The City of London Law Society

RESPONSE OF THE CITY OF LONDON LAW SOCIETY CONSTRUCTION LAW COMMITTEE TO THE DEPARTMENT FOR BUSINESS, ENERGY & INDUSTRIAL STRATEGY'S CONSULTATION ON THE PRACTICE OF CASH RETENTION UNDER CONSTRUCTION CONTRACTS

A. INTRODUCTION

1. This Response is presented to the Construction Unit of the Department of Business, Energy & Industrial Strategy (BEIS) by the Construction Law Committee ("CLC") of the City of London Law Society (CLLS) as its response to BEIS' consultation on the practice of holding cash retentions under construction contracts which opened on 24 October 2017.[1, 2] Alongside the Consultation, BEIS published a research report[3] and Consultation Stage Impact Assessment dated 7 September 2017.[4] The Consultation closes on 19 January 2018.

2. BEIS described the purpose of the Consultation as follows:

   "…to seek information on the practice of cash retention under construction contracts and gather views on the findings of the supporting documentation.

   The consultation is relevant to any party to a commercial construction contract as defined by the [Housing Grants, Construction and Regeneration Act 1996[5]]. It is also relevant to adjudicators, arbitrators and lawyers. While this consultation concerns construction specific legislation it may also be relevant for those with an interest in prompt payment more generally and to insolvency practitioners. The legislation does not apply to residential occupiers.[6]*"*

3. The Consultation comprises six sections, named from A to F:

   A) Existing measures: the effectiveness of existing prompt and fair payment measures for retentions;

   B) Supporting documentation: the Research Report and the Impact Assessment;

   C) Late and non-payment of retentions: measuring the incidence of unjustified late and non-payment of retention monies;

   D) Retention "Caps": the appropriateness of a "cap" on the proportion of contract value that can be held, and the length of time it can be held;

[1] *"Retention Payments in the Construction Industry: A consultation on the practice of cash retention under construction contracts"* dated 24 October 2017. This is referred to in this Response as the "Consultation".

[2] This Response has been sent by email to BEIS at constructionpayment.consultation@beis.gov.uk.

[3] *"Retentions in the Construction Industry"* (BEIS Research Paper 17) dated October 2017 prepared for BEIS by Pye Tait Consulting. This is referred to in this Response as the "Research Report".

[4] This is referred to in this Response as the Impact Assessment.

[5] The Housing Grants, Construction and Regeneration Act 1996 is amended by the Local Democracy, Economic Development and Construction Act 2011 and this amended legislation is referred to in this Response as the "Construction Act".

[6] The final sentence corresponds to the exclusion of residential occupiers under Section 106 of the Construction Act. It is indicated in the Consultation that, should the United Kingdom Government feel it appropriate that retention monies for construction contracts in England, Wales and Scotland to become regulated, then the new measures would be incorporated into the Construction Act through amendments. Regardless of the reasons, there is logic to having such consistency as it will greatly aid parties in understanding whether their contract is likely to be caught by any such legislation affecting retention monies. However, whether or not residential occupiers should be treated contrarily to others with regard to monetary retentions (as they currently are for matters governed by the Construction Act) is a different matter and is discussed in our response to Question 4.

E) Existing alternative mechanisms to retentions: the effectiveness of existing alternative mechanisms to retentions; and

F) Retention deposit schemes: the scope, operation, features and potential costs of holding retentions in a retention deposit scheme.

4. The persons responsible for preparing this Response are:

   a. Francis Ho (Partner, Penningtons Manches LLP), member of the CLC;

   b. John Hughes-D'Aeth (Partner, Berwin Leighton Paisner LLP), Chair and member of the CLC;

   c. Martin Potter (Group Legal Counsel and Head of Construction Legal Services, Canary Wharf Group), CLC Industry Representative; and

   d. Drew Norman (Solicitor, Sir Robert McAlpine Limited) and his colleague, Philip Vickers (Solicitor).

5. The CLC would be happy to discuss any aspect of this Response with BEIS, if required.[7] If so, please contact our Chair, John Hughes-D'Aeth, or our CLLS Main Committee Liaison, Marc Hanson, both of Berwin Leighton Paisner LLP.

B. ABOUT THE CLLS AND THE CLC

6. The CLLS was originally part of the City of London Solicitors' Company, which was founded in 1908. It is the largest of England and Wales' regional law societies; 15% of the practising solicitors in England and Wales (17,000 solicitors) are based in the City of London and the CLLS represents 15,000 of them. Its members represent some of the world's largest international law firms and the Committee acts as a forum for lawyers in the Square Mile to meet and consider topical areas of law relating to the construction industry. All areas of construction law are catered for, including litigation, drafting, PFI/PPP work and international and domestic projects work.

7. Committee members comprise many leading practitioners from private practice. The CLC also regularly includes associate members, such as leading in-house construction lawyers from major contractors and consultants or insurance advisers, to represent the construction industry ("Industry Representatives"). The Committee has been active in particular in responding to governmental consultations including, most recently, those on the draft Business Contract Terms (Assignment of Receivables) Regulations and the 2011 changes to Part II of the Construction Act (the latter of which runs concurrent to the Consultation).

[7] The CLC comprises John Hughes-D'Aeth (Berwin Leighton Paisner LLP, Chair), Matthew Jones (Taylor Wessing LLP, Vice-Chair), Peter Brinley-Codd (Sir Robert McAlpine Limited, Industry Representative), Stephanie Canham (Trowers & Hamlins LLP), Richard Ceeney (Reed Smith LLP), Julia Court (Addleshaw Goddard LLP), Paul Cowan (4 New Square), Angus Dawson (Macfarlanes LLP), Nicholas Downing (Herbert Smith Freehills LLP), Fiona Edmond (Charles Russell Speechlys LLP), Marc Hanson (Berwin Leighton Paisner LLP, CLLS Main Committee Liaison), Richard Hill (Norton Rose Fulbright LLP), Francis Ho (Penningtons Manches LLP), Rob Horne (Osborne Clarke LLP), Jane Jenkins (Freshfields Bruckhaus Deringer LLP), Alistair McGrigor (CMS Cameron McKenna Nabarro Olswang LLP), David Metzger (Clifford Chance LLP), Huw Morgan (Veale Wasbrough Vizards LLP), Victoria Peckett (CMS Cameron McKenna Nabarro Olswang LLP), Martin Potter (Canary Wharf Group, Industry Representative), James Pratt (Ove Arup & Partners Limited, Industry Representative), Timothy Reid (Ashurst LLP), John Scriven (Allen & Overy LLP), Gillian Thomas (Hogan Lovells International LLP) and Andrew Thornton (JLT Group, Industry Representative).

8. The CLC's current Chair is John Hughes-D'Aeth. Importantly, our members represent developers (in both the private and public sectors), lenders, contractors, professional consultancies, specialists and insurers. The intent of this submission is therefore to expound a market-facing approach rather than to focus narrowly on the perspective of any single faction of the UK construction market.

9. Given the composition of the CLLS and the CLC's respective memberships, it has not been appropriate for the CLC to respond to a number of the questions posed by the Consultation. These largely affect questions which assume that the respondent is itself commonly a party to construction contracts. Where we have not been able to provide a suitable response, this is indicated in our reply.

10. In preparing this response, it is not our intention to influence the Consultation on behalf of particular clients or any particular part of the construction industry. Our intention instead is to reflect on the Consultation with the benefit of our collective experience in this area.

C. REPLIES TO CONSULTATION QUESTIONS FROM THE CLC

11. **Section A) Existing measures**

Consultation Question	
1a.	*To what extent do existing prompt and fair payment measures, such as the Construction Supply Chain Payment charter, Project Bank Accounts and the Public Contracts Regulations, help to address the specific challenges with retentions?*
CLC Response	
1a.	All of these three measures help curb abuse through the unjustified late release of retentions. By reducing late payment, they also mitigate the risk of an upstream insolvency depriving those in the supply chain their receipt of retention monies. A Project Bank Account (PBA) which is ring-fenced and has its funds held in trust, would further reduce the adverse impact on the supply chain arising from such insolvency. However, against this, the following factors should be considered: • Only a small proportion of construction contracts use the Construction Supply Chain Payment Charter (and/or the Prompt Payment Code) and/or PBAs and both measures remain voluntary in both the public and private sectors; • While mandatory for public contracts above the required thresholds, the Public Contracts Regulations do not catch private sector contracts or public-sector bodies exempted from Regulation 113 of the Regulations for England and Wales and Northern Ireland; • Administrative cost and time are necessary to implement the Charter and PBAs. PBAs may have other disadvantages, too, such as tying up funds that could be used elsewhere in the construction client's business, particularly if Government guidance is followed suggesting that the full amount of the contract price is held in the ring-fenced account – using a PBA to hold each

	interim payment instalment would be more palatable to clients and their funders; • With regard to the PBA, primary responsibility falls on the construction client. Rather than making it a cost to the client, BEIS might wish to consider how clients can be positively incentivised to use PBAs. These factors are discussed in more detail in our response to Question 1b below.

Consultation Question	
1b.	*Please explain the reasons for your answer to question 1a.*
CLC Response	
1b.	A consistent theme with the Construction Supply Chain Payment Charter and PBAs is that each involves a learning curve and, depending on the organisation involved, the need to change internal processes which requires time and cost. In many respects, larger organisations are more likely to have the resources in place to cope with this, particularly in relation to higher value construction projects. The CLC would be interested to understand how BEIS intends for the SMEs (small and medium-sized enterprises) that make up the vast majority of the UK's construction industry to benefit from these initiatives. For example, is the intention that the influence enjoyed by larger players will have a knock-on effect for the rest of the industry or that, as these ideas gain traction, they would be increasingly adopted by others? **The Construction Supply Chain Payment Charter** The voluntary Construction Supply Chain Payment Charter published by the Construction Leadership Council[8] and jointly promoted by Build UK covers a range of payment matters. In respect of retention, it includes the following specific commitment for its signatories: *"We will either not withhold cash retention or ensure that any arrangements for retention with our supply chain are no more onerous than those implemented by the client in the Tier 1 contract. Our ambition is to move to zero retentions by 2025."* The Charter should hence reduce the abuse of unnecessarily high retentions by its signatories (for instance, preventing its signatories from imposing higher levels of retention downstream to those required of them). However, implicit in the above commitment is the fact signatories are required to see that their supply chains comply with the same commitment, which is ideally enforced through imposing contractual commitments on those they contract with for their construction project. Despite this, the Charter has had a limited influence. At the date of writing, the Charter has only 40 signatories,[9] a drop in the ocean in the UK's large construction

[8] The Construction Leadership Council is jointly chaired by the Secretary of State for Business, Energy & Industrial Strategy and an industry representative, currently Andrew Wolstenholme OBE.
[9] According to the Chartered Institute of Credit Management.

industry.[10] Secondly, it is unclear whether the second part of the first sentence quoted above binds construction clients, of which only two major clients have thus far signed up (one of these, Crossrail Limited, has pledged to hold zero retention for its "main civils contracts" but will seek a 2.5% retention bond in lieu[11]). Furthermore, it is unclear what monitoring is being carried out to verify that signatories' supply chains are honouring any reciprocal commitments imposed on them under contract. With regard to the phrase "zero retentions", it is uncertain whether this means simply no cash retentions at all or whether an equivalent form of security to cash (such as on demand retention bonds) would still be permitted. The implication is that it would be but it should be noted that on demand retention bonds and other forms of security to replace retention monies can have their own problems.

Aside perhaps from damage to reputation and breach of any relevant contractual provisions, there are no sanctions for breaching the Charter.[12]

Project Bank Accounts

While the issue of retention is not mentioned as a separate issue in the UK Government's guidance regarding PBAs, the core principles of a PBA in such guidance are that all monies payable to the supply chain on a construction project are ring-fenced and held in trust and when payments are made, they are made to the supply chain simultaneously. This should eliminate the risk of retentions being lost to sub-contractors or suppliers due to an insolvency up the supply chain and should reduce the practice of retention payments being unscrupulously delayed. In practice, however, PBAs often tend to be used to disburse interim payments as they fall due into the ring-fenced account. The manner in which PBAs deal with retention does vary. Given that they are primarily found in the public sector and clients in this field often do not require retention, it is usually a non-issue.

As with the Charter, PBAs have had limited adoption in the construction industry. Moreover, putting in place a project bank account is a task for which the burden and cost falls heavily on the construction client and which would need to be undertaken for each separate project.[13] The other factor to consider is how much of the construction cost should be placed in the PBA. While the guidance suggests this is the full amount, this may be onerous on the construction client, which may wish to use some of the monies in other parts of its business or in relation to receivables finance and, as mentioned, even public-sector clients rarely put the full contract price into the PBA. Banks providing development finance (or forward purchasers/forward funders), on which a good proportion of large and medium-sized projects are dependent, also prefer to release funding for a construction project in instalments as needed. Releasing a larger amount early on could mean the borrower bearing higher interest payments.

[10] The Office for National Statistics' Construction Statistics Annual Table for the third quarter of 2016 (published on 2 October 2017) indicates the UK has 296,093 construction businesses.

[11] As stated in Crossrail's Procurement Department's Procurement Policy with reference CR/QMS/PROC/POL/1101.

[12] Presumably, there could also be the ignominy of being removed from the public list of signatories.

[13] The Government guidance suggests that the costs can be offset by interest generated on the monies in the account. However, this may be impacted by interest rates at the relevant times – currently the Bank of England base rate is just 0.5%. More critically, this ignores the fact that the money could potentially be used by the client to generate a higher return had it not been placed into the PBA in the first place.

	Under the Charter, there is a commitment on signatories to use PBAs on central Government contracts where specified by the client.[14] In an escrow account arrangement (which can sometimes be found between a construction client and a Tier 1 contractor and is not to be confused with a PBA), it would be more realistic either for the amount to be, assuming this is a relatively high value contract of reasonably substantial duration, two months' cashflow for the project (which would be topped up as needed) or even limited to each single payment due from the client at each stage. **Public Contracts Regulations** Unlike the Charter or PBAs, the Regulations are mandatory for any construction contracts caught by its provisions. There is substantial overlap between the Regulations and the Charter, the latter being aimed primarily at the private sector. The Regulations, however, include no commitments on the percentage or amount of retention that may be stipulated to be withheld under a construction contract. Although the Regulations are primarily designed to achieve fairness between tenderers, the UK Government added Regulation 113 to impose fair payment requirements on all public contracts (including for undisputed invoices to be paid within 30 days by the contracting authority and its supply chain) and require details of compliance to be published each financial year.[15] The Regulations do not specifically address retention but Regulation 113 should help to ensure that any retention due to be released is passed on without delay. A difficulty with expecting the Regulations to anchor good industry practice is that, in reality, those in the construction industry whose businesses are significantly involved in private sector work are likely to operate differently on such projects.

Consultation Question	
2a.	*Are there any challenges that these do not address.*
CLC Response	
2a.	Unusually, while the Research Report and the Impact Assessment correctly identify that parties from whom retention monies are being withheld take insolvency risk in relation to the person holding the monies, they do not mention that the retention monies also provide such person with a measure of protection against the insolvency of its contractor(s). Consequently, retention monies are not simply *"insurance against defects"*, as asserted in paragraph 11 of the Impact Assessment, for many clients they represent security against general non-performance (including for losses arising from non-completion by a contractor due to its insolvency).

[14] This commitment is somewhat superfluous since one would expect it to be a condition of the relevant tender and/or contract for the successful bidder to use a PBA in any event.

[15] Contracts for health services under the NHS Regulations or those awarded by a maintained school or Academy are excluded from the scope of Regulation 113. There is no equivalent to Regulation 113 in the equivalent Regulations which apply to Scotland.

	As mentioned above, we would add that that there are some questions marks over the issue of what "zero retentions" under the Charter is intended to mean. If the result is that parties stipulate that on demand bonds are required instead, then that simply replaces retention monies with a product with different advantages and disadvantages. Furthermore, if the Government is to consider imposing a ban or other restriction on the holding of retention monies, then some thought may need to be given to what (if any) anti-avoidance measures should be used. For example, to minimise the heightened risk of contractor insolvency as a result of no retention monies being withheld, a construction client might require contractors to provide a higher than market level of performance bond (in the commercial UK market, such a bond is often 10% of the expected contract price). If so, the question may be whether the client expects to pick up the cost of the enhanced level of performance bond itself or pass this cost on to its contractor. It is already noted in the Research Report, for example, that a reason for sub-contractors not pursuing claims for unpaid retention monies is due to a wish to preserve their relationship with their employer. If some sub-contractors choose not to enforce subsisting rights under contract (or under the Construction Act), how is a change in law going to improve this? Assumed within this is that there is some form of quid pro quo – that the sub-contractors must gain sufficiently in another way from declining to enforce their rights – otherwise this would simply be poor and unsustainable business practice. The Research Report does not discuss contractual provisions that are often used alongside retention monies provisions by repeat and experienced construction clients. A primary driver for retention monies is to require the contractor to remedy defects not simply within the defects rectification period but as soon as reasonably practicable (or promptly in the event of a defect which substantially undermines the occupier's ability to trade). Hence, such clients may include a provision stating that if the contractor does not rectify a notified defect within such timescale, the client may instruct another contractor to do so and deduct the cost of doing from the retention. Although this may appear to be a provision that benefits the client solely, by being able to instruct another contractor, the client may be able to mitigate its losses from the defect which would correspondingly reduce any client loss that the contractor is liable for to the extent the defect arose from its breach of contract. Here, the provisions work to ensure that the client can address defects quickly and hence avoid accruing substantial losses from their consequences.

Consultation Question	
2b.	*Please explain the reasons for your answer to question 2a.*
CLC Response	
2b.	See our response to Question 4 below.

12. **Section B) Existing measures**

Consultation Question

3a.	*Do you agree with the findings and conclusions drawn from the Pye Tait research?*
CLC Response	
3a.	Broadly so but not entirely.

Consultation Question	
3b.	*Please explain the reasons for your answer to question 3a.*
CLC Response	
3b.	One of the assertions which surprised us is the comment that retentions are typically at 5% of the contract price. This seems to us to be an over-generalisation. While 5% is more common for lower value contracts (in order to make sure that the level of retention is sufficient to encourage a contractor to deal with defects during the rectification period), we usually see 3% for higher value construction contracts. The difference between the two percentages is substantial, particularly because the lower level tends to cover contracts with higher values, and could affect the cost-benefit analysis of the Government taking action to regulate retentions. In this vein, it would have been interesting to see a fuller comparison of responses to the Pye Tait's surveys based on the turnover of the respondent and whether they are a Tier 1, 2, 3 or 4 contractor or other participant in the construction industry. There are potential deficiencies where certain survey responses are grouped together without clarifying these distinctions since the experiences of Tier 1 contractors will differ from those of Tier 4 contractors. Furthermore, it would be helpful to understand whether Pye Tait's research indicated disparities in overall retention percentages between different tiers of contractors. See also our response to Question 4 below.

Consultation Question	
4.	*Do you have any further comments on the Pye Tait research?*
CLC Response	
4.	We note that all of the research was undertaken prior to the UK's European Union Referendum on 23 June 2016. BEIS may wish to give regard to two considerations, as a consequence. Firstly, given the continuing uncertainty over Brexit, which has the potential to cause substantial disruption to an industry dependent on EU workers and goods and materials sourced from the rest of the EU and where some areas of construction demand have been impacted by the possible loss of EU passporting rights (such as a slowdown in requirements for new prime office space in the City of London), there may be merit in BEIS undertaking further consultation (perhaps once the composition of the EU withdrawal treaty is clearer) before any legislative measures are considered to

	address retention monies.[16] In the meantime, there is a danger that any unintended consequences of new construction legislation may cause further consequences where longer-term confidence is currently fragile not necessarily due to Brexit but possibly as part of the natural economic cycle and the fall in the value of sterling against the euro following the EU Referendum result. The flipside of this argument is that this risks delaying reforms that BEIS may conclude are necessary following the Consultation. It is, of course, unclear what the impact of Brexit will be on the industry and it could be said that dips and slowdowns in the construction industry are as inevitable as the peaks are. There is also the potential to adopt a halfway-house on reform, for example, by including changes similar to New Zealand's recently-implemented changes, with the prospect of more substantial change taking place after Brexit. However, potentially having two sets of changes may also be disruptive – there would, at least, need to be several years' gap between them. The CLC is unable to comment on Pye Tait's estimate of total monies held in retention in the English construction industry in any given year. A recurrent theme of the Research Report is that there appears to be a weak understanding of the 2011 changes to the Construction Act amongst some Tier 2 and Tier 3 participants in the research, which may indicate a wider trend. The Government should consider how the wider industry can gain a better understanding of the payment protections built in to the amended Construction Act, possibly by making use of the educational support offered in conjunction with the Construction Industry Training Board's Apprenticeships. Understandably, the Impact Assessment states that some research respondents considered the legal costs of recovering retention to be disproportionately high. To mitigate this and prevent employers from abusing this situation, BEIS could consider whether the Construction Act could be amended so that the adjudicator always has the power to award costs where the referral is for unpaid retention monies – at present the Construction Act is silent on the issue of costs. We note that the Consultation is considering changes to the dispute resolution process as part of its current and parallel review of the 2011 amendments to the Construction Act. We appreciate, however, the possibility that this approach could lead to attempted abuse by Referring Parties. There may be a temptation for a Referring Party to shoehorn in to any dispute the issue of retention in an effort to benefit from any provision empowering the Adjudicator to award costs in circumstances where the adjudication includes a claim for unpaid retention monies; one way to avoid this would be to have this apply only to "retention-only" adjudications. Otherwise, it may be difficult for the Adjudicator to determine which costs are purely related to addressing the issue of retention. The Impact Assessment states that because a different dynamic exists for business-to-consumer relationships, no action is being considered in relation to owner-occupiers carrying out works to their own homes. In our view, this is largely correct but, if action is taken in relation to commercial contracts, it may also make sense to

[16] Indeed, given that a substantial amount of Parliamentary time is presently being consumed by Brexit, it may be some time before any capacity to consider fresh legislation is available.

	cap both the amount of retention that could be held by owner-occupiers as well as the duration for which the retention can be withheld following practical completion[17], particularly since, for high value construction contracts in such realm, the potential for pressure to be put on contractors (who would not have the right to adjudicate under the Construction Act) if retentions are not paid on time would be equally pertinent as it would be for a commercial contract. One factor the Research Report does not appear to have considered is that, with development finance (which underpins a good proportion of higher value construction projects), the construction client (as borrower) usually does not draw down loan amounts to pay for construction costs which are not yet due to be paid. If it did, the lender would require it to pay interest on such sums and it would increase the lender's risk exposure. Since no retention is due to be paid usually until practical completion at the earliest, the first drawdown to release retention monies would occur at such time. A lender would also be concerned about diminished security due to an earlier drawdown of the loan amount for either the money to be placed in a retention deposit scheme or otherwise in trust; without this requirement the monies would, of course, not be loan monies and would hence the lender could be sure from its own perspective that they are safe from the borrower's insolvency. Another issue is that retention is not deducted at point but at multiple points during the construction period. It is common for a contractor on a major project to invoice monthly (the Construction Act requires stage or interim payments for all but a small proportion of construction contracts) and a retention is withheld from each related payment. This would require multiple deposits to be made into the retention deposit scheme, which would be administratively gruelling and expensive. The Research Report refers to research being carried out with three round table discussions, two surveys and 50 in-depth telephone interviews. The round table discussions involved 32 industry stakeholders in England, including a mix of clients, main and sub-contractors and trade federations/professional bodies. It would be interesting to understand whether any industry associations were chosen to represent construction clients and interested third parties, such as development funders – in the case of the former, examples would be the British Property Federation, the British Council for Offices, the British Retail Consortium, the City Property Association, the Westminster Property Association and the Local Government Association. These groups can often be under-represented in such consultations.[18] It is useful for both sides of the fence to be adequately represented so that outliers can be more easily identified. The issue of deductions or withholdings from monies payable under construction contracts is a complex area. A supplier may feel that retention monies have been unjustifiably withheld or unpaid; the payer, on the other hand, may feel its reasons are sound. The research found that the average amount lost per contractor due to non-payment arising from insolvency is £10,000 over three years. Note that this is all lost

[17] Notwithstanding this, there should be some consistency between any requirements imposed on consumers and those on commercial organisations, even if the requirements imposed on consumers are necessarily less onerous.

[18] Although this should not have impacted on the research's overall conclusions, it is noted that all the research took place with persons based in England even though the Construction Act also covers Wales and Scotland and equivalent legislation is in place for Northern Ireland.

	payments, not just those relating to the loss of retention monies. If this is correct, careful thought needs to be given to the cost-benefit analysis of significant legislation being brought in to regulate retentions. Other conclusions from the Research Report are disputable. For example, the assumptions relating to the full economic assessment presumably including management time. If so, the estimates look rather low to us. One such instance (and the Research Report admits it has incomplete evidence) is that the cost to the contract writing bodies of any changes to the law on retention monies is £0.04m. This estimate is far too low. Many of those who write or contribute to the drafting of standard form contracts are senior in the construction or legal profession and donate their time (which is usually extensive) for free. Notwithstanding this, there must be a "value" attributable to their time. A point we believe should be carefully considered by BEIS is that construction clients may also feel that the imposition of a mandatory statutory retention deposit scheme is an over-reaction. The Pye Tait research indicates that non or late payment of retention monies is a much more significant problem for contractors in Tiers 2 and 3 than it is for Tier 1 contractors. Perhaps it is for this reason that the nascent scheme in New South Wales only covers contractors between Tier 1 and Tier 2 contractors and between Tier 2 and 3 contractors (and even then only for higher value contracts). BEIS seems to be advocating broad measures for the entire market despite the fact the evidence appears to point to SMEs being disproportionately affected by the issue. This is not to underestimate what is clearly an issue with some parts of the market but BEIS may feel that a segmented approach to retention monies might be more appropriate in light of such findings. As mentioned elsewhere in this response, construction clients are, in addition, often constrained by the requirements of the banks or other businesses providing them with development finance. In our view, it would be advisable for development lenders to comment on any proposals for a statutory retention monies deposit scheme that could catch projects requiring debt finance. It would be helpful to understand the relationship between trade credit and retention monies. Although it is logical that the delay in receiving payment may require greater or longer trade credit to be obtained, exactly how much of this is influenced by retention monies? The Pye Tait research refers to a number of cases and we understand that it is sensible and necessary for Pye Tait to consider all information available including these cases. As the Research Report acknowledges, only a small proportion of retention cases have gone to court. Other cases may have gone to adjudication or arbitration but because these are private procedures, these disputes will generally not be public knowledge (except to the extent they are subject to legal proceedings). Given the paucity of cases and the large number of contracts for which retentions are withheld and which have not gone to court, we would caution – as we assume BEIS have done – that undue weight is not given to these cases.

Consultation Question	
5a.	*Do you think this estimate is reasonable?*

CLC Response	
5a.	As stated in our response to Question 3b, we would query whether it is appropriate to apply a 4.85% retention basis throughout (as Pye Tait have done) and whether a lower percentage (e.g. 4%) would be more accurate given the number of higher value construction contracts that our members see which put retention at 3%.

Consultation Question	
5b.	*If no, please explain the reasons for your answer to question 5a.*
CLC Response	
5b.	See above.

Consultation Question	
6a.	*Do you agree that this is a suitable methodology for estimating the total amount held in retentions across the sector over the course of a year?*
CLC Response	
6a.	We are unable to comment.

Consultation Question	
6b.	*If no, please explain the reasons for your answer to question 6a. If you think that an alternative methodology is needed, please provide details and supporting evidence.*
CLC Response	
6b.	Not applicable.

Consultation Question	
7a.	*Do you agree that, as retentions are a proportion of contract value, sector turnover is a more appropriate basis for estimating the total amount held in retentions over the course of a given year than sector output?*
CLC Response	
7a.	We are unable to comment but, ideally, it would have been helpful to have an understanding of each survey respondent's typical contract value to add further accuracy.

Consultation Question	
7b.	*If no, please explain the reasons for your answer to question 7a. If you think that an alternative methodology is needed, please provide details and supporting evidence.*
CLC Response	
7b.	See above.

Consultation Question	
8a.	*Do you think that the assumptions made for this methodology look reasonable?*
CLC Response	
8a.	We have no further comments on this.

Consultation Question	
8b.	*If no, please explain the reasons for your answer to question 8a. If you think that alternative assumptions are needed, please provide details and supporting evidence.*
CLC Response	
8b.	Not applicable.

Consultation Question	
9a.	*Do you think that the assumptions made for this sensitivity are reasonable?*
CLC Response	
9a.	We are unable to comment.

Consultation Question	
9b.	*If no, please explain the reasons for your answer to question 9a. If you think that alternative assumptions are needed, please provide details and supporting evidence.*
CLC Response	
9b.	Not applicable.

Consultation Question	
10a.	*Do you think this estimate is reasonable?*
CLC Response	
10a.	We are unable to comment.

Consultation Question	
10b.	*If no, please explain the reasons for your answer to question 10a.*
CLC Response	
10b.	Not applicable.

Consultation Question	
11a.	*Do you agree that this is a suitable methodology for estimating the total amount of retention monies not paid over the course of a year due to upstream insolvencies?*
CLC Response	
11a.	We are unable to comment.

Consultation Question	
11b.	*If no, please explain the reasons for your answer to question 11a. If you think that an alternative methodology is needed, please provide details and supporting evidence.*
CLC Response	
11b.	Not applicable.

Consultation Question	
12a.	*Do you think that the assumptions made for this methodology look reasonable?*
CLC Response	
12a.	We are unable to comment.

Consultation Question

12b.	*If no, please explain the reasons for your answer to question 12a. If you think that alternative assumptions are needed, please provide details and supporting evidence.*
CLC Response	
12b.	Not applicable.

Consultation Question	
13a.	*Do you agree that this is a suitable methodology for estimating the total amount that construction clients and contractors holding retentions would need to fund from elsewhere, in order to maintain current levels of expenditure?*
CLC Response	
13a.	We are unable to comment.

Consultation Question	
13b.	*If not, please explain the reasons for your answer to question 13a. If you think that an alternative methodology is needed, please provide details and supporting evidence.*
CLC Response	
13b.	Not applicable.

Consultation Question	
14a.	*Do you think that the assumptions made for this methodology look reasonable?*
CLC Response	
14a.	We are unable to comment.

Consultation Question	
14b.	*If no, please explain the reasons for your answer to question 14a. If you think that alternative assumptions are needed, please provide details and supporting evidence.*
CLC Response	
14b	Not applicable.

Consultation Question	
15a.	*Over the last year did you make any use of the retentions monies you held (for example, as part of general expenditure, working capital, or to support investment)?*
CLC Response	
15a.	Since the CLLS is not a construction client, we are not able to respond to this question on our own part. However, we would observe that the construction clients, contractors, consultants and suppliers that the CLC members provide legal advice to often propose to use retention monies for other purposes.

Consultation Question	
15b.	*If yes, approximately what proportion of the total value of retentions held by you did you make use of last year?*
CLC Response	
15b.	Since the CLLS is not a construction client, we are not able to respond to this question.

Consultation Question	
16.	*Do you have any further comments on the Construction Stage Impact Assessment analysis?*
CLC Response	
16.	No.

13. **Late and non-payment of retentions**

Consultation Question	
17.	*What was your annual turnover last year?*
CLC Response	
17.	The CLLS is not itself a participant in the construction industry (it is a regional law society) so this question is not relevant.

Consultation Question	
18a.	*Do you think that non-payment of retentions due to the company holding the*

	retention becoming insolvent before the retention is paid is a significant issue in the construction sector?
CLC Response	
18a.	Clearly, in such circumstances, the loss of the retention monies will prejudice the company involved. There can be difficulties caused in circumstances where the contracting parties have indeed given some thought to this possible scenario (by agreeing to terms requiring that retention is placed in a trust) but that trust is never established. As a result the trust is not effective and the retention monies are effectively available to any administrator or liquidator appointed to the insolvent company as part of the assets for distribution. This is one of the weaknesses of the regime implemented in New Zealand and can be a significant issue for parties adversely affected. It might be helpful if, as part of any legislation addressing retention, it is provided that where the circumstances show that the parties to construction contract clearly intend that the retention be held as trust monies, an implied trust will exist even though there are no written terms to that effect (i.e. mirroring the Court of Appeal of Malaysia's approach in *Qimonda Malaysia v Sediabena* BLR [March 2012], part 2, 65). This might also link with the proposed deposit scheme referred to in the Consultation (see below in relation to Question 40a). One option – the "New Zealand option" - is to avoid the need to establish a deposit scheme, would be to amend the Construction Act (and the Scheme) to provide that all construction contracts must include a provision requiring that any retention deducted is held in trust for the payee. In the absence of such a provision, such a provision is deemed to be included. In conjunction with the proposal above, this would mean that any retention held will not form part of the general assets of the insolvent company. This avoids the need to establish a potentially cumbersome and expensive deposit scheme, which may require a sizeable amount of public money to be used to get off the ground. Parties could still be free to agree a retention bond in lieu of retention (or some other form of security if they prefer). However, if the company is insolvent at any time prior to final account having been settled, in our view the other party will likely suffer other losses which are greater (such as non-payment for work carried out, preliminaries and/or materials or good ordered as well as loss of profit and costs in seeking legal and insolvency advice). In comparison, retention monies held prior to practical completion are generally 3% to 5% of monies due to date (with the first moiety of this released upon practical completion). There is an obvious risk regarding the second moiety of retention, which is generally released 12 months following practical completion. However, in our experience with our clients, in the event of an upstream insolvency, losses not relating to retention tend to be more substantial and hence take greater priority. Nonetheless, we would concede that it may simply be that contractors or sub-contractors are less inclined to seek external legal advice where their primary loss from an insolvency is outstanding retention monies.

Consultation Question	
18b.	*Please explain the reasons for your answer to question 18a, and if possible provide supporting evidence.*
CLC Response	
18b.	See above.

Consultation Question	
19a.	*Excluding the money not paid because the company holding the retention became insolvent. Do you believe that unjustified non-payment of retention monies is a significant issue in the construction sector?*
CLC Response	
19a.	We are aware of instances where retention monies have not been released and there appear to be no valid reasons for such non-payment under the construction contract. In other cases, there may be reasons advanced for this, albeit the threshold for justification is low as the payment of the final moiety of retention is usually the final payment made under the contract, therefore the reasons relied on are often not reasons which necessarily permit withholding under the construction contract), for example: 1. While the payer itself is not necessarily aware of any issue with the works (e.g. construction defects), a third party which is to have the benefit of those works (such as a tenant, purchaser or development finance provider) has made a deduction or a withholding from a payment due to the payer on account of issues such as perceived defects or else due to not having approved practical completion or making good of defects and the payer does not wish to release the retention (and lose leverage over the payee in respect of potentially necessary remedial works) until the corresponding payment has been released to it;[19] or 2. Where the payer believes that the payee is effectively insolvent and that the payer is likely to have claims against the payee arising that will either outweigh or at least match the level of retention – the payer's logic being that it is unlikely to be able to obtain a suitable level of redress for its claims due to the payee's likely insolvency. We recognise from the Research Report that the experience of Tier 2 and Tier 3 contractors regarding non-release has tended to be worse than for Tier 1 contractors. There are also rare occasions where the payee has not chased outstanding retention monies and the payer has forgotten (this is more prevalent where the retention monies were withheld pending the rectification of agreed defects). In some cases, we have not seen what amounts to bad faith on the payer and the money is usually

[19] Note that including a contractual provision making payment condition upon receipt of payment from a third party would be contravention of Section 113(1) of the Construction Act, unless the non-payment from the third party arises from its insolvency.

	quickly released following the payee sending an invoice or reminder.

Consultation Question	
19b.	*Please explain the reasons for your answer to question 19a, and if possible provide supporting evidence.*
CLC Response	
19b.	See above.

Consultation Question	
20a.	*Do you believe that non-payment of retention monies due to payers citing that obligations under another construction contract have not been met is a significant issue in the construction sector?*
CLC Response	
20a.	From the question, we assume this refers to a situation where, for example, a Tier 2 contractor is not paid the second half of its retention monies on the basis that its payer, a Tier 1 contractor, has not been issued with a making good of defects certificate (which would entitle the Tier 1 contractor to receive back the second moiety of its retention). Making a payment to a payee conditional upon the occurrence of an event under a contract between different parties is outlawed through the 2011 amendments to the Construction Act. Nonetheless, we are aware that this may happen but have not seen it do so often enough to be able to form a view as to whether the issue is significant. We would also note, however, that given that that conditional payment clauses have not been permissible since October 2011, a payer aware of this fact but still wishing to withhold or deduct from retention monies regardless in relation to circumstances under a construction contract with different parties, may choose to do so by advancing alternate reasons which do not so obviously fall foul of the amended Construction Act.

Consultation Question	
20b.	*Please explain the reasons for your answer to question 20a, and if possible provide supporting evidence.*
CLC Response	
20b.	See above.

Consultation Question	
21a.	*Approximately, what was the total value of retentions due to be released to you over the last year?*
CLC Response	
21a.	Not applicable.

Consultation Question	
21b.	*If retention money was due, approximately what proportion of this was not released?*
CLC Response	
21b.	Not applicable.

Consultation Question	
22.	*Please provide further details on the reasons for this non-payment:*

	The company holding the retention amount became insolvent	*Payer cited that obligations under another construction contract had not been met*	*Other reasons*
What proportion of the total <u>value</u> of retentions <u>not released</u> to you was because of: *(Note: this row should add to 100%)*			

CLC Response	
22.	Not applicable.

Consultation Question	
23a.	*Of the non-payment unpaid for 'other reasons' in question 22 above, in your view, what proportion was unjustified within the contract terms?*

CLC Response	
23a.	Not applicable.

Consultation Question	
23b.	*Please explain the reasons for your answer to question 23a.*
CLC Response	
23b.	Not applicable.

Consultation Question	
24a.	*Did you challenge the non-payment that occurred due to the payer citing obligations under another construction contract not being met (outlined in question 22)?*
CLC Response	
24a.	Not applicable.

Consultation Question	
24b.	*Please explain the reasons for your answer to question 24a.*
CLC Response	
24b.	Not applicable.

Consultation Question	
25a.	*Did you believe that <u>unjustified late payment</u> of retention monies is a significant issue in the construction sector?*
CLC Response	
25a.	Please see our response to Question 19a above.

Consultation Question	
25b.	*Please explain the reasons for your answer to question 25a, and if possible provide supporting evidence.*

CLC Response	
25b.	See above.

Consultation Question	
26a.	*Do you believe that late payment of retention monies due to the payer citing obligations under another construction contract not being met is a significant issue in the construction sector?*
CLC Response	
26a.	See our response to Question 20a above.

Consultation Question	
26b.	*Please explain the reasons for your answer to question 26a, and if possible provide supporting evidence.*
CLC Response	
26b.	See our response to Question 20b above.

Consultation Question	
27.	*Approximately what proportion of the total value of retentions due to be released to you over the last year was paid late?*
CLC Response	
27.	Not applicable.

Consultation Question	
28.	*Please provide further details on the reasons for this late payment:*

	Payer cited that obligations under another construction contract had not been met	*Other reasons*
What proportion of the total value of retentions that was paid late was		

	because of: *(Note: this row should add to 100%)*		

CLC Response	
28.	Not applicable.

Consultation Question	
29a.	*Of the late payment for 'other reasons' in question 28 above, in your view, what proportion was justified within the contract terms?*
CLC Response	
29a.	Not applicable.

Consultation Question	
29b.	*Please explain the reasons for your answer to question 29a, and if possible provide supporting evidence.*
CLC Response	
29b.	Not applicable.

Consultation Question	
30.	*For the amount that you believe was 'unjustified' what was the typical length of delay?*
CLC Response	
30.	Not applicable.

Consultation Question	
31a.	*Did you challenge the late payment that occurred to the payer citing that obligations under another construction contract had not been med (outlined in question 28)?*
CLC Response	
31a.	Not applicable.

Consultation Question	
31b.	*Please explain the reasons for your answer to question 31a.*
CLC Response	
31b.	Not applicable.

Consultation Question	
32a.	*Are you aware that the 2011 amendments to the "Construction Act" mean it is no longer possible to make payment, including retention payments, conditional on the performance of obligations under another contract?*
CLC Response	
32a.	The CLC believes that its members are aware of these amendments.

Consultation Question	
32b.	*Over the past year, approximately what proportion of contracts issued to you were inconsistent with the 2011 amendments that payment cannot be made conditional on performance under another contract?*
CLC Response	
32b.	The CLC believes that its members have not prepared any contracts which do not comply with these 2011 amendments.

Consultation Question	
32c.	*Did you raise the inconsistencies with the awarding party?*
CLC Response	
32c.	Not applicable.

Consultation Question	
32d.	*If you did raise the inconsistencies with the awarding party, typically what was the outcome?*
CLC Response	

32d.	Not applicable.

Consultation Question	
32e.	*If you did raise the inconsistencies with the awarding party, what expense did the requirement to clarify the contract(s) incur?*
CLC Response	
32e.	Not applicable.

Consultation Question	
32f.	*Would you have challenged <u>non-payment</u> (due to performance of obligations under another contract), if you had known that this is what the "Construction Act" means for retention payments?*
CLC Response	
32f.	Not applicable.

Consultation Question	
32g.	*Would you have challenged the <u>late payment</u> (due to performance of obligations under another contract), if you had known that this is what the "Construction Act" means for retention payments?*
CLC Response	
32g.	Not applicable.

Consultation Question	
32h.	*What measures would assist in increasing your awareness of such legislative changes?*
CLC Response	
32h.	Not applicable.

Consultation Question	
33a.	*Do you believe those withholding retentions due to reasons that are now illegal under*

	the 2011 changes to the "Construction Act" are doing so due to a lack of awareness of the 2011 changes or for other reasons?
CLC Response	
33a.	Other reasons, largely commercial (see our responses to Questions 20a and 20b). There are rare instances in which the payer may withhold retentions due to unfamiliarity with the 2011 changes. Whilst it is true in our view that a number of construction professionals and parties are unfamiliar with all aspects of the Construction Act, we have found that they generally understand when retention monies should be released.

Consultation Question	
34a.	*When the 2011 amendments were introduced it was suggested that some parties to construction contracts may respond by simply extending the defects liability period so that the retention was held for longer. Do you believe that this has occurred?*
CLC Response	
34a.	No.

Consultation Question	
34b.	*Please explain the reasons for your answer to question 34a.*
CLC Response	
34b.	We have not seen any increase in the length of defects liability period arising from the 2011 amendments.

Consultation Question	
35a.	*It has been suggested that some parties to construction contracts ask contractors to give an overall discount on the contract price, in return for ensuring prompt payment. Have you encountered this in practice?*
CLC Response	
35a.	In our view, this tends to be more commonly seen in contractors' relationships with sub-contractors rather than between construction clients and contractors – this is often referred to as "sub-contractor discount". Sub-contractor discounts have declined in usage since the Construction Act's coming into force gave payees stronger tools against non-payment and possibly due to greater usage of open-book pricing and payment procedures which may be complemented by a requirement to pass such discounts through to more savvy

	construction clients (thus reducing the attractiveness of sub-contractor discounts to main contractors). We do, however, see from time to time volume discounting, which is a different category of discounting. We are also aware of occasions where the construction client has agreed to zero retentions in return for a discount on the contract price. However, given that retention monies form part of a construction client's security from its contractor, this is relatively rare.

Consultation Question	
35b.	*Have you encountered this practice specifically with regard to retentions payments?*
CLC Response	
35b.	Yes but rarely. See our response to Question 35a above.

Consultation Question	
36.	*Do you have any further comments on late and non-payment of retentions?*
CLC Response	
36.	We have nothing further to add.

- **Section D) Retention "Caps"**

Consultation Question	
37a.	*Pye Tait research provided no evidence that a large proportion [of] construction customers are systematically setting retention rates at high levels. It presents a similar picture on the length of time retentions are intended to be held. It is therefore suggested that a cap on the time that a retention can be held or the retention rate that can be held would have limited impact. Do you agree?*
CLC Response	
37a.	We would agree.

Consultation Question	
37b.	*Please explain the reasons for your answer to question 37a.*
CLC Response	

37b.	Retentions are generally set at 3% or 5% prior to practical completion and halve upon such event occurring. While the Pye Tait research implies that the 5% figure is more common, we do see the 3% level used often on higher value construction contracts in line with the default percentage set under the JCT suite of construction contracts.[20] It is very rare to see monetary retentions at a level higher than 5% in the UK due to neither party wishing to put undue pressure on the payee's cashflow so, if an enhanced level is required, there are likely to be sound reasons. Examples of such reasons may be: • Another form of security offered by the contractor as part of the overall package is weaker than the construction client would like, e.g. the contractor's financial covenant is not ideal or the contractor is unwilling to offer a performance bond and/or parent company guarantee – the greater level of retention monies is seen by the payer as balancing out this weakness to a degree; • The value of the contract is relatively low and hence the actual level of retention is considered to be insufficient to encourage the contractor to return to site within a reasonable time to remedy defects which affect the construction client's intended use of the building. For example, modest refurbishment works to a medium-sized office may have a contract price of £75,000. Since the first moiety of retention is released at practical completion, if the retention amount was originally 5%, then the retention monies held during the defects rectification period would only be £1,500 (2.5%).[21]

20. **Section E) Existing alternative mechanisms to retentions**

Consultation Question	
38a.	*Over the last 5 years, on what proportion of your construction contracts, have alternative mechanisms to retentions, or alternative mechanisms for implementing retentions, been utilised?*
CLC Response	
38a.	The collective practices of the CLC's members advise on several thousand construction contracts in the UK each year. As statistics are not maintained as to when monetary retentions are or are not used, only an estimate can be offered in response to this question. In relation to UK contracts, we see that retention bonds are occasionally offered in lieu of retention monies. As observed within the Research Report, these are more

[20] In contrast, the default position under the NEC Engineering and Construction Contract, a popular standard form contract for major engineering and infrastructure works, is that there is no retention at all unless specified in the Contract Data.

[21] Having said this, a construction client's response would not necessarily be to increase the overall retention percentage but simply to increase the amount retained during the defects rectification period, e.g. the retention percentage could be stipulated as 5% prior to practical completion but that it would not reduce at practical completion. Instead, the full retention would be released upon making good of defects.

	common on infrastructure or engineering projects, as well as for utilities projects. They are also often seen on international construction projects, typically on an "on demand" basis. Whether on demand or conditional (the latter meaning that the beneficiary can be put to proof regarding any claim), there is a discussion to be had over who meets the cost of the bond. If the payer is to bear the cost (retaining retention monies, on the other hand, for it would be free), then it may feel entitled to ask for a discount on the contract price to offset this further cost. If, as the Research Report states, contractors simply "price in" the retention through higher contract sums, then the impact on overall cost may be minimal. Retention monies may still be needed (is it feasible to ask for, say, a Tier 3 contractor to seek a retention bond from its Tier 4 works contractor, given the likely lower contract value and contract sophistication?). The advantage of a retention bond is that the contractor need not be concerned about losing retention monies in the event of the payer's insolvency. However, there is no standard form (the template form included in the JCT contracts is the closest to one) for this and this leads to occasional variability in the forms of these bonds and the participants' understanding of their terms. With retention bonds generally being on demand, the banks issuing them often require them to be backed by cash. In terms of cash-flow during the course of a project, a contractor is drip-fed the contract price against works carried out. Consequently, the cash-flow advantage sometimes held to be associated with retention bonds may be much overstated. A call on a bond could, however, prejudice the contractor's credit rating. This could make the cost of its procurement of a bond for a future project more expensive, as well as any surety products that the contractor may require in other areas (e.g. trade credit insurance). This situation would not occur with retention monies. PBAs are less common in the private sector but have been used by a number of public sector clients. In general, a PBA does not necessarily do away with retention monies but, as a trust arrangement, any retention monies held should be protected against the insolvency of any construction team member. As mentioned in our response to an earlier question, how a PBA deals with retention monies will vary from case to case. For example, it is not uncommon for a PBA to only hold each interim payment instalment, rather than the entire contract price. Similar to retention bonds, there is a cost involved and a question mark as to who should bear this cost. Like retention bonds, an advantage of a PBA is that it protects the contractor against loss of outstanding retention monies in the event of the payer's insolvency. In the UK, performance bonds offer a payer a measure of security against the payee's failure to perform and are often 10% of the contract price. They are usually given on a conditional basis and are commonly used to offset the payer's additional costs on the project caused by the payee becoming insolvent before it has fully discharged its obligations under its construction contract. Performance bonds are often required by a construction client (and in some cases contractors) from its contractor(s) in order to mitigate insolvency risk. However, they are usually required as an addition to retention monies (or a retention bond) and are a cost that is usually borne by the payer. We do not tend to see performance bonds being used in lieu of retention monies. A further disadvantage of a performance bond (which would not affect a PBA or an on demand retention bond) is that, because of the difficulties in calling under a performance bond (most being conditional) means that it is not an effective incentive to compel the contractor to return to site to remedy defects. It is also the case that most performance bonds given in the current market expire at practical completion. In order to cover the defects under the rectification period,

these would need to be extended which generally increases the bond premium cost substantially because of the longer exposure of the bond provider to the contractor's potential insolvency.

An associated issue with bonds in recent years is that sureties have increasingly been seeking to impose long-stop expiry dates on them, in order to ensure that they do not face the prospect of exposure for indefinite duration. These long-stop dates can be as short as three years from the bond issue date and may mean that performance bonds are unable to cover defects rectification periods (or even the construction works period) for larger or more complex projects. This aspect may make them an inadequate analogue to retention monies. Related to this, with on demand bonds (as clients would prefer retentions bonds to be (indeed, the JCT form of retention bond is an on demand variant)), sureties often insist that these are prepared so that the bond beneficiary cannot run a "pay or extend" strategy. This is sometimes employed where a bond is approaching a long-stop expiry date but the intended event for its expiry (for example, practical completion) has not been achieved, which could be for a variety of reasons including employer or third party action, contractor default and/or force majeure. In such case, the bond may expire while the project is still continue, leaving the client unprotected. If clients move toward using retention bonds in greater quantities, sureties may face pressure to offer more generous long-stop dates but this may have a knock-on effect of the cost of the bond.

Parent company guarantees (PCGs) are often considered by construction clients to be similar to performance bonds in that they protect against the non-performance (chiefly due to insolvency) of the contractor. Unlike performance bonds, these usually only expire when the contractor's liability under the construction contract being guaranteed expires. Also, unlike performance bonds, there is no fee involved (although from the guarantor's perspective, the liabilities on the guarantor go on to its balance sheet). However, PCGs are not always available and therefore could not be considered as a sector-wide solution (a number of contractors do not have parent (or holding) companies, may have parent companies based overseas (and therefore which may more difficult or expensive to successfully claim and enforce against) or may have parents which are unwilling to expose their balance sheets to more risk). A PCG is also dependent on the continuing covenant strength and solvency of the parent, which requires the payer to carry out financial due diligence and credit checking to establish. Indeed, in a situation where a contractor lapses into insolvency, if its parent company has given a substantial number of guarantees of its subsidiary's liability, the parent may find itself heading into insolvency as a direct consequence of claims being pursued through these guarantees.

Escrow stakeholder accounts are sometimes required to be put in place by Tier 1 contractors from construction clients where they have concerns regarding the client's financial covenant. They are more commonly required in the UK's private sector where the value of the contract is significant and the client entity is a special purpose vehicle and/or based outside of the UK. "Stakeholder" refers a third party holding the money on the part of two parties (the client and the contractor). In this arrangement, the stakeholder is often called the escrow agent and the monies should be held in a ring-fenced bank account. Potentially all of the monies to be paid under the contract could be held in escrow but this is typically a fraction (e.g. two months' cash-flow, which is required to be topped-up by the payer when any use is made of it) which will help shield the contractor from the client's insolvency during the project. There are a

	number of difficulties with escrow accounts. Escrow account arrangements should be documented clearly between both parties and the escrow agent. This often requires experienced construction law specialists to advise each party.[22] Furthermore, securing an escrow agent can be difficult and parties will be keen appoint a reputable, neutral and established escrow agent. Escrow agents commonly include law firms who provide such services reluctantly as a necessary means of enabling the contract to be entered into since the escrow account will reduce the contractor's concerns over client insolvency. This type of arrangement would be difficult to roll-out more expansively as it stands. Escrow arrangements are necessarily legalistic and administratively burdensome and there would be an acute shortage of businesses comfortable or well-suited to act as escrow agents (given that such a role could extend up to several years). A straightforward solution may simply be to mandate that payers hold any retention monies in trust and in a separate bank account – this is the approach recently adopted in New Zealand (but without the requirement for ring-fencing). Indeed, the JCT forms of contract for commercial projects require this, again without any ring-fencing (although this provision is often removed for higher value projects by contract amendments).[23] The reasons payers may resist such a requirement is the administrative burden involved in having to keep account of the money, as well as not being able to use the retention monies for other purposes (due to the fact it has to be ring-fenced). As mentioned previously, this may cause issues where the retention monies would need to be provided through borrowing. There are also large projects where there are a large number of contractors which could make the retention bond alternative or the retention monies deposit scheme highly burdensome. An example would be construction of a skyscraper using a management contracting or construction management procurement. Instead of one main contractor, there will be multiple contractors engaged by the same party.

Consultation Question	
38b.	*What alternative mechanisms were utilised?*
CLC Response	
38b.	See above.

Consultation Question	
38c.	*Typically were these alternative mechanisms used in addition to, rather than as an alternative to retentions?*

[22] The CLLS will be publishing a standard form escrow agreement for construction contracts during 2018 which will hopefully help to standardise practice in relation to escrow arrangements.

[23] Where retention monies are contractually required to be held in a separate bank account, an injunction to enforce this will likely be successful (*Henry Boot Building Ltd v The Croydon Hotel & Leisure Co Ltd* (1987) 36 BLR 41, see also *Wates Construction (London) Ltd V Franthom Property Ltd* (1991) 53 BLR 23).

CLC Response	
38c.	Aside from retention bonds, they were all used in addition to retention monies and are not generally considered to be alternatives to retention monies.

Consultation Question	
38d.	*Do you think that any of these alternative mechanisms would be applicable for wider use across the sector?*
CLC Response	
38d.	See our comments in our response to Question 38a above.

Consultation Question	
38e.	*Please explain the reasons for your answer to question 38d. If applicable, please list those alternative mechanisms that you think would be applicable for wider use across the sector.*
CLC Response	
38e.	See our comments in our response to Question 38a above. The closest equivalent to retention monies is a retention bond. However, the viability of this will depend on the ability of the contractor to procure a bond in a suitable form at the required level (usually 3% or 5% of the contract price) and at a suitable cost and clients will likely want the retention bond to be a pre-condition to payment to the contractor. Businesses with fewer assets, with higher insolvency risk, which are less established in the construction field, have a poor claims history or which are taking on a project which, relative to their balance sheet, is sizeable may find that bonds are less readily available, that counter-indemnity requirements are more onerous or the bond costs simply higher as a consequence. There is a danger that this creates a point of differentiation between various businesses bidding for a construction contract unlike the more common regime which, theoretically, provides a level playing field to tenderers on this front. On demand bonds are not surety products and hence a bond provider (often a bank) will expect to pay out to a compliant demand. Clients are less comfortable with retention bonds with are conditional (rather than on demand) but in such case the providers (which are often surety companies) make money from taking in more in premium receipts than they pay out in claims and would have to adjust their premiums to reflect the level of risk. In addition to the alternatives listed in the Consultation, we would consider simply

	having zero retention to be a substitute.[24] However, in order to accept this, payers may need to be incentivised by the contractor, for example, through a lower contract price. Some clients, such as those within central government, may be better placed (or more willing) to negotiate with contractors to hold zero retention due to greater negotiating leverage. We have further ideas of alternatives/restrictions on retention monies, which are not – as far as we are aware – in usage but which may merit further exploration through consultation and research in the industry. We consider all of these to be easier to implement than a statutory retention deposit scheme: • Capping monetary retentions at a particular level (e.g. 3% of the contract price subject to the total retention not being less than, say, £5,000), above which monies must be held in trust (minimum criteria would be specified for the trust arrangements and if the client is in breach, it would then obliged to release retention monies at the required times under the construction contract with no deduction or withholding – statutory interest would accrue daily for any late release, possibly with ring-fencing depending on market demand); • The Government working with insurers, construction clients, contractors, publishers of UK standard form construction contracts and contractors to produce a model form of retention bond which will be readily available to the construction market at reasonable cost. This could be a voluntary scheme but would give suppliers a ready and suitable product to suggest to employers as an alternative to retention monies during contract negotiations; • For retention monies above a certain threshold, there could be a requirement for payers to provide a surety bond (rather than an on demand bond, which often comes with more onerous counter-indemnity requirements) for the retention monies it holds, to protect against its insolvency. As with the above, it would be helpful for the Government to lead the way in designing a suitable product; • A Government-backed retention monies scheme is created which is voluntary but has measures which are attractive to both construction parties under a contract. For example, the payer could be permitted to use Trustmark or a similar accreditation arrangement if it uses the voluntary scheme, which help its industry image and reputation; • Requiring the payer to set out its reasons for any deduction, withholding or delay relating to retention monies through written notice (this could, at the payer's election, be included in any "Pay Less Notice" rather than form a separate notice). A failure to include such reasons would prohibit the payer from subsequently making any deduction, withholding or delayed release; or

[24] The JCT Major Project Construction Contract 2016, first introduced in 2003 by the Joint Contracts Tribunal as the Major Project Form, is a notable example of a standard form construction contract which envisages no retention monies will be held. Neither does it provide for any alternative security in lieu, such as a retention bond. However, the Major Project Construction Contract and its sub-contract counterpart (the Major Project Sub-Contract) are rarely used and even when they provisions to withhold retention monies are usually added by bespoke amendments.

	• Changing the law to put the burden of proof in legal proceedings on the payer regarding the retention monies in the event that it deducts, withholds or delays release of retention monies that it has acted in accordance with the contract and any common law rights. It could also be made clear through legislative amendment that interest would automatically apply for late payment or unjustified retention of retention monies, perhaps through a change to the Late Payment of Commercial Debts (Interest) Act 1998. Some of the above ideas could be modified or combined. A primary difficulty of regulating all retention monies is that those with greater bargaining power could simply move the goalposts elsewhere. They could require contractors to take out higher levels of performance bond, they could seek to drive down the contract price or they could restrict less established businesses from tendering. More critically, the costs arising from these measures could be pushed down the supply chain. We note the allusion to the possible usage suggested in the Research Report of an instrument similar to the Lift and Escalator Industry Association's Contract Guarantee. It is not necessarily the fact that lift and escalator clients are satisfied with the terms of the Guarantee but the increased market acceptability of it, referred to in the Research Report, has been driven by the fact that demand for lifts and escalators has grown sharply in recent years but there are relatively few major players, leading to a disparity of bargaining positions. For this reason, a retention bond would be more acceptable to clients as a substitute for retention monies.

Consultation Question	
39a.	*The Pye Tait research concludes that a retention deposit scheme and holding retentions in trust appear to be applicable to the whole of the sector. Do you agree?*
CLC Response	
39a.	As an alternative to retention monies, a retention deposit scheme – if implemented correctly, well-administrated and at reasonable cost – could apply to the whole construction sector. However, our view is that such a scheme could be difficult to establish and run and, until and unless such teething issues can be successfully resolved, the scheme has the potential to cause more headaches than it aims to resolve. It may, on the other hand, have the effect of driving payers to consider other measures such as retention bonds as a means of avoiding any undesirable requirements from such a scheme. Please also see our response to Question 38e above.

Consultation Question

39b.	*Please explain the reasons for your answer to question 39a.*
CLC Response	
39b.	See above and also our response to Question 40b below.

Consultation Question	
40a.	*The Pye Tait research concludes that a retention deposit scheme and 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. Do you agree?*
CLC Response	
40a.	Our view is that a retention deposit scheme could eliminate these issues but it should be considered whether it is the most suitable option on balance. See also our comments in our response to Question 18a. There is also the issue of proportionality regarding whether the scheme should be introduced. The Pye Tait research found that the average amount lost per contractor due to non-payment arising from insolvency was £10,000 over three years and it seemed to indicate that this figure covers all lost payments, not just those relating to the loss of retention monies. It appreciated that this is an average but, for those parties entering into construction contracts, this does not seem such a substantial loss that it would drive many SME participants out of business. There is also the issue of how to enforce compliance with the scheme. A fine would appear to be the easiest solution but clearly the issue of sanctions is one that needs further consideration. We have discussed the possibility of conferring upon an adjudicator the power to award costs in such circumstances in our response to Question 4. Furthermore, the Research Report states *"of the three-quarters of contractors with experience of retentions, contractors say retentions are not held on an average of 35% of all their current contracts"*. As we have stated before, retention monies are important but insolvency has the potential to cause far greater losses for those in the supply chain. Given this finding, does the proposed new scheme, which will likely take millions of public funds to implement, constitute value for money? We would suggest that more consideration ought to be given to other possible measures.

Consultation Question	
40b.	*Please explain the reasons for your answer to question 40a.*
CLC Response	

40b.	See above.

Consultation Question	
41a.	*Do you agree that a range of alternative mechanisms could exist within the industry, to account for variation in projects and supply chain circumstances?*
CLC Response	
41a.	As indicated in our response to Question 38a, there are already a range of options available. Although there may be advantages to providing parties with a range of options, e.g. the choice of a statutory retention scheme, PBA, retention bond or retention monies to be held in trust, we have a concern that this would merely lead to greater confusion in the industry when uncomplicatedness might fare better. After all, the Pye Tait research, highlighted that the 2011 amendments to the Construction Act are poorly understood in parts of the industry.

Consultation Question	
41b.	*Please explain the reasons for your answer to question 41a.*
CLC Response	
41b.	See above.

Consultation Question	
42.	*Do you have any further comments on the alternative mechanisms to retentions in the construction sector?*
CLC Response	
42.	No.

21. **Section F) Retention deposit schemes**

Consultation Question	
43a.	*Do you think it is important to place a threshold on the application of any measure requiring retentions to be held in trust or ring-fenced in another way?*
CLC Response	
43a.	Yes, although the level of threshold should be informed by further industry consultation in our opinion.

Consultation Question	
43b.	*Please explain the reasons for your answer to question 43a.*
CLC Response	
43b.	As indicated elsewhere in our Consultation response, the issue of proportionality is important.

Consultation Question	
44a.	*Any measure to require the retention money to be held in trust needs to be simple, consistent and transparent. A retention deposit scheme may represent the best way of achieving this. Do you agree?*
CLC Response	
44a.	We would agree wholeheartedly with the first sentence of the Question. We have strong reservations over the second sentence.

Consultation Question	
44b.	*Please explain the reasons for your answer to question 44a.*
CLC Response	
44b.	We have set out our reasons throughout this Consultation response.

Consultation Question	
45a.	*In your opinion, what would be the most appropriate design of a retention deposit scheme?*
CLC Response	
45a.	See our response below to Question 46a-h. To this we would add the following - from the Research Report, the idea of the retention deposit scheme appears to stem from two sources: • The creation of such schemes in the Australian state of New South Wales and in New Zealand. These schemes are quite different from each other; • The tenancy deposit protection schemes which have existed for about a decade in England and Wales, Northern Ireland and Scotland.

	Rather than suggest how the design should evolve, our suggestion would be to observe how the New Zealand and New South Wales processes operate in practice over the next few years. There appears, so far, to be little available publicly available analysis on their respective operations. The New Zealand legislation has only been effective since 31 March 2017.[25] In some respects, it reflects BEIS' proposals in that it would cover all Tier 1 contractors and below with no threshold limit. However, it is simply a requirement that retentions monies must be held in trust and there is no legal requirement to hold the money in a separate account. It is in this sense, a restrained measure. In an insolvency, this could still mean there are delays in contractors obtaining their retention monies if the money has been mixed with other monies. It is also likely to be more difficult for the contractor to establish that the monies are being left alone; it is doubtful that its payer would allow it to check its current account balance on a regular basis. The contractor therefore needs to be comfortable that the payer's arrangements for a trust work effectively, which is not necessarily straightforward. As an alternative to the trust arrangements, the New Zealand rules permit a payment/insurance bond to be required instead, which complies with specified criteria. Interest is payable on any late release of retention. The New South Wales, on the other hand, is a statutory retention monies scheme and more onerous but narrower.[26] It currently only applies to Tier 1 contractors and their Tier 2 contractors for projects with a value of more than AUD$20 million, covering all contracts entered into after 1 May 2015.[27] It is noted that New South Wales is still experimenting with its own scheme and imposes an administrative charge (AUD$1,500) for taking part. Whether this charge is sufficient to make the scheme self-sustaining without further financial support from the Government of New South Wales remains to be seen. We would also add that for projects over AUD$20 million, the level of charge being used seems likely be affordable for those parties on which it is imposed. Whether it becomes more burdensome if applied to lower value projects is another question. There are fines if the payer fails to comply with the requirements of up to AUD$22,000. In the New South Wales scheme, the Tier 1 contractor can only withdraw funds from the retention account pursuant to the terms it has agreed with its sub-contractor. This is an area which may cause concern – what if both parties disagree as to whether the contractor should be able to call on the deposit? What if the contractor seeks to make such terms more subjective so that such disagreements cannot arise (similar to a properly-drafted on demand bond)? Construction disagreements can be complicated – is the deposit scheme capable of making a resolution and, if not, do the parties need to then resort to adjudication, the courts or arbitration? We would note that the Research Report envisages that disputes over the release of retention would be dealt with under existing dispute resolution procedures under the construction contract. This would indicate that, in the event of a dispute, the party

[25] This stems from the country's Construction Contracts Amendment Act 2015 and the Regulatory Systems (Commercial Matters) Amendment Act 2017 which amend the Construction Contracts Act 2002.

[26] These arise from amendments to the Building and Construction Industry Security of Payment Regulation 2008 introduced through the Building and Construction Industry Security of Payment Amendment (Retention Money Trust Account) Regulation 2015.

[27] Statutory adjudication in the construction industry also applies in each of the jurisdictions of New South Wales and New Zealand so there are further parallels here with the UK.

	requiring payment (either the client for breach by the contractor or the contractor for return of the deposit) would require a relevant adjudication or arbitration award, court judgment or, where relevant, proof of the other party's insolvency in order to withdraw funds from the account. Inherent in this is that the scheme's administrators need to be able to clearly able to discern that the award, judgment or other satisfactory documentation entitles a party to a certain pay-out from the account. In the event of legal proceedings, the claimant or referring party will need to shape its claim to obtain such clarity. The dispute resolution schemes for tenancy deposit schemes have shown they can be limited in what disagreements they are comfortable dealing with. Although tenancy deposit schemes are not an area where the CLC's members (being construction lawyers) have particular expertise, our understanding is that they were introduced to curb more widespread abuse of the tenancy deposits for tenants with assured shorthold tenancies (or their equivalents in Scotland and Northern Ireland). The Research Report seems to indicate that abuse of construction retentions is less prevalent. In the tenancy deposit scheme, if the landlord has failed to put the deposit into the scheme, it may be liable for up to three times the value of the deposit. It may also prejudice any Section 21 notice (this refers to the Housing Act 1988 and enables a landlord to evict an assured shorthold tenant under certain circumstances). We comment below in our response to Question 57 on the differences between the circumstances which drove the introduction of the tenancy deposit scheme and the present situation with cash retentions in construction. If a retention deposit scheme is introduced, construction parties would still have the option of opting for other forms of security. Our view is that the larger players may simply root for alternatives, primarily on demand retention bonds, which retain the immediacy of claim that makes them attractive to clients who require defects to be fixed within a reasonable timescale. Which party is expected to carry the premium cost would be a matter of bargaining power. In terms of penalties for non-compliance, a fine would appear to be the easiest solution but clearly the issue of sanctions is one that needs further consideration.

Consultation Question	
45b.	*Please explain the reasons for your answer to question 45a.*
CLC Response	
45b.	See above.

Consultation Question	
46 a – h.	*It is proposed that, if established, a retention deposit scheme should have the following features:*

	Do you agree that the following features should be included? *a. The scheme should be set up on a statutory footing.* *b. The market will deliver private provision of any retention deposit scheme(s).* *c. 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.* *d. The scheme can only hold retention money (plus any related interest).* *e. The money will be held in trust for the payee.* *f. Where the contract makes no provision, the Scheme for Construction Contracts will imply relevant terms requiring retention money to be held in a deposit scheme.* *g. Scheme operators would be required to report on an annual basis on their performance.* *h. Any disputes about the operation, amount and timing of the release of retention payments will be dealt with by existing dispute resolution processes.*
CLC Response	
46 a - h.	We would agree with the above with the exception of: b. What happens if the market is unwilling to provide a suitable scheme (either due to trustworthiness, reliability, quality of service and/or at a reasonable cost)? Would the Government offer a contingency plan such as subsidising a reputable company to establish and run the scheme until it becomes self-sustaining? c. Threshold levels would need to be considered as the burden of administration may not be appropriate for smaller value construction contracts, e.g. contracts for painting walls are caught as construction contracts under the Construction Act. h. We have commented on this in our response to Question 45a above.

Consultation Question	
46i.	*Please explain the reasons for your answers.*
CLC Response	

46i.	See above.

Consultation Question	
47.	*Are there any further features to the retention deposit scheme that you would recommend?*
CLC Response	
47.	We would recommend that there is third party auditing and validation of any retention deposit schemes including, for instance, making sure that the monies are being properly held in trust (rather than simply relying on them to provide their own reporting). An alternative would be for the Government to underwrite each scheme. This would give construction parties confidence to use any particular retention deposit scheme.

Consultation Question	
48 a – e.	*It is proposed that, if established, a retention deposit scheme would operate according to the [principles] listed below.* *Do you agree that the following features should be included?* *a. Organisations withholding retention payments will be required to register with a scheme as an account holder.* *b. The retention holder to register specific contracts and the relevant information (such as start and end dates, payment schedule and retention terms).* *c. The retention holder to notify the scheme of the timing, amount and allocation of retention money which is being deposited.* *d. The retention holder to notify the scheme if any changes are made to the timings and payment due, and why.* *e. The scheme operator to pay the retention on the retention release date.*
CLC Response	
48 a – e.	We would agree with these features except for “e”.

Consultation Question	
48f.	*Please explain the reasons for your answers.*

CLC Response	
48f.	"e" needs to be carefully considered. The scheme operator will need to be comfortable that the retention release date has been reached and there is no reason for all or any parts of the retention monies to be withheld (for example, because the payer contends that there are outstanding defects in the works). How will the "retention release date" be defined? Is this a matter which will be left to the construction contract (and may vary from contract to contract) and, if so, can we be sure that its achievement is sufficiently obvious to the scheme operator to enable it to release the monies? One means by which this could be made easier for the scheme operator is that it would only release retention monies in the following circumstances: • A notice is issued signed by authorised signatories of both parties requiring the scheme operator to release retention monies and stating the amount to be released; • An adjudicator's or arbitral award or UK court judgment is provided stating the amount to be released from the retention fund; • Where relevant, one party provides satisfactory proof of the other party's insolvency entitling it to draw on the retention funds. Regardless, it should be noted that these are solutions which may require time and cost and exist to resolve obstacles that would not exist with cash retentions or on demand retention bonds.

Consultation Question	
49.	*Are there any further features to the operation of the "retention deposit scheme" that you would recommend?*
CLC Response	
49.	We would recommend that a template form is prepared with guidance notes so that the retention holder can provide the scheme operator with all the details it requires. The form should be jointly signed by both parties to the construction contract. The scheme operator's terms and conditions should include adequate non-disclosure, confidentiality and data security provisions, given that a number of construction projects will be commercially-sensitive.

Consultation Question	
50.	*There may be "in-house" costs which companies required to use the scheme will incur. We consider these administrative costs would comprise of the following:*

	a. *Provision of contract details (such as start and end dates, payment schedule and retention terms) to the retention deposit scheme.* b. *Notification to the scheme of the timing, amount and allocation of retention money which is being deposited.* c. *Notification to the scheme operator if any changes are made to the timings and payment due, and why.* *Please give an estimation of how much administration time you think would be reasonable for these processes?*
CLC Response	
50.	We are unable to comment.

Consultation Question	
51.	*Are there any further features to the operation of the "retention deposit scheme" that you would recommend?*
CLC Response	
51.	No.

Consultation Question	
52.	*If you hold retentions, who in your organisation do you envisage would be required to manage your contracts with the retention deposit scheme?*
CLC Response	
52.	Not applicable.

Consultation Question	
53.	*If you have had retentions held from you, what cost per contract would you be willing to incur if it meant that your retention was held in trust in a retention deposit scheme?*
CLC Response	
53.	Not applicable.

Consultation Question

54.	*If you currently hold retentions, above what cost per contract for the retention deposit scheme do you think you would [no] longer choose to hold retentions on your contracts?*
CLC Response	
54.	Not applicable.

Consultation Question	
55.	*Changes to how retentions can be held would mean that parties to construction contracts would need to familiarise themselves with new guidance. How much time do you think it would be reasonable to expect you to spend reviewing guidance to familiarise yourself with any changes?*
CLC Response	
55.	The CLC is comprised of construction lawyers so we would expect to familiarise ourselves quickly with any such guidance.

Consultation Question	
56.	*What was the total number of contracts that you issues last year on which you hold retentions?*
CLC Response	
56.	Not applicable.

Consultation Question	
57.	*Do you have any other comments that might aid the consultation process as a whole?*
CLC Response	
57.	We would emphasise that the retention scheme proposed, covering all of the construction sector (aside from domestic residential clients) is highly ambitious and will encounter a number of technical and practical obstacles that are likely to require public time and money to resolve. Nonetheless, we appreciate the Research Report findings that retention monies are often paid late, particularly to Tier 2 and Tier 3 contractors, which often leads to higher business overheads. The announcement that Carillion plc, the UK's second largest contracting group, will enter into liquidation will also refocus discussion and attention on the subject of retentions. Consideration should be given to the variety of forms a construction contract may take. Under the amended Construction Act, a construction contract would include a

	letter of intent, agreements made through simple means (e.g. an exchange of email correspondence) and even oral or party oral contracts. While a revised Scheme for Construction Contracts could dictate the minimum criteria for monetary retentions in the absence of contractual provisions for this (or where the provisions are non-compliant), it may well be the case that the contracting parties do not immediately consider how to deal with retention monies. For instance, under a letter of intent retention is usually deducted as the parties anticipate that retention should follow the terms of the construction contract which it is assumed with follow and supersede such letter. However, this does not mean that the parties are concerned with thinking about the retention provisions during the negotiations for the letter of intent (which often take a few short hours, if that). On this basis, BEIS should consider whether construction contracts of short duration should be exempted from any statutory retention deposit scheme. It may be disproportionate to use the statutory retention deposit scheme where the construction contract will be completed in, say, two weeks. There is also a argument that parties should not be punished for failing to comply with the scheme if, in fact, the payees have not suffered any delay or deductions from the retention amounts they are properly due. The Consultation suggests three policy options: *Option 1: Do nothing.* *Option 2: Promote greater awareness of existing statutory requirements to improve the communication of the timing and amount of retention payments.* *Option 3: Create a "retention deposit scheme" to hold retention money in a separate ring-fenced account, protecting the money where there is an insolvency and reducing the incentive to unjustifiably delay or withhold payment when due.* We do not see why Options 2 and 3 are implied to be mutually exclusive. The Research Report has shown that parts of the construction sector appear to be unfamiliar with some of the protections that have been available to them under legislation since October 2011 so it seems clear that, if funds are available, the Government should do more to promote awareness of the existing statutory requirements in any event. We would also note that Research Report advises that abuse of retentions appears to be more likely to be experienced by Tier 2 and Tier 3 contractors than their Tier 1 counterparts. The National Association of Citizens Advice Bureaux (NACAB) published a report in 1998 highlighting their clients' difficulties in obtaining repayment of tenancy deposits from private landlords. NACAB concluded that the evidence indicated the case for reform was "overwhelming" and that these failures damaged the image and reputation of the private rented sector. In our view, this established widespread public opinion prior to the enactment of the tenancy deposit protection legislation. Although we would not deny there is an issue in some instances with retention monies under construction contracts, the scale of the problem seems less acute and comprises less of a consumer protection issue. Furthermore, and this is an important point to bear in mind, the majority of residential renters have a particularly weak negotiating position with landlords due to issues with the availability of accommodation in the UK, including often having to provide the deposit upfront together with the first rental instalment. The situation is different in the construction sector and, if tenderers are uncomfortable with the level of retention monies being

	demanded, they can (and the Research Report indicates that they often do) increase their tendered contract sums to mitigate the risk. If BEIS is minded to pursue Option 3, then it would be preferable for it to draw up a model scheme and criteria (including thresholds) for further consultation.

The Construction Law Committee of the City of London Law Society
19 January 2018