount of payments due to subcontractors for work which is subcontracted without taking account of the amounts deducted for retention’.

This reinforces the issue in the guidance notes review and ensures that retention is effectively not deducted twice. However, this does mean that where the retention option is not selected in the main contract then the contractor does not have retention deducted and is paid the gross amount of defined cost in the assessment. However, the contractor may choose to deduct retention from the sub-contractor if the appropriate optional clause is selected in the sub-contract.

Option D

There is no change to Option C. Please also refer to the guidance note review in section 3.1.2.

Option E

There is no change to Option C. Please also refer to the guidance note review in section 3.1.2.

Option F

There is no change to Option C. Please also refer to the guidance note section above.

Please also refer to the guidance notes regarding the use of option clause X16 with main Option C

3.1.3 FIDIC Red Book and Orange Book

Red Book (Conditions of Contract for Construction – for building and engineering works designed by the employer)

The definition of retention money is as follows:

“Retention Money” means the accumulated retention moneys which the Employer retains under Sub-Clause 14.3 [*Application for Interim Payment Certificates*] and pays under Sub-Clause 14.9 [*Payment of Retention Money*].

Note that this is a quotation from the first edition 1999 and therefore may be subject to revisions, including the sub-clause references, in future editions.

The contractor is required to submit an application for payment, referred to in the contract as a Statement, after the end of each month, which should include:

‘any amount to be deducted for retention, calculated by applying the percentage of retention stated in the Appendix to Tender to the total of the above amounts, until the amount so retained by the Employer reaches the limit of Retention Money (if any) stated in the Appendix to Tender’.

It is noted that no payments are made unless the employer has received and approved the performance security. Please refer to the contract and guidance notes for further advice on payment and security/performance bonds. Also, there is provision for a minimum payment certificate/notice. Please refer to the contract for more details.

Retention release is dependent upon the issue of the Taking-Over Certificate. This triggers the first half of the retention release, which is certified by the engineer. A Taking-Over Certificate may be issued for a section or part of the works. Here, only 40 per cent of the retention is released rather than half and this is proportional to the estimated value of the section, compared to the estimated contract price. This automatically increases to 50 per cent once the whole of the works has a Taking-Over Certificate.

The engineer then certifies the remaining retention after the latest expiry of the defects notification periods. However, if there was a Taking-Over

Certificate issued for sections of the works then only a further 40 per cent of the retention is released after the expiry of the defects notification period for that section. Again, this is proportional based on the estimated value of the section compared to the estimated final contract price.

Certification of the retention will be withheld if remaining work is outstanding in accordance with the defects liability clause. The amount withheld is the estimated cost of the work to be undertaken and this is released once this outstanding work is completed.

It is also advisable to note the following requirement when calculating the proportions of retention release for sections of the work, as previously noted:

‘When calculating these proportions, no account shall be taken of any adjustments under Sub-clause 13.7 [*Adjustments for Changes in Legislation*] and Sub-Clause 13.8 [*Adjustment for Changes in Cost*].

A review of the general payment clauses is recommended but the application is the estimated value of works up to the month end including variations, changes in legislation and cost as defined elsewhere in the contract. It is also noted that the contract contains provision for advance payment, which will be stated in the Appendix to Tender if the employer wishes this to be applicable. In summary, the contractor will receive reduced payments until the advance payment sum is repaid.

It is interesting to note that the employer certifies the amounts which are due to nominated sub-contractors and the contractor then pays the sum thereby certified. The engineer may then request evidence that the contractor has paid such sums to the nominated sub-contractor after the deduction of retention, prior to issuing a payment certificate/notice to the contractor.

The defects liability clause may be relevant as it contains clauses regarding extension of the defects notification period to a limited period and clauses, should the contractor fail to rectify defects. The latter may lead to the contractor having to pay the employer the cost of rectifying the defects or determine a reduction in the contract price. While it is not stated in the clause, the balance of retention due back to the contractor will be used in determining the payments required from one party to the other.

Guidance for the preparation of particular conditions

The contract contains guidance notes as previously covered, and there is guidance on retentions as follows.

Payment of retention money: If the employer wishes to have a guarantee in place and allow retention to be released, a suitable clause will need to be added to the contract. This will need to be included in the tender documents and an appropriate form is included as an annex within the contract. An example of a suitable clause is also included within the guidance.

Appendix to Tender

The percentage of retention to be deducted and the limit of retention money will be entered in the Appendix to Tender, which will be sent to the tenderers during the tender process.

It is also noted that the contract contains a minimum amount of interim payment certificates/ notices. Please refer to the contract for more detail.

Orange Book (Conditions of Contract for Design – Build and Turnkey)

The definition of retention money is as follows:

“Retention Money” means the accumulated retention monies retained by the Employer under Sub-Clause 13.3’.

Note that this is a quotation from the first edition in 1995 and therefore may be subject to revisions, including the sub-clause references, in future editions.

The contractor is required to submit an application for payment, referred to in the contract as a Statement, after the end of each month, which should include:

‘any amount to be deducted for retention, calculated by applying the percentage of retention stated in the Appendix to Tender to the total of the above amounts, until the amount so retained by the Employer reaches the limit of Retention Money (if any) stated in the Appendix to Tender’.

It is noted that no payments are made unless the employer has received and approved the performance security. Please refer to the contract and guidance notes for further advice on payment

and security/performance bonds. Also, there is provision for a minimum payment certificate/notice. Please refer to the contract for more details.

Retention release is dependent upon issue of the Taking-Over Certificate. This triggers the first half of the retention release. A Taking-Over Certificate may be issued for a section or part of the works. Here, part of the first half of the retention is certified by the employer’s representative proportionally to the value of the section of the works which is contained in the Appendix to Tender. Once taking-over is certified for all of the works, the retention release will then equate to 50 per cent of the retention held.

The employer’s representative then certifies the remaining retention upon the expiry of the contract period, which effectively means 365 days after the whole of the works are certified as complete by the employer’s representative. It shall be noted that this period can be extended up to a maximum period of two years if the works cannot be used due to defects or damage after the take over of the works. It is advisable to refer to the defects liability clause within the contract. Unlike the Red Book, the Orange Book does not allow for proportional release of the second half of the retention where there is sectional take over.

Certification of the retention will be withheld if remaining work is outstanding in accordance with the defects liability or tests after completion clauses. The amount withheld is the estimated cost of the work to be undertaken.

A review of the general payment clause is recommended but the application is the estimated value of works up to the month end, including variations and changes in legislation and cost, as defined elsewhere in the contract. It is also noted that the contract contains provision for advance payment, which will be stated in the Appendix to Tender if the employer wishes it to be applicable. The contractor will receive reduced payments until the advance payment sum is effectively repaid.

The defects liability clause may be relevant as it contains clauses regarding extension of the defects notification period to a limited period and clauses should the contractor fail to rectify defects. The latter may lead to the contractor having to pay the employer the cost of rectifying the defects or determine a reduction in the contract price. While it

is not stated in the clause, the balance of retention due back to the contractor will be used in determining the payments required from one party to the other.

Guidance for the preparation of conditions of particular application

The contract contains guidance notes as previously stated and there is guidance on retentions as follows.

Payment of retention money: If the employer wishes to have a guarantee in place and allow retention to be released, a suitable clause will need to be added to the contract. This will need to be included in the tender documents, however there is not an appropriate form included as an annex. An example of a suitable clause is included within the guidance.

Appendix to Tender

The percentage of retention to be deducted and the limit of retention money, should be entered in the Appendix to Tender, which should be sent to the tenderers during the tender process.

It is also noted that the contract contains a minimum amount of interim payment certificates/ notices. Please refer to the contract or other guidance notes regarding payments for more detail.

3.1.4 Common contract features

It can be seen from the three suites of contracts reviewed that, in general, the contracts use similar principles:

- There are sections in the contract to enter the level of retention to be deducted.
- The amount of retention may be capped at a certain level.
- Retention is applicable to some but not always all of the amount applied for or later certified.
- A percentage, usually 50 per cent, of the retention is released upon completion of the works but prior to the defects liability period. Retention is generally released for sections of the work where there is sectional completion within the contract.
- A proportion of the retention is released upon certification of sectional completion. This is usually dependent upon the value of the section.
- The remainder of retention is certified and released at the end of the defects liability period. This may result in multiple releases where there is sectional completion.
- Where the contractor does not rectify defects, the client/employer may use the retention held to cover the cost of rectification of those works by others.
- Retention bonds are sometimes available where there is no requirement to deduct 'cash' retention.

Please refer to individual contracts if they have not been reviewed within this guidance as they may vary from the general principles set out above.

4 Practical considerations (Level 3 – Doing/Advising)

4.1 Common issues

4.1.1 Problems with release

The release of retention will generally occur a considerable time after the project has been completed and occupied or taken over by the user. This often results in a change in personnel from those who were involved in the day to day administration of the project to those who deal with retention release. It is therefore important that as they finish their involvement on the project, clear records are kept to allow others to administer the certification of final retention monies at the end of the project.

Retention certification and release will be affected if there are defects in the works discovered in the defects liability period but then not corrected in such period. Dependent on the conditions of contract, an amount may be set off against the retention release in order that defects may be rectified by others should the client/employer require. It is advisable to check the exact wording of the specific contract in this regard. Any sum set off against the retention should be fully justified.

Dependent on the conditions of contract, the rectification/making good defects certificate may not be issued until all defects are complete, which may be some time after the expiration of the contractual rectification period. Some contracts issue a certificate, e.g. NEC ECC, listing the defects outstanding at the end of the defects period.

On smaller projects or further down the supply chain, the level of retention held may be a very insignificant sum. Therefore, the retention sum is not large enough to incentivise the (sub) contractor back to correct the defective works. This will, of course, depend on the value of the contract and therefore the retention held and the severity of the defect. Also of consideration may be the importance of the client/employer to the contractor or sub-contractor. When filling in the particulars of such a contract or sub-contract, it is advisable to

consider whether or not retention should be deducted. In some cases, the cost of administering the retention withheld at the end of the contract may be high in proportion to the actual payment sum, or some of the problems outlined may occur. However, the employer may still wish retention provisions to apply.

4.1.2 Financing/insolvency

There is a possibility that the employer/client, contractor or sub-contractor may become insolvent at any stage or during the defects liability period. The JCT form of contract deals with this by noting the employer is a trustee for the contractor. This will protect the contractor in the event of insolvency of the employer, if the money is actually set aside in a separate marked account or fund, rather than just held in a regular client account. It will therefore be the responsibility of the administrator or liquidator to apply for or administer the retention as applicable. If the retention is not set aside in a separate marked account, this is likely to lead to a delay in such payment.

After a client/employer goes into liquidation, a bank's charge over the fund will take precedence over the contractual obligation of the client/employer to place funds in a separate account, i.e. if the client/employer is in breach of his obligation to set aside the retention fund, and the contractor has not successfully insisted this takes place, the obligation and breach are not considered when prioritising unsecured creditors.

This is the position in the standard forms, however it is common for these provisions to be amended by clients and the signed agreement should be consulted.

4.1.3 Latent defects

The contractor/sub-contractor will be issued with a list of defects to be made good in accordance with the provisions of the relevant contract, following completion of which retentions will normally be released. Sometimes the contractor/sub-contractor will continue to receive notification of latent

defects, in addition to the list issued at the end of the defects liability/rectification period. The contractor/sub-contractor is entitled to receipt of retention payments/release from retention bonds, once the contractual provisions have been complied with, notwithstanding that the rectification of some latent defects may remain outstanding.

Retention

1st edition, guidance note

This guidance note introduces the subject by looking at the general principles of retention, including areas such as law; reasons for introduction within a contract; levels of retention, and how amounts are deducted, certified or released.

It then focuses on how the standard forms of contract deal with the issue. A list of the contracts reviewed is included within the table of contents. This paper reviews methods and limits of deduction, inclusion of the retention amount to be included within the contract, release and set off against sums held.

The guidance note concludes with a review of common issues including areas such as commonly occurring problems; financing; insolvency, and defects rectification.

Guidance is given for each of the main groups of contracts and the forms in most regular use within those groups, under the following headings, which map to the Assessment of Professional Competence (APC):

- General Principles (Level 1 – Knowing)
- Practical Application (Level 2 – Doing)
- Practical Considerations (Level 3 – Doing/Advising)



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