

CICV Best Practice Guide

Practice Note 7: Retention

This Practice Note is the seventh in a series designed to enhance commercial management in construction projects by promoting best practices for the management of Retentions. Authored by experienced consultants Len Bunton, Sean Bradley, and Mark Holden-Smith, it outlines key recommendations from the CICV Best Practice Guide (BPG) to help subcontractors and contractors safeguard their contractual position.

Retentions under Construction Contracts – Key Considerations

How much is Retained, and what is the Retention of Payment for?

The agreed rate of retention should be clearly defined in the contract agreement, and generally, between 3-5% of the payment is retained for security until works are completed and defects are corrected; in this way, retention can also be viewed as a form of incentive for one party to perform their obligations efficiently.

JCT Contracts: Under JCT Contracts, the retention is generally 3% unless a different amount is specified, with the first half being released on Practical Completion and the second half being released either on the expiry of either the rectification or defects liability period or when any defects are made good, usually whichever is later.

NEC3 & NEC4 Contracts: Under NEC Contracts the retention is an option under Secondary Option X16, under which half of the retention is released on completion with the balance released after the issue of the defects certificate.

Top Tip: Under Option X16, the retention is deducted after the value exceeds the 'retention free amount,' so if no amount is stated, then retention is deducted immediately.

Risks Concerning Retention

A delay in the release of the retained payments and insolvency by the paying party pose a serious risk to contractors and subcontractors. To reduce these risks, the treatment of retained payments should be clearly set out under the express terms and managed in accordance with those agreements. **This means knowing and tracking when the payment should be released so you can apply for the payment at the right time.**

Under some JCT Contracts the Employer has a fiduciary duty to the contractor to act as a trustee in respect of the retention. This means that the Employer must set aside the retained payments and hold them in trust in a separate bank account, meaning the payments are protected against insolvency. However, this provision is not included in all JCT forms and, even when it is, it is often removed by the Employers through amendments.

Under NEC3 & NEC4 contracts, there is no provision for the retention to be placed in a separate bank account or to be held in trust.

In the case of *Wates (Construction) London v Franthom Property*¹, the court held that where the employer is taken to be a trustee in respect of amounts retained from the payments, then it is an implied term that the retention should be held in a separate bank account. **However, this is not a set rule for each case, so it is vital that the treatment of retention is expressly agreed and clearly defined in the contract terms.**

Things to Watch Out For

- Under Section 110(1A) of the Construction Act², the legal requirement for the contractual mechanism for determining what payments become due under a contract and when, is not satisfied where the contract makes payment conditional on (a) the performance of obligations under another contract or (b) a decision by any person as to whether obligations under another contract have been performed. What this means, in relation to retention held under a subcontract, for example, is that the payment of retention cannot be determined solely by reference to whether the main contract works have reached practical completion or whether the main contractor has completed its own defects under the main contract.
- (a)
- Generally, it will not be correct for the retention to be taken from the amount before the discount. Logically, the amount before the discount is not the actual payment amount to be received, but also, if the discount is taken to produce the contract sum, then the gross value of the contract sum from which retention would be taken is not the amount before discount but is the amount after the discount.

Final Advice

Ensure that **before you sign the contract**, you understand the contractual provisions for retention and the paying party's obligations as to how to treat your retained payments. Have commercial management processes in place that ensure the right amount is being deducted from your payments and that you are claiming the repayments at the right time and without delay.

¹ *Wates (Construction) London v Franthom Property*¹ (1991) 53 BLR 23

² The Housing Grants Construction and Regeneration Act 1996 as amended by the Local Democracy, Economic Development and Construction Act 2009.