

# **Consultation on the Practice of Cash Retention Under Construction Contracts**

**December 2019**

## **Scottish Government Consultation**

### **The practice of cash retention under construction contracts**

#### **1. Consultation Overview**

There is evidence that some payment practices prevalent in the construction industry are a barrier to investment, productivity improvements and growth. Cash retention, where the process is misused or abused, can be one such practice.

The retention system is a long-standing practice in the construction industry throughout the UK. A retention is money withheld from payment of a construction project. The purpose of a retention is to mitigate the risk of a failure to complete a construction project or a failure to rectify defects. The part of the contract sum which is held back is intended to provide a means of incentivising contractors and subcontractors to return to correct any defects during a specified period of time or to provide towards a means of funding the procurement of another contractor to do so if necessary, as outlined in contract terms and conditions. In most cases a retention is imposed by the client employing the main or Tier 1 contractor and this is mirrored in all subsidiary contracts throughout the supply chain.

Following concerns expressed by parts of the industry, the Scottish Government agreed to undertake a review of retention payments. To support the review, the Scottish Government commissioned independent research from Pye Tait and that research is published alongside this consultation. It illustrates the challenges with retentions - in particular understanding the extent to which this practice has a negative impact and what solutions would be effective and proportionate in addressing this.

#### **2. Why we are Consulting**

The purpose of this consultation is to seek information on the practice of cash retention in public and private sector construction contracts in Scotland and to gather views on the findings of the supporting documentation.

In addition to asking questions about the Pye Tait research “Retentions in the Scottish Construction Industry” we are also asking for views on the potential impacts of introducing legislation in this area.

### **3. Executive Summary**

There is evidence that some payment practices prevalent in the construction industry are a barrier to investment, productivity and growth. Cash retention, where the process is misused or abused, can be one such practice.

As a sum of money withheld from the contractually-agreed amount due on a construction project, the purpose of a retention is to mitigate risk should some of the work not be completed satisfactorily, or any resulting defects not be rectified by the contractor.

To support this consultation, the Scottish Government commissioned independent research from Pye Tait Consulting. The report they produced - Retentions in the Scottish Construction Industry, is published with this consultation. It illustrates the challenges with retentions - in particular understanding the extent to which this practice has a negative impact and what solutions would be effective and proportionate in addressing this.

A number of key issues were identified by the research:

- Evidence suggests that a significant proportion of companies say they deliberately avoid business in which retentions are involved
- It suggests that the current system operates to the advantage of clients and Tier 1 contractors but to the disadvantage of medium and smaller companies, particularly where a contractor insolvency might occur.
- Qualitative evidence suggests that late and non-payment of retention monies is a significant issue for some contractors; and
- There is a need to investigate a fairer, more neutral and more protected approach to assurance in construction contracts.

Unjustified late and non-payment of a retention or any other amount owed is unacceptable.

This consultation aims to gather views and information on:

- the effectiveness of existing prompt and fair payment measures for retentions;
- views on the Pye Tait independent research on retentions in the construction industry;
- late and non-payment of retentions;
- the effectiveness of existing alternative mechanisms to retentions; and
- the benefit of holding retentions in a retention deposit scheme or trust account.

#### **4. Current Policy Landscape**

The Scottish Government is responsible for setting official policy on performance assurance mechanisms in construction contracts for in-scope organisations, including cash retentions. “In-scope organisations” are those bodies for which the Scottish Public Finance Manual is applicable guidance (paragraph 7 et seq). Organisations which are out of the Scottish Government’s administrative scope include, for example: local authorities; the higher education sector; and housing associations. Such bodies are therefore free to implement their own requirement for performance assurance mechanisms, or indeed none, as they think appropriate.

The Scottish Government’s performance assurance mechanism policy is set out below. In summary, it encourages contracting authorities to consider assurance methods, including the use of retentions, on a project-by-project basis: the use of retentions is not the default position.

Current Scottish Government Policy on Performance Assurance Mechanisms in Public Works Contracts

#### **5. Need for assurance**

Realistically, defects occur in most construction works and project owners therefore need to be assured by measures designed to protect the public purse from becoming liable for defective or sub-standard work and to ensure their projects are completed as contractually-specified. An evaluation of the options among available assurance mechanisms should be conducted in respect of strategic factors, including the specific nature of a project’s value, procurement method and market conditions.

#### **6. Assessment of assurance**

Scottish Government does not prescribe particular assurance processes. Decisions should be project-based and processes should be proportionate to the specific circumstances of the project. Wherever possible, they should also be applied consistently along the supply chain. In most cases, professional advice and specialist input will be required to help fully inform decisions. Cash retentions or other traditional means of assurance should not prevail purely by default or without adequate analysis. “Custom and practice” is not of itself adequate justification for the implementation of any performance assurance mechanism. Hence, Scottish Government does not prescribe the use of cash retentions.

#### **7. Cash retentions - principles**

Project assurance mechanisms which utilise cash retention are permissible where an evaluation of options identifies them as offering the best overall value for money (rather than a retention bond or parent company guarantee, for example). Clients

should ensure they receive advice from professionals, having regard to project circumstances. Whilst Scottish Government does not prescribe the proportion, or amount, of cash to be held, it should be reasonable and commensurate with strategic project factors, as should the triggers for its release.

Any costs associated with properly establishing and monitoring the retention fund should be compared with the benefits of minimising scope for abuse along the supply chain. Retention monies should not be unjustifiably withheld at any point along the supply chain on Scottish Government projects, those holding monies should observe the associated fiduciary duties (where applicable) and the relevant clauses in conditions of contract should be adhered to at all times.

## **8. Alternatives to cash retentions**

Alternatives include the following:

**Retention bonds** - under a typical retention bond, the contractor's performance of its obligations to complete the works as contractually-specified is guaranteed by a third party, or surety, which undertakes to pay damages sustained by the employer in the event of any default on the part of the contractor. Normal practice is to provide conditional retention bonds that increase in value as payments are made (in full i.e. no cash retentions applied) in accordance with the contract. The surety's liability is limited to the sum which would otherwise have been held by the employer by way of cash retention at the time of any breach and is automatically reduced by half upon issue of the certificate of practical completion.

**Performance bonds** - the contractor may be able to give a "default" (or "on default") bond to the public authority. This type of bond is conditional on performance of the contract or payment of damages by the bondsman if the contractor defaults. This bond is a guarantee because the bondsman assumes a secondary obligation to pay if the contractor fails to perform. The amount of the bondsman's liability is proportional to the damages sustained by the employer. Another type of performance bond is an "unconditional on demand" bond: however, it is Government policy not to use these. "Maintenance" bonds are also available, which provide limited security for performance of the contractor's obligations during the defects liability period. These can be of use where there has been a performance bond which has expired on practical completion or the works comprise a specialist installation demanding a high level of care after practical completion.

**Parent company guarantees** - This form of guarantee is given by a parent company (or holding company) to guarantee the proper performance of a contract by one of its subsidiaries (the contractor), and can only be given where the contractor is owned by a parent company or is the subsidiary of a larger group. Because the financial strength of the parent company may be linked to that of the contractor, a

parent company guarantee will be acceptable only if the parent company (or holding company) is financially strong and its financial resources are largely independent of those of the contractor.

Such a guarantee is free of cost to the client, but may give less certainty of redress than a bond because it is not supplied by an independent third party. However, whilst accepting less independence, parent company guarantees for the proper performance of the contract can be more advantageous than bonds. The conditions of a parent company guarantee will usually give the parent company the opportunity to remedy any default within a period of notice before the guarantee is called. Rather than the client receiving a fixed amount in compensation, the parent company is obliged to complete the contract. The way in which this is done can, to some extent, be at the discretion of the parent company. Costs for completion are borne by the parent company - and these costs may be significantly more than the compensation provided for in a bond.

### **Escrow**

Being in escrow is a contractual agreement in which a third party (the stakeholder or escrow agent) receives and disburses money or property for the primary transacting parties. The disbursement is dependent on conditions agreed to by the transacting parties.

### **Assurance drivers and constraints**

Contracting authorities should seek appropriate professional advice when considering the use of bonds and guarantees on public works contracts, to clarify their practicalities, technicalities and legalities, and also their overall value for money compared with other performance assurance mechanisms. The use of bonds transfers some of the project financing cost from the contractor to the public client and will pass cashflow benefits to the contractors. Their use should result in a lower overall cost to the client if the contractor is prepared to reduce its tender price accordingly. Only one type of performance assurance mechanism should be deployed by the client at any time on a single project: for example, retention bonds should not be supplemented by the withholding of cash retentions. There can be greater scope for implementing alternatives to cash retentions on longer term contracts, framework agreements or serial contracts in which teambuilding and collaborative working practices can be more readily introduced.

## **Responding to this Consultation**

We are inviting responses to this consultation by 25/03/2020.

Please respond to this consultation using the Scottish Government's consultation hub, Citizen Space (<http://consult.gov.scot>). Access and respond to this consultation online at <https://consult.gov.scot/industrial-sectors/retention-payments-in-construction>. You can save and return to your responses while the consultation is still open. Please ensure that consultation responses are submitted before the closing date of 25<sup>th</sup> March 2020.

If you are unable to respond using our consultation hub, please complete the Respondent Information Form and send to:

Industrial Sectors Team  
Scottish Government  
Economic Development Directorate  
Manufacturing & Industries Division  
5 Atlantic Quay  
150 Broomielaw  
GLASGOW, G2 8LU

### **Handling your response**

If you respond using the consultation hub, you will be directed to the About You page before submitting your response. Please indicate how you wish your response to be handled and, in particular, whether you are content for your response to be published. If you ask for your response not to be published, we will regard it as confidential, and we will treat it accordingly.

All respondents should be aware that the Scottish Government is subject to the provisions of the Freedom of Information (Scotland) Act 2002 and would therefore have to consider any request made to it under the Act for information relating to responses made to this consultation exercise.

If you are unable to respond via Citizen Space, please complete and return the Respondent Information Form included in this document.

To find out how we handle your personal data, please see our privacy policy: <https://beta.gov.scot/privacy/>

### **Next steps in the process**

Where respondents have given permission for their response to be made public, and after we have checked that they contain no potentially defamatory material, responses will be made available to the public at <http://consult.gov.scot>. If you use the consultation hub to respond, you will receive a copy of your response via email.

Following the closing date, all responses will be analysed and considered along with any other available evidence to help us. Responses will be published where we have been given permission to do so. An analysis report will also be made available.

## **Comments and complaints**

If you have any comments about how this consultation exercise has been conducted, please send them to the contact address above or at [RetentionPaymentsConsultation@gov.scot](mailto:RetentionPaymentsConsultation@gov.scot).

## **Scottish Government consultation process**

Consultation is an essential part of the policymaking process. It gives us the opportunity to consider your opinion and expertise on a proposed area of work.

You can find all our consultations online: <http://consult.gov.scot>. Each consultation details the issues under consideration, as well as a way for you to give us your views, either online, by email or by post.

Responses will be analysed and used as part of the decision making process, along with a range of other available information and evidence. We will publish a report of this analysis for every consultation. Depending on the nature of the consultation exercise the responses received may:

- indicate the need for policy development or review
- inform the development of a particular policy
- help decisions to be made between alternative policy proposals
- be used to finalise legislation before it is implemented

While details of particular circumstances described in a response to a consultation exercise may usefully inform the policy process, consultation exercises cannot address individual concerns and comments, which should be directed to the relevant public body.

## About You

Please indicate how you wish your response to be handled and, in particular, whether you are content for your response to be published. If you ask for your response not to be published, we will still take account of your views in our analysis but we will not publish your response, quote anything that you have said or list your name. We will regard your response as confidential, and we will treat it accordingly.

To find out how we handle your personal data, please see our [privacy policy](#).

### Questions

1. What is your name?

2. What is your email address?

Entering your email address allows you to return to edit your consultation at any time until you submit it. You will also receive an acknowledgement email when you complete the consultation.

3. Are you responding as an individual or an organisation?

- Individual
- Organisation

What is your organisation's name?

a) If you are responding as an organisation does your business work on construction projects across the United Kingdom?

- Yes
- No we only work in Scotland
- Not applicable

4. Are your business headquarters registered in Scotland?

- Yes
- No

a) What is the nature of your business within the construction sector? (Check all that apply)

- Client
- Tier 1 contractor
- Sub-contractor
- Both Tier 1 contractor and sub-contractor
- Other (please specify below)

b) How many direct employees (i.e. excluding sub-contractors) does your business have? *(Required)*

*Please select only one item*

- Sole Trader
- Less than 10 (micro)
- 10 - 49 (small)
- 50 - 249 (medium)
- More than 250 (large)

c) What is your experience of retentions in the construction industry?

*Please select only one item*

- As a client who uses retentions
- As a business subject to retentions
- As a business who uses and is subject to retentions
- Not exposed to retentions

d) What SIC codes does your company operate under?

*Please select all that apply*

- 42130 Construction of bridges and tunnels
- 42210 Construction of utility projects for fluids
- 42220 Construction of utility projects for electricity and telecommunications
- 42910 Construction of water projects
- 42990 Construction of other civil engineering projects
- 43110 Demolition
- 43120 Site preparation
- 43130 Test drilling and boring
- 43210 Electrical installation
- 43220 Plumbing, heat and air-conditioning installation
- 43290 Other construction installation
- 43310 Plastering
- 43320 Joinery installation
- 43330 Floor and wall covering
- 43341 Painting
- 43342 Glazing
- 43390 Other building completion and finishing
- 43910 Roofing activities
- 43991 Scaffold erection
- 43999 Other specialised construction activities
- Not applicable (Client)

5. The Scottish Government would like your permission to publish your consultation response. Please indicate your publishing preference: *(required)*

*Please select only one item*

- Publish response with name
- Publish response only (without name)<sup>1</sup>
- Do not publish response<sup>2</sup>
- Information for organisations only:

6. We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

- Yes
- No

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<sup>1</sup> The option '*Publish response only (without name)*' refers only to your name, not your organisation's name. If this option is selected, the organisation name will still be published.

<sup>2</sup> If you choose the option '*Do not publish response*', your organisation name may still be listed as having responded to the consultation in, for example, the analysis report.

## **Section A – Supporting Documentation – Retentions in the Scottish Construction Industry**

The Pye Tait research - Retentions in the Scottish Construction Industry

The independent research accompanying this consultation, Retentions in the Scottish Construction Industry draws a number of conclusions and areas for potential further investigation:

1. The financial consequences for contractors and subcontractors in the event of a large organisation going into liquidation can be significant.
2. Research has estimated the value of retentions at any one time in the Scottish construction sector at around £124m. Retention money held in a main bank account can be used by the holder to fund expenditure on labour, plant and materials on other projects and/or as part of the working capital of the business.
3. A significant proportion of companies say they deliberately avoid business in which retentions are involved.
4. Alternatives to common retention practices are available but they tend to be used infrequently. They include performance bonds, retention bonds and escrow accounts.
5. The research found that the retention system in Scotland works reasonably well when all parties adhere to the letter and spirit of the arrangement. It does not recommend a move away from retentions as a form of assurance.

However it also concludes that there is strong reason to accept that the current system of retention is not working to the advantage of the Scottish construction sector.

The research makes the following recommendation:

1. That a fairer, more neutral and more protected approach to the practice of retention should be sought.

The consultation seeks to establish whether people agree with this recommendation and whether the findings and conclusions of the independent research reflect their own views on the practice of retentions.

**Questions:**

1. Do you agree with the Pye Tait conclusion that "the financial consequences for contractors and subcontractors in the event of a large organisation going into liquidation can be significant"? (*Please select only one item*)

- I fully agree     I partially agree     I neither agree nor disagree     I partially disagree     I disagree

a) Do you agree with the Pye Tait conclusion that "retention money held in a main bank account can be used by the holder to fund expenditure on labour, plant and materials on other projects and/or as part of working capital"?

- I fully agree     I partially agree     I neither agree nor disagree     I partially disagree     I disagree

b) Do you agree with the Pye Tait conclusion that "some companies deliberately avoid business in which retentions are involved"?

- I fully agree     I partially agree     I neither agree nor disagree     I partially disagree     I disagree

c) Do you agree with the Pye Tait conclusion that "alternatives to common retention practices are available but used infrequently"?

- I fully agree     I partially agree     I neither agree nor disagree     I partially disagree     I disagree

d) Do you agree with the Pye Tait conclusion that "the retention system in Scotland works reasonably well when all parties adhere to the letter and spirit of the agreement"?

- I fully agree     I partially agree     I neither agree nor disagree     I partially disagree     I disagree

2. Which of the following do you believe to be the intended purpose of retentions as part of construction contracts?

*Please select all that apply*

- To act as a warranty against poor quality work
- To encourage sub-contractors to return to fix any defects
- To fund works required to fix defects in the event that the sub-contractor did not return
- Other – please specify below

3. Do you agree that some form of assurance is needed in construction contracts?

*Please select only one item*

- Yes
- No

a) How effective do you feel the current system of retention is?

- I fully agree
- I partially agree
- I neither agree nor disagree
- I partially disagree
- I disagree

4. Do you agree that retentions are the best form of assurance within construction contracts?

*Please select only one item*

- Yes
- No

a) If you answered no to Question 4 (i.e you do not think retentions are the best form of assurance within construction contracts) what would be your preferred form of assurance for construction projects?

*Please select only one item*

- Retention bonds
- Performance bonds
- Escrow stakeholder accounts
- Parent company guarantees
- Other (Please provide details)

5. The recommendation made within the Pye Tait research is - "That action should be taken to create a fairer, more neutral and more protected approach to the practice of retentions" Do you agree with this recommendation?

*Please select only one item*

- Yes
- No

a) If you answered yes to question 5 - how do you feel this could be achieved?

b) If you answered no to question 5 - what would you suggest for the practice of retentions?

6. Do you actively avoid bidding for contracts subject to retention?

*Please select only one item*

- Yes
- No
- It depends on the value/type of contract
- Not applicable (client)

a) If so, would you bid for contracts if an alternative to the current practice of retention was established or as Pye Tait recommend a "fairer, more neutral and protected approach to the practice of retentions"?

*Please select only one item*

- Yes
- No
- It depends on the value/type of contract
- Not applicable (client)

7. If you were unable to use retentions what method of assurance would you use?

*Please select only one item*

- Retention bonds
- Performance bonds
- Escrow stakeholder accounts
- Parent company guarantees
- Other (Please provide details)

Can you tell us why you answered this way?

a) If you were unable to use retentions would your cashflow be affected?

*Please select only one item*

- Yes, I hold retentions in a main bank account
- No, I hold retentions in a separate account
- I do not hold retentions from others
- Other (please provide details below)

b) If you answered yes above, what impact would not being able to use retentions for cashflow have on your business?

- |   |   |   |   |                               |   |
|---|---|---|---|-------------------------------|---|
| <input type="checkbox"/> Very significant | <input type="checkbox"/> Slightly significant | <input type="checkbox"/> Neither significant or insignificant | <input type="checkbox"/> Fairly insignificant | <input type="checkbox"/> None | <input type="checkbox"/> Not applicable |
|---|---|---|---|-------------------------------|---|

8. Is there anything else you would like to say about the Pye Tait research?

## **Section B – Non Payment of Retentions**

Measuring the incidence of unjustified late and non-payment of retention monies

Alongside a wealth of anecdotal evidence and several surveys by trade bodies with a close interest in a particular aspect of the argument, Pye Tait research indicates that there is frequent late and non-payment of retentions.

It is not known what proportion of this late and non-payment of retention monies is for genuine reasons (for instance, the failure of a supplier to return promptly to correct defects), and what proportion is for unjustified reasons (for instance, non-payment because of a pending payment from another client or because a contractor retained monies for longer than specified in contract terms).

The qualitative information gathered by Pye Tait from workshops and interviews does, however, indicate that unjustified late and non-payment of retentions appears to be a significant cause of issues associated with the practice of holding retentions within the construction sector. However, they found that it was not possible to use the survey evidence gathered to measure what proportion of late and non-payment counted by the survey is justified within contract terms, what proportion is unjustified, and what proportion retentions are lost due to insolvencies.

For the questions below we would like you to think about non-payment of retentions.

**Questions:**

1. Can you provide an estimate of the total number of construction contracts that your business both secured and issued over the last 12 months?

Total number of contracts secured

Total number of contracts

Don't know

- a) What was their approximate combined value?

- b) Of the total construction contracts over the past twelve months, how many had retentions written into the contract (i.e. a client or main contractor is holding a retention against you or where you are holding a retention over others?)

Please provide details of the number of contracts won that subjected you to a retention?

Please provide details of the number of contracts you have issued that have applied a retention on others?

Nil

- c) Approximately how many of your current contracts with retentions (where you are holding a retention or are subject to a retention) are for work undertaken in a) the public sector and b) the private sector (if zero enter 0).

Public sector

Private sector

2. How significant an issue do you think non-payment of retentions is in the construction sector?

- Very significant       Significant       Neither significant or insignificant       Not very significant       Not significant at all       I don't know

a) What, in your experience, are the main reasons for non-payment of retentions?

*Please select all that apply*

- Insolvency
- Contractors not returning to fix defects
- Poor quality of work
- Other – please specify below

3. If you have been holding retentions within the last 12 months and withheld payment. What were the reasons for doing so?

*Please select all that apply*

- Insolvency
- Contractors not returning to fix defects
- Poor quality work
- Contractors obligations on another account
- Contractors did not request payment
- Other – please specify below

a) If you have been subject to a retention within the last twelve months and this was not repaid - what were the reasons for non-payment?

*Please select all that apply*

- Insolvency
- Not returning to fix defects
- Poor quality work
- Work on another contract not completed
- Other – please specify below
- Not applicable (Client)

4. Approximately, what was the total value of retentions due to be released to you or by you over the last twelve months?

*Please select only one item*

- Below £10,000
- Between £10,000 and £50,000
- Between £50,001 and £100,000
- Between £100,001 and £200,000
- Between £200,001 and £500,000
- Over £500,000

5. If retention money was due to you in the last twelve months, approximately how much of this was not released?

*Please select only one item*

- Not applicable (Nil)
- Below £10,000
- Between £10,000 and £50,000
- Between £50,001 and £100,000
- Between £100,001 and £200,000
- Between £200,001 and £500,000
- Over £500,000

a) If you were due to release retention money in the last twelve months, approximately how much of this was not released?

*Please select only one item*

- Not applicable (Nil)
- Below £10,000
- Between £10,000 and £50,000
- Between £50,001 and £100,000
- Between £100,001 and £200,000
- Between £200,001 and £500,000
- Over £500,000

b) Please provide further details on the reasons for this non-payment. Of the amount of retention not released, how much falls into each of the categories below:

The company holding the retention became insolvent (Please provide cash value £)

Payer cited that obligations under another construction contract had not been met (Please provide cash value £)

I did/contractor did not return to fix defects (Please provide cash value £)

Poor quality work

I did/contractor did not claim payment of the retention

Other reasons (please provide cash value £ and specify below)

Not applicable (Nil)

Please provide details

6. How much of the retentions not paid (question 5) were in your view unjustified within the contract terms?

Please provide a percentage

a) Why did you feel the non-payment of your retention was unjust?

Please provide details

7. Did you challenge the non-payment that occurred due to the payer citing obligations under another construction contract not being met (outlined in question 5a)? *This question is about non-payment of retentions, not late payments.*

*Please select only one item*

- Yes
- No

If you answered no above - why did you not challenge the non-payment?

a) What happened when you challenged the non-payment?

*Please select only one item*

- Payment was made
- Partial payment was made
- Payment was disputed
- Nothing
- Other (Please specify below)
- Not applicable

Please provide details

## Section C – Late Payment of Retentions

Questions:

1. How significant an issue do you believe late payment of retentions is in the construction industry? *This question is about late-payment of retentions, not non-payment.*

*Please select only one item*

- Very significant       Significant       Neither significant or insignificant       Not that significant       Not significant at

2. Approximately what was the total value of retentions due to be released to you over the last twelve months that were paid late?

*Please select only one item*

- Below £10,000  
 Between £10,000 and £50,000  
 Between £50,001 and £100,000  
 Between £100,001 and £200,000  
 Between £200,001 and £500,000  
 Over £500,000  
 Not applicable (Nil)

3. Please provide further details on the reasons for late payment. Of the amount of retention paid late how much falls into each of the categories below?

I did not meet the provisions of my contract (Please provide cash value £)

Payer cited that obligations under another construction contract had not been met (Please provide cash value £)

The company holding the retention cited cash flow problems (Please provide cash value £)

Poor quality work (Please provide cash value £)

Other reasons (please provide details below)

a) What percentage of the retentions paid late (question 2) were in your view unjustified within the contract terms.

*Please select only one item*

- Less than 10%
- Between 11% and 25%
- Between 26% and 50%
- Between 51% and 75%
- Between 76% and 100%
- Not applicable

4. For the amount that you believe was 'unjustified' what was the typical length of delay?

*Please select only one item*

- Less than 1 month
- Between 1 and 3 months
- Between 3 and 6 months
- Between 6 and 12 months
- Over a year
- Not applicable

a) Can you provide an estimate of the cost to your business in pursuing late (including those that were ultimately unpaid) retention payments over the last twelve months? *As a value of your total construction contracts with a retention (Please provide cash value £)*

5. Did you challenge the late payment that occurred due to the payer citing that obligations under another construction contract had not been met (outlined in question 3)?

*Please select only one item*

- Yes
- No
- Not applicable

*If you answered no above - why did you not challenge the late payment?*

a) What happened when you challenged the late payment?

*Please select only one item*

- Payment was made
- Partial payment was made
- Payment was disputed
- Nothing
- Other (Please specify below)
- Not applicable

6. Were you previously aware that the 2011 amendments to the “Housing Grants, Construction and Regeneration Act 1996”<sup>3</sup> mean it is no longer possible to make payment, including retention payments, conditional on the performance of obligations under another contract?

*Please select only one item*

- Yes
- No

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<sup>3</sup> More Information <http://www.legislation.gov.uk/ukpga/1996/53/part/II>

- a) Would you have challenged the late-payment (due to performance of obligations under another contract), if you had known that this is what the "Housing Grants, Construction and Regeneration Act 1996" means for retention payments?

*Please select only one item*

- Yes
- No
- Depends on the value of the contract
- Not applicable

*If you answered no above - why did you not challenge the late payment?*

- b) How could future amendments to the "Housing Grants, Construction and Regeneration Act 1996" be better promoted to raise awareness?

7. It has been suggested that some parties to construction contracts ask contractors to give an overall discount on the contract price or interim payment related thereto, in return for ensuring prompt payment. Have you encountered this practice?

*Please select only one item*

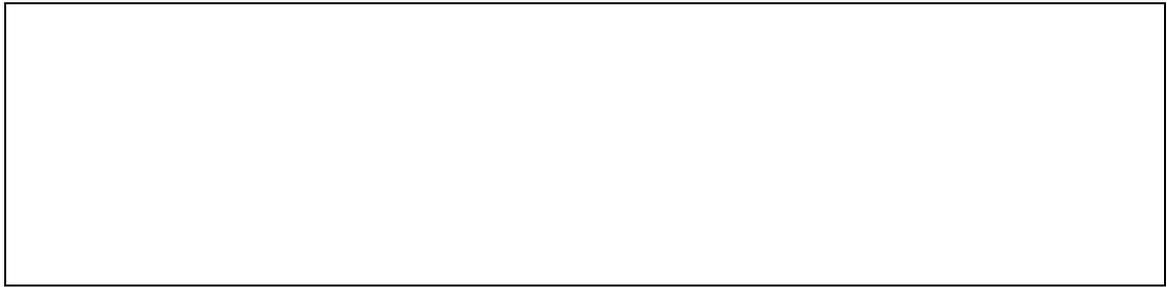
- Yes
- No

8. It has also been suggested that some companies artificially inflate their tender price where a retention is being applied. Have you encountered this?

*Please select only one item*

- Yes
- No
- Not sure

9. Do you have any further comments on late and non-payment of retentions?

A large, empty rectangular box with a thin black border, intended for the user to provide their comments on late and non-payment of retentions.

## **Section D – Existing Alternative Mechanisms to Retentions**

The effectiveness of existing alternative mechanisms to retentions

The Pye Tait research considered a number of mechanisms already in use within parts of the construction sector, to assess the extent to which they could be used as sector-wide alternatives to retentions. These were:

- Retention bonds;
- Performance bonds;
- Escrow stakeholder accounts;
- Parent company guarantees; and
- Retentions held in trust.

Pye Tait research shows that where other measures of assurance are used, most are used in conjunction with cash retentions rather than as a complete alternative to them.

The most commonly used alternative is performance bonds.

Qualitative feedback suggests that some contractors who accept retentions and agree the system works as a means of assurance would like to see some changes to the system. Improvements suggested are centred on:

1. the perceived need for funds held in retention to be protected and not threatened by client or main contractor insolvency,
2. the need for retentions to be released on time and without the need for multiple requests,
3. changing the system to eradicate the commercial dominance of the main contractor or client in terms of future work, and,
4. enhancing the system to ensure that clients and main contractors cannot derive a commercial, financial benefit from it.

The research does not recommend a legislated switch from the practice of retentions to an alternative means of assurance. Instead it suggests that a fairer, more neutral and more protected approach to retentions is required.

The consultation questions seek to establish the use and range of alternative mechanisms and their effectiveness in providing assurance against defects and critical issues associated with retentions.

## Questions:

1. Over the last twelve months, approximately how many of your construction contracts, have had alternative mechanisms to retentions, or alternative mechanisms for implementing retentions applied? *Please provide details. Only numerical responses will be accepted.*

--

- a) Which alternative mechanisms were utilised?

*Please select all that apply*

- Retention bonds<sup>4</sup>
- Performance bonds<sup>5</sup>
- Escrow stakeholder accounts<sup>6</sup>
- Parent company guarantees<sup>7</sup>
- Retentions held in trust
- Other (Please provide details)

---

<sup>4</sup> **Retention bonds** - under a typical retention bond, the contractor's performance of its obligations to complete the works as contractually specified is guaranteed by a third party, or surety, which undertakes to pay damages sustained by the employer in the event of any default on the part of the contractor. Normal practice is to provide conditional retention bonds that increase in value as payments are made (in full i.e. no cash retentions applied) in accordance with the contract. The surety's liability is limited to the sum which would otherwise have been held by the employer by way of cash retention at the time of any breach and is automatically reduced by half upon issue of the certificate of practical completion.

<sup>5</sup> **Performance bonds** - the contractor may be able to give a "default" (or "on default") bond to the public authority. This type of bond is conditional on performance of the contract or payment of damages by the bondsman if the contractor defaults. This bond is a guarantee because the bondsman assumes a secondary obligation to pay if the contractor fails to perform. The amount of the bondsman's liability is proportional to the damages sustained by the employer. Another type of performance bond is an "unconditional on demand" bond: however, it is Government policy not to use these. "Maintenance" bonds are also available, which provide limited security for performance of the contractor's obligations during the defects liability period. These can be of use where there has been a performance bond which has expired on practical completion or the works comprise a specialist installation demanding a high level of care after practical completion.

<sup>6</sup> **Escrow** - Being in escrow is a contractual agreement in which a third party (the stakeholder or escrow agent) receives and disburses money or property for the primary transacting parties. The disbursement is dependent on conditions agreed to by the transacting parties.

<sup>7</sup> **Parent company guarantees** - This form of guarantee is given by a parent company (or holding company) to guarantee the proper performance of a contract by one of its subsidiaries (the contractor), and can only be given where the contractor is owned by a parent company or is the subsidiary of a larger group. Because the financial strength of the parent company may be linked to that of the contractor, a parent company guarantee will be acceptable only if the parent company (or holding company) is financially strong and its financial resources are largely independent of those of the contractor. Such a guarantee is free of cost to the client, but may give less certainty of redress than a bond because it is not supplied by an independent third party. However, whilst accepting less independence, parent company guarantees for the proper performance of the contract can be more advantageous than bonds. The conditions of a parent company guarantee will usually give the parent company the opportunity to remedy any default within a period of notice before the guarantee is called. Rather than the client receiving a fixed amount in compensation, the parent company is obliged to complete the contract. The way in which this is done can, to some extent, be at the discretion of the parent company. Costs for completion are borne by the parent company - and these costs may be significantly more than the compensation provided for in a bond.

b) Were these additional mechanisms used in addition to or as an alternative to retentions?

*Please select only one item*

- In addition to
- As an alternative to

c) Which of these do you think would be applicable for wider use across the whole sector?

*Please select all that apply*

- Retention bonds
- Performance bonds
- Escrow stakeholder accounts
- Parent company guarantees
- Retentions held in trust
- None of these
- Other (Please provide details)

d) Please explain the reasons for your answer to question 1c

2. Do you think it's important for Scotland to use the same mechanism of assurance in construction contracts as the rest of the UK?

*Please select only one item*

- I fully agree
- I partially agree
- I neither agree nor disagree
- I partially disagree
- I disagree

3. To what extent do you agree that a retention deposit scheme to protect retentions should be applied to the whole sector.

*Please select only one item*

- Fully agree
- Partially agree
- Neither agree nor disagree
- Slightly disagree
- Not at all

a) Please explain the reasons for your answer to question 3

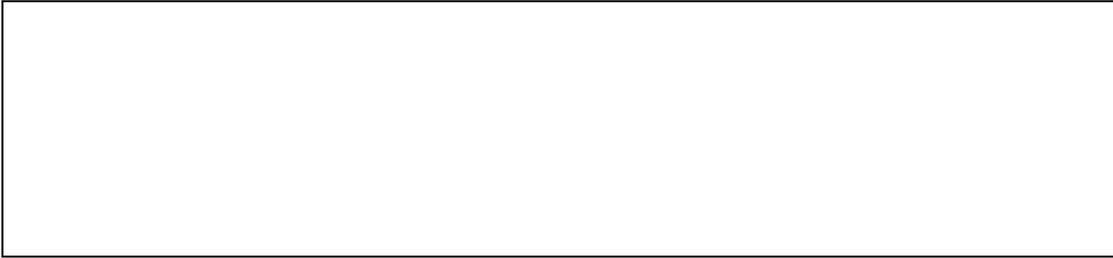
4. How strongly do you believe that a retention deposit scheme and/or holding retentions in trust could eliminate some of the critical issues associated with retentions (notably the risk of delayed or non-payment of retention monies) and provide surety against defects.

*Please select only one item*

- Fully agree
- Partially agree
- Neither agree nor disagree
- Slightly disagree
- Not at all

a) Please explain the reasons for your answer to question 4.

5. Do you have any further comments on alternative assurance mechanisms available to the construction sector?

A large, empty rectangular box with a thin black border, intended for the respondent to provide their comments on alternative assurance mechanisms for the construction sector.

## **Section E – Retention Deposit Scheme**

The potential of a Retention Deposit Scheme.

The practice of holding retentions is widespread in the construction sector but it can be associated with a number of negative impacts for contractors and the sector as a whole. In particular, the cascade system of payment in the industry, and the fact that an insolvency further up the supply chain can cause that cascade to stop, can make exposure to insolvency particularly acute to a participant further down the supply chain. This is particularly magnified by the practice of cash retention where the money can be held for extended periods after the project has been completed, coupled with being typically held in a main bank account rather than a separate account protected from the risk of insolvency.

The Pye Tait research explored the evidence for alternative mechanisms to retentions. The research concluded that the most likely alternatives to retentions are those which appear to be applicable to the whole of the sector, eliminate some of the potential difficulties associated with retentions (notably the risk of delayed or non-payment of retention monies) and still provide the insurance mechanism for the customer.

The research particularly noted that retention money held in trust in a separate, ring-fenced account until it is either used to rectify defects or becomes due for payment or in some form of retention deposit scheme would meet almost all of the serious criticisms of the current retention system.

The features and operation of a retention deposit scheme could be developed in a number of ways. For example, retention monies associated with practical completion and defects liability period could be paid into the scheme at each payment stage or just those retention monies associated with the defects liability could be paid in one lump sum at the start of the defects liability period. There may well be other design options.

In order to further minimise burdens, any measure to require the use of trust accounts for retention money needs to be simple, consistent and transparent, particularly if it is to benefit small firms in the construction supply chain. It is believed that a “retention deposit scheme”, similar to the “Tenancy Deposit Scheme”, represents the best way of achieving this.

This consultation seeks to explore the design, costs and benefits of introducing a “retention deposit scheme” for the retention money.

## A Retention Deposit Scheme

It is envisaged that the requirement to hold retentions in a “retention deposit scheme” would have the following features:

- the scheme should be set up on a statutory footing;
- the market will deliver private provision of any retention deposit scheme(s);
- businesses holding retentions under construction contracts (as defined by Part 2 of the Housing Grants, Construction and Regeneration Act 1996) will be required to deposit retentions in the scheme;
- the scheme can only hold retention money (plus any related interest);
- the money will be held in trust;
- where the contract makes no such provision, the Scheme for Construction Contracts will imply relevant terms requiring retention money to be held in a deposit scheme;
- scheme operators would be required to report on an annual basis on their performance; and
- any disputes about the operation, amount and timing of the release of retentions payments will be dealt with by existing dispute resolution processes.

## Operation

It is envisaged that organisations withholding retention payments will be required to register with a Retention Deposit Scheme as an account holder and to:

- register specific contracts and the relevant information (such as start and end dates, payment schedule and retentions terms);
- notify the scheme of the timing, amount and allocation of retention money which is being deposited;
- notify the scheme if any changes are made to the timings and payment due, and why; and
- the scheme operator to pay the retention on the retention release dates.

The following questions consider the features and operation of a retention deposit scheme. Questions also seek information to help quantify the potential costs of operating such a scheme.

**Questions:**

1. Do you think a retention deposit scheme could be used for all contracts or only for contracts over a certain value?

*Please select only one item*

- For all contracts
  - Only for contracts over a certain value
  - It should not be used at all
- a) Is it important to place a threshold on the application of any measure requiring retentions to be held in trust or ring-fenced in another way and, if so, at what minimum value of the total retained money (the retention) should it commence?

*Please select only one item*

- Yes
- No

If you answered yes at what minimum value would the requirement for retentions to be held in trust or ring-fenced be inappropriate?

*Please select only one item*

- Less than £100,000
- Between £100,000 and £500,000
- Between £500,0001 and £1,000,000
- Other

2. To what extent do you think a retention deposit scheme may allow for a fairer approach to retentions? The Pye Tait research recommended that a fairer, more neutral and more protected approach to retentions is required. A retention deposit scheme may represent the best way of achieving this. Do you agree?

*Please select only one item*

- Fully agree
- Partially agree
- Neither agree nor disagree
- Not particularly
- Not at all

Can you tell us why you answered this way?

a) To what extent do you believe a retention deposit scheme allows for a more neutral approach to retentions?

*Please select only one item*

- Fully agree
- Partially agree
- Neither agree nor disagree
- Not particularly
- Not at all

Can you tell us why you answered this way?

b) To what extent do you think a retention deposit scheme may allow for a more protected approach to retentions?

*Please select only one item*

- Fully agree
- Partially agree
- Neither agree nor disagree
- Not particularly
- Not at all

Can you tell us why you answered this way?

3. Which of the features listed below do you believe should be included within a potential future retention deposit scheme?

*Please select all that apply*

- The scheme should be set up on a statutory footing.
- The market will deliver private provision of any retention deposit scheme.
- Businesses holding retentions under construction contracts (as defined by Part 2 of the Housing Grants, Construction and Regeneration Act 1996) will be required to deposit retentions into the scheme.
- The scheme can only hold retention money (plus any related interest).
- The money will be held in trust for the payee.
- Where the contract makes no such provision, the Scheme for Construction Contracts will imply relevant terms requiring retention money to be held in a deposit scheme.
- Scheme operators would be required to report on an annual basis on their performance.
- Any disputes about the operation, amount and timing of the release of retention payments will be dealt with by existing dispute resolution processes.

a) Are there any additional features to the operation of a “retention deposit scheme” that you would recommend?

4. Were you to have retentions held from you, what cost per contract (as a percentage) would you be willing to incur if it meant that your retention was held in trust in a retention deposit scheme? The administrative costs of a Retention Deposit Scheme could be significant.

*Please select only one item*

- Below 1% of the contract value
- Between 1% to 3% of contract value
- Over 3% but under 5% of contract value
- Above 5% of contract value

a) Is the price you would be willing to pay for a retention deposit scheme dependent on contract value?

*Please select only one item*

- Yes
- No

If you answered yes above, what would be the maximum price you would pay (£'s) for a retention deposit scheme, per contract?

b) If you currently hold retentions, what cost would you be willing to pay (per contract) for the administration of a retention deposit scheme?

*Please select only one item*

- Below 1% of the contract value
- Between 1% to 3% of contract value
- Over 3% but under 5% of contract value
- Above 5% of contract value
- Depends on contract value

## Evaluation

Please help us improve our consultations by answering the questions below.  
(Responses to the evaluation will not be published.)

Very dissatisfied	Slightly dissatisfied	Neither satisfied nor dissatisfied	Slightly satisfied	Very satisfied
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How  
satisfied  
were you  
with this  
consultation?

*Please  
select only  
one item*

Please enter comments here



**Title: The Practice Of Cash Retention Under Construction Contracts**

**RESPONDENT INFORMATION FORM**

**Please Note** this form **must** be completed and returned with your response.

To find out how we handle your personal data, please see our privacy policy:  
<https://beta.gov.scot/privacy/>

Are you responding as an individual or an organisation?

Individual

Organisation

Full name or organisation's name

Phone number

Address

Postcode

Email

The Scottish Government would like your permission to publish your consultation response. Please indicate your publishing preference:

Publish response with name

Publish response only (without name)

Do not publish response

**Information for organisations:**

The option 'Publish response only (without name)' is available for individual respondents only. If this option is selected, the organisation name will still be published.

If you choose the option 'Do not publish response', your organisation name may still be listed as having responded to the consultation in, for example, the analysis report.

We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again

in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

Yes

No



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