

Project Initiation and Business Case Handbook

Chapter 17

Retention in Construction Contracts

Contents:

Section	Subject
1.	<u>Summary</u>
2.	<u>Definition</u>
3.	<u>Scope</u>
4.	<u>Preparing for procurement</u>
5.	<u>After contract award</u>
6.	<u>Project delivery culture</u>
7.	<u>Handover</u>
8.	<u>Conflict avoidance</u>
9.	<u>Duration and release</u>
10.	<u>Supply chain equivalence</u>
11.	<u>Trust accounts</u>
12.	<u>Compliance</u>
13.	<u>Publication of policy and practice</u>
14.	<u>Directory of Retention Policy and Compliance Statements</u>

Summary

1.1 Contracting authorities considering using retention in construction projects must follow the provisions in this guidance, which are summarised as follows:

- Assess the likelihood and impact of defective work occurring
- Ascertain whether or not retention is needed at all
- Avoid defaulting automatically to standard retention percentages
- Analyse evidence, use experience and assess risk to implement retention
- Apply retention as the minimum required amount
- Accumulate and hold retention for the shortest appropriate duration
- Administer one assurance process per project where possible
- Aim for and prioritise the objective of zero defects
- Acknowledge the possibility of defective work occurring
- Agree a remediation estimate to supplant the accumulated retention
- Automatically release retention when the contractual trigger is achieved
- Activate clauses which apply these principles fairly in the supply chain

Definition

2.1 These provisions complement the [Quality chapter](#) of The Client Guide to Construction Projects and adopt the definition agreed by the short life working group:

- Retention is an amount deducted and withheld from each progress payment made to a contractor or subcontractor to secure obligations under a construction contract and ensure defects are remediated without the holder becoming liable for costs arising from unmet contract performance

Scope

3.1 Public bodies in scope of the Scottish Public Finance Manual (SPFM) must consider the following for capital works projects:

- Is a cash retention appropriate; and if so
 - how much is proportionate to the likelihood and impact of defective work?
 - how long should it be retained?
 - what requirements should trigger its release?
 - how can it be implemented to incentivise zero defects?

3.2 Where retention is deemed relevant, the practices set out in these provisions should be implemented regardless of the estimated capital works cost. Monetary value is not always a reliable measure of risk and complexity. Smaller projects should not be exempt from benefitting from a considered approach to retention. Those closest to a project are best placed to make an assessment which is scaled and proportionate to its particular characteristics.

3.3 A contracting authority may have to consider taking on more risk than they otherwise might have under traditional retention practices. They should not take on

any more risk than they can manage within the parameters permitted by their corporate governance. Underestimating the retention needed for remediating defective work is avoidable if authorities interpret their project and its inherent characteristics accurately.

3.4 These provisions do not cover bonds, parent company guarantees etc, regarding which contracting authorities should seek relevant advice (e.g. financial, legal, procurement etc). They should understand what various means of assurance are intended to achieve and avoid implementing more than one to serve the same purpose. That is unless doing so is considered absolutely necessary to mitigate the assessed likelihood and impact of failure to comply with the contract specification.

3.5 These provisions are to be given effect in the contracting authority's contract with the main contractor. Where 'standard' contracts are not aligned with or impede them, authorities should develop relevant alternative terms and conditions. These provisions do not contain model or template terms and conditions. It is impossible to anticipate and provide for every way they might be implemented within every 'standard' form used by each contracting authority.

Preparing for procurement

4.1 The interfaces and configurations of materials in the design of construction projects can imply certain predictable working sequences and construction process ergonomics. The potential sources, likelihood and possible impact of defects can also be reasonably predictable. The combined experience of seasoned practitioners can bring reliable insight to, and inform an objective assessment of, a proportionate amount of retention.

4.2 An objective assessment and analysis of potential factors which might generate the potential for defective work and other non-compliant delivery should be carried out. By way of illustration, the following considerations are among those which are relevant:

- Technical complexity of design, particularly at interfaces e.g. materials, components
- Materials selection and characteristics e.g. shrinkage; cracking; warping
- Extent of novel and/or innovative design
- Ergonomics and buildability inherent in design
- Volume, detail and format of as-built, operating and maintenance information, including compliance with BIM requirements¹
- Extent of off-site and on-site work implied by the design
- Standard of finish required
- Standard of vocational qualification needed to achieve the specified finish
- Availability of labour at required standards
- Frequency and intensity of site inspection envisaged by the contracting authority
- Extent of contractor self-certification anticipated

¹ [Building Information Modelling in Construction: CPN 8/2017](#)

- Contractors' commercial ability to provide the contracting authority's retention

4.3 Normal multi-disciplinary collaboration necessary for working up the design and specification of a project naturally lends itself to undertaking such an assessment. Usual preparatory activities can also serve to inform an assurance strategy's relevance to the project and its proportionality to the likelihood of defective work. Where this involves a procurement route featuring early contractor involvement then the contractor should be consulted.

4.4 Contemplating the possibility of defective work does not make it inevitable. On the contrary, it is the first action in a systematic process of implementing an integrated commercial, contractual and inspection regime. This should be more targeted to the project's specific profile compared to the cover assumed by a standard percentage applied to the contract sum.

4.5 An evidence-based, relevant and proportionate retention may be higher or lower than a sum produced simply by applying standard percentages. It will however be based on and aligned with the project's design, buildability, ergonomics, specification and materials. It will consider the specific likelihood and impact of defective work occurring in a project and so should achieve the following objectives:

- Produce a fund to cover the holder against having to pay for all remedial work necessary to comply with the contract specification
- Avoid retaining an amount greater than actually required by the project's intrinsic characteristics

4.6 A systematic approach which produces a retention that seems excessive or penal may indicate hitherto unknown or unrecognised project characteristics. The contracting authority will have to address this, which can include the following:

- Inherent but unacknowledged riskiness
- Potentially unsuitable procurement strategy
- Possible inappropriate risk posture, at corporate and/or individual level

4.7 Project particulars in public procurement procedures may state the maximum level of retention that will apply. Contracting authorities should frame their evaluation criteria to focus on a bidder's ethos for complying with the specification and how they implement it. Some factors for consideration include the following:

- Which position in the bidder's senior management is responsible for ensuring work on site complies with the specification?
- How will the bidder embed their processes in day-to-day work on site?
- How objective and investigative are the bidder's project delivery processes?
- When are these processes supported in practice e.g. regular inspections?
- Where can site workers access the bidder's procedures for ensuring work on site complies with the specification?
- What commitments have been made in the tender submission relating to ensuring work on site complies with the specification?

- How does the bidder describe their approach to delivering compliant as-built, operating and maintenance information?
- Has the bidder committed to delivering zero defects?

4.8 Contracting authorities should replicate where possible the manner and amount/proportion of main contract retention as the maximum permissible level in supply chain contracts. This would ensure that retention in contracts between businesses will not exceed those provisions. The same detailed retention regime should only be applied without unsustainably burdening supply chain firms.

4.9 Contracting authorities should consider the feasibility of applying a retention regime targeted on distinct activities. Payment processes triggered by demonstrable milestone events on site instead of set intervals of time could facilitate a more systematic and proportionate approach. For example (illustrative only):

- Groundwork and/or excavations complete - potential for little or no risk where deemed suitable to build upon - little/no retention potentially need be withheld
- Structural steelwork - potentially minimal risk once fixed and permanently erected - little/no retention potentially need be withheld
- Envelope complete - potential risk of compromised wind and weather tightness or poor joint/seal integrity - retention possible
- Internal decoration complete - potential risk of smearing, poor coverage, cracking etc - retention probable

4.10 No retention should be applied to payments for temporary works procured directly by the public contract that will not be permanently incorporated.

4.11 Contracting authorities must support the implementation of their chosen retention process in order to make it properly operational. This includes providing the necessary terms and conditions of contract describing the parameters within which the retention will be administered. Contracting authorities must themselves adhere to the procedures they implement for making the governance properly functional and effective.

4.12 For example, pricing documents should allow work that the contracting authority has advised may be treated as retention-free to be readily identified and separately priced. It will be difficult if not impossible for the contracting authority to implement a targeted approach to retention without the commensurate level of supporting detail. It is in the contractor's interests to supply it, proactively if necessary, for example in their method statement and price breakdown.

4.13 Contracting authorities can implement a retention strategy based on a percentage deduction from the progress payment due to the contractor, as per traditional practice. This may only be done to accumulate the necessary amount for a reasonable pre-determined assessment of the likelihood and impact of defective work.

After contract award

5.1 After contract award, contracting authorities should consider scope to abate

the retention commensurate with the contractor's work on site. They should ensure deployment of such a strategy is appropriate, proportionate and practicable.

5.2 Contracting authorities could for example apply less retention as work proceeds where patently defective work is absent or very quickly rectified. Traditional retention practice assumes a contractor's performance will be constant whereas in reality it may vary depending, for example, on their own staff and subcontractors. It assumes that standard percentages will not accumulate excessive retention despite these variances, particularly where zero defect delivery is the objective.

5.3 Information/evidence of the contractor's performance on site gleaned by direct inspection of their work would help establish a factual basis for an active retention regime. This would seek to reduce the prevalence of defective work, aiming towards zero defects at handover. The contractor would have certainty on the maximum amount/proportion stated in the contract. Potential reductions would be determined by their own performance. An active retention process where retention cashflow depends on specification compliance empowers the contractor to eliminate defective work.

Project delivery culture

6.1 Contracting authorities should ensure that their contract terms both enable and empower a collaborative culture to be established on site. They should lead by example and exhibit themselves the conduct and behaviours they expect of supply chain businesses. Regular and detailed site inspections as work proceeds can inform and support the commercial element of the overall project delivery strategy. They can help sustain the focus on ongoing defect remediation to deliver a specification-compliant project with zero defects at practical completion.

6.2 Implementing these provisions may involve more frequent site inspection and/or more detailed payment assessments. This is an unavoidable consequence of the increased focus on site productivity, compliance inspection and commercial management inherent in and necessitated by better retention practice. The contracting authority should identify the inspection regime deemed necessary to receive a compliant project into their estate. Financial headroom may potentially be carved from a fixed capital budget through cash freed-up by engineering best value into project or programme scope and specification.

6.3 A contracting authority's inspection regime is not a substitute for the contractor's obligation to deliver the standard of materials and workmanship required by the specification. The contractor remains obliged to perform the contract and should routinely, objectively and rigorously apply their policies for complying with the specification. A greater propensity to regularly deliver compliant projects demonstrates reliable and efficient corporate processes. This in turn produces more reliable project budgeting. Contractors can choose to recover related costs by charging them to tenders if they wish.

6.4 The need for and the amount of retention should be inversely proportionate to how reliably the contractor complies with the specification. This is within the gift of every contractor engaged in delivering construction projects to the public estate to

control. Where a contracting authority considers improvements in the standard of project delivery to be permanent and ingrained, they should decrease retention applied to future projects. Where a contracting authority considers that a contractor is capable of and committed to delivering zero defects, they should consider applying zero retention.

Handover

7.1 The practical application of the portion of cash retention accumulated for potential patent defects should be aligned to identified defects. It should not persist as a general remediation fund. The contracting authority's decision to take possession of an asset is always a matter for the contract and is not supplanted by these provisions.

7.2 The contracting authority and contractor should collaborate to identify and agree instances of defective work to be noted in a schedule of patent defects. They should work together to develop it into an estimate of the cost and time needed for remediation. This will include any defective work manifesting at handover which was not previously discovered in addition to any pre-existing outstanding defects.

7.3 Where the remediation estimate for patently defective work exceeds the amount of retention held to cover it, the contracting authority must avoid paying the difference. For example, a progress payment should not include defective work which is patent when evaluated for payment purposes. The following factors can help inform the contracting authority's retention process at practical completion:

- Amount of retention accumulated to date
- Cost and duration of remediating patently defective work
- Amount to be held for remediating potential latent defective work
- Retention with no attributable purpose for return to the contractor

7.4 These provisions extend the systematic process for accruing retention into a more consistent and transparent remediation regime attributed to specification compliance. They seek to make retention an active process which places maximum cashflow under the contractor's control by minimising patently defective work at practical completion.

7.5 Traditional practice leaves contracting authorities with only half of the accumulated retention fund at practical completion just as the extent of patent defects is evident. Such a release of retention may not fully reflect the contracting authority's potential exposure to the cost of remedial work. The contracting authority should retain the estimated cost of remediating patently defective work from a retention fund accumulated under contract terms drafted to reflect this guidance. They will also retain the amount for potential latent defects. The contractor can no longer assume they will receive half the accumulated retention at practical completion. They will receive the amount unable to be contractually attributed to rectifying patent defects evident at that point.

7.6 Any defects remaining latent at handover clearly cannot be subject to a process of attributing remedial time and money. They are inherently unknowable and unquantifiable unless and until they manifest, for example if the structure or systems

are sensitive to seasonal conditions. Authorities should not interpret this guidance to permit holding a greater retention for latent defects than would have been held traditionally. A percentage of the contract sum held for the pre-specified period as in traditional practice is acceptable. The contracting authority's position in the event of latent defects manifesting after the final payment of retention to the contractor is beyond the scope of these provisions. Potential recourse may be available through manufacturers' performance warranties and suppliers' guarantees.

Conflict avoidance

8.1 Contracting authorities should consider embedding a conflict avoidance approach into the project delivery process. This is particularly pertinent to drawing up the schedule of patent defects, a process which can ill-afford to suffer unnecessary disagreements and delays. The schedule's focus on detailed technical matters will need to be balanced with the strategic benefit to the contracting authority of occupying and using the asset. Construction Policy Note [2/2021](#) confirmed Scottish Government's support for the principle of avoiding conflict in construction contracts. The provisions in this guidance do not supplant the terms of compliance for handing the asset over stated in the contract.

Duration and release

9.1 Contracting authorities should carefully consider the duration to be specified in the public contract for holding the accumulated retention pending release. Retention should only be held for the minimum duration necessary for any defective work to have a reasonable opportunity to manifest itself. The contracting authority must release the retention due to the contractor as soon as the necessary contractual triggers for doing so have been met. The contractor should not have to apply for this money, the contracting authority should return it of their own volition.

Supply chain equivalence

10.1 Contracting authorities should ensure that the public contract contains provisions for the contractor to implement retention as set out therein to subcontractors. Contracting authorities should enact retention provisions of the public contract towards the contractor in the way they expect supply chain business to do so between themselves. Those provisions should be drafted to enable them to be replicated in so far as is reasonably possible in successive contracts along the supply chain. This is in effect the same principle as set out in [SPPN 2/2022](#) (Prompt Payment in the Supply Chain - terms and conditions).

Trust accounts

11.1 Where deemed proportionate to and feasible for a particular project, contracting authorities can require the main contractor to open a trust account with each subcontractor. These separate accounts should be opened in joint names with each subcontractor to deposit the retention, ring fence and protect it from upstream insolvency. The availability of this type of account to serve the stated purpose at the required time and at reasonable cost may vary. Contracting authorities should check this in good time.

Compliance

12.1 Accountable Officers in Scottish Government are required to prepare governance statements as part of the annual accounts for which they are directly responsible. They rely on key individuals to provide them with reasonable assurances of compliance with applicable policies and procedures. It includes procurement policy stated in The Client Guide to Construction Projects and Construction Policy Notes² as implemented by contracting authorities in scope of SPFM. It covers their consideration, implementation and operation of cash retention, as noted in these provisions, in their construction contracts.

Publication of policy and practice

13.1 Each contracting authority is required to undertake the following actions:

- by 31 August 2024, publish a retention policy statement on its website and then review and where necessary revise it by each subsequent 31 August thereafter
- from 20 February 2025, publish a retention policy compliance statement on its website for every project, initially as soon as possible after practical completion, whose contract was awarded on or after 20 February 2023

13.2 Templates have been created to help contracting authorities structure and populate their statements. They are available, on request, from the Construction Procurement Policy Unit by e-mailing: propertyandconstruction@gov.scot. They contain detailed completion footnotes to facilitate accuracy and consistency within and across contracting authorities. The retention policy statement must cover all contracts awarded by a contracting authority for construction projects irrespective of value. This also applies to the retention policy compliance statement.

13.3 The retention policy statement is for contracting authorities to state how they have incorporated the guidance in this chapter into their construction procurement policy. These statements are intended to achieve the following objectives:

- raise awareness of how retention is deployed across the public sector
- to promote transparency among contracting authorities
- facilitate related knowledge understanding and decision-making among contractors.

13.4 The retention policy compliance statement compares the retention policy applicable to a project with the actual procedures included in the contract documents and used on a project. The bulk of the compliance statement covers information which should ordinarily be available to contracting authorities at or very soon after practical completion. It can be completed as a separate document per project or, if preferred, periodically/annually as a series of line entries for multiple projects in batches. Both formats cover exactly the same information.

² [Construction Policy Notes](#)

Directory of Retention Policy and Compliance Statements

14.1 Scottish Government has set up a directory of links to web pages where contracting authorities have published their statements (please see below). Any contracting authority wishing to contribute their page address to it should contact the e-mail address noted in paragraph 13.2. It would also be helpful if contracting authorities could provide a link to the directory on their relevant web page(s).