

House of Commons
Trade and Industry Committee

**THE USE OF
RETENTIONS IN THE UK
CONSTRUCTION
INDUSTRY**

Second Report of Session 2002–03

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*Report, together with
Proceedings of the Committee,
Minutes of Evidence and Appendices*

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Footnotes

In the footnotes of this Report, references to oral evidence are indicated by 'Q' followed by the question number. References to written evidence are indicated in the form 'Ev' followed by the page number.

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SECOND REPORT

The Trade and Industry Committee has agreed to the following Report:

THE USE OF RETENTIONS IN THE UK CONSTRUCTION INDUSTRY

Summary

The withholding of retentions is a practice which places a heavy burden on many companies in the construction industry, particular the SMEs which make up the majority of firms in the sector. It is an out-dated practice which should not be necessary in a modern, productive industry which delivers a high quality product. Yet the perception by construction clients that the system is needed is a reflection of the mistrust between them and the construction industry. The process of engineering the change in attitudes and encouraging the culture of trust between clients, contractors and subcontractors envisaged by the Strategic Forum for Construction is, understandably, a long term process, but it should lead to better productivity, fewer defects and greater client satisfaction, as witnessed by those major clients who have adopted integrated supply chain management in partnership with their contractors. Such changes will eventually eliminate the need for retentions for all but the smallest or most infrequent client.

All Government departments and agencies should provide the lead to others by adopting the new working practices as quickly as possible and taking a uniform approach to the phasing out of retentions.

It may take some time for small or infrequent clients to be persuaded to adopt the new way of working and that retentions are no longer necessary. The Government should continue its support for the education of local authorities and other client groups of the advantages in a more collaborative approach to construction projects and to work towards the goal of removing retentions from their standard procurement contracts. Meanwhile, we see no attraction in the prospect of engineering their abolition through legislation.

I INTRODUCTION

1. The retentions system originated in Victorian times. Clients for large railway construction projects sought to protect themselves by retaining a proportion of the value of their contracts, thereby creating a fund which could contribute towards the cost of completing the project in the event (frequent at that time) that the contractor became insolvent. The practice spread to the rest of the construction sector, and clients now use the retentions system as an incentive to avoid or eliminate defects.

2. Retentions have attracted widespread criticism, particularly from companies who act as subcontractors, and sub-subcontractors, on large construction projects. Most of these firms are small and medium-sized enterprises (SMEs) which have to bear the cost of having a proportion of the value of their work withheld until the completion of the project on which they are engaged, irrespective of their place in the construction process. Indeed, the abolition of retentions was first proposed by Banwell in 1964.¹

3. We decided to hold a brief inquiry into the practice of retentions, to see if it did in fact provide an incentive to avoid or eliminate defects. We wished to examine the advantages and disadvantages of the system and to review recent developments in working practices within the industry, which might remove or reduce the need for retentions. We also wanted to review the use of retentions in the public sector.

4. During the course of this inquiry, we received 30 written submissions. We also took oral evidence from the Specialist Engineering Construction Group (SECG), the Confederation of Construction Clients (CCC), the Construction Confederation (CC) and officials from the Department of Trade and Industry (DTI). We are grateful to these witnesses and to all those who contributed to our inquiry.

¹ *The Placing and Management of Contracts for Building and Civil Engineering Work*. HMSO 1964

II WHAT ARE RETENTIONS?

5. The retention system originated in the railway construction sector in the 1840s. The rapid expansion of the railway network led to a high demand for construction workers and the creation of a large number of construction companies. The high rate of insolvency among such companies (and consequent delays to building projects) drove clients to deduct a 'retention' from payment schedules, in order to ensure that there was a fund available to them to help defray the cost of completion. This practice spread to the rest of the construction industry, and, until recently, was standard practice throughout the sector.

6. Under the retention system, once a construction project has been costed out, the client will apply a reduction to the gross valuation of the project. The exact amount of retention is written into the contract. The reduction is commonly 5% of the total value of the contract, but can be much more than that. The net effect is that, until the completion stage of the contract, the client holds the agreed retention sum. Half of this is paid over to the primary contractor once the project is certified complete. The other half is held until the end of what is specified in the contract as the "defects liability period" or "maintenance period", during which the contractor must correct any defects identified when the project was certified complete.

7. The primary contractor spreads the impact of the retention by applying the same retention to all subcontractors and sub-subcontractors involved in the project. We have been told that all subcontracts will reflect the main contract retention, irrespective of the value of the subcontract, the nature or duration of the work to be subcontracted, or the payment arrangements to be adopted in the subcontract.² The overall effect is that all construction firms involved in a construction project have to wait until the project has been certified as complete before they receive half of the retention withheld from them; and longer until all retention monies are paid over to them. Payment of retentions is not automatic. In most cases, subcontractors have to apply for the release of the retentions, adding to administrative costs for all concerned.³

8. The system of retentions is peculiar to the building industry. We were told that retentions are not applied to other forms of construction, such as the shipbuilding and aerospace industries, where contract payments are generally made at defined stages in the contract, dependent on satisfactory completion of the scheduled work.⁴ There was some debate about whether retentions were applied throughout the construction industry. SECG felt that the retention system is limited to actual building, construction and maintenance contracts,⁵ whereas architects, engineers and other consultants did not appear to have retentions applied to them. The CCC suggested that while this may have been the case in the past, with the introduction of the Private Finance Initiative and Design Build contracts, consultants were increasingly being asked to be party to retention.⁶

Financial impact of retentions

9. The annual output of the UK construction sector has been estimated at £65 billion. On this basis, the SECG estimates that the application of 5% retentions to construction

² Ev 34

³ As above

⁴ Ev 35

⁵ Q 3

⁶ Q 46

contracts removes at least £3.25 billion from the cash flow of the UK construction sector.⁷ Given the widespread concern about retentions within the sector, and that the majority of the firms adversely affected by the system are SMEs, it is perhaps surprising that the DTI has not made its own assessment of the impact of retentions on the sector.⁸

10. It is difficult to make an informed assessment on the impact of retentions on individual businesses, but the anecdotal evidence provided by the SECG suggests that it can be significant, especially for SMEs. It would appear that firms now routinely build retention costs into their annual budget and that these can amount to 5% or 6% of annual turnover.⁹ For small firms, the 5% retention can represent all or at least a significant part of the profit to be found from a particular project. If the examples provided to us are representative of the industry as a whole, then the impact of the system on SMEs in the sector is considerable. Given the serious impact of retentions on the cashflow of many SMEs, there have been many calls for the abolition of the system from that sector.¹⁰

11. It also appears — though the evidence is necessarily anecdotal — that the cost of retentions is sometimes passed on to clients in higher initial estimates, with the result that clients are paying extra to have the facility to retain a percentage of the bill. On the other hand, we heard that the removal of retentions would not necessarily reduce the overall cost to clients¹¹ and that it was likely that contractors would use the cash released by the abolition of retentions for investment in equipment, training and other resources.¹²

⁷ Ev 30

⁸ Q 102

⁹ Ev 61

¹⁰ Ev 91-94, Ev 103

¹¹ Q 48

¹² Q 25

III ADVANTAGES AND DISADVANTAGES OF THE RETENTIONS SYSTEM

Do retentions work?

12. We found conflicting views on the effectiveness of retentions in eliminating or avoiding defects, or in encouraging contractors to return to site to remedy defects during the defects liability period following handover of the project to the client. The SECG and several individual contractors argued that there was little evidence to suggest that the majority of firms in the industry felt that retentions were effective in this respect.¹³ **The SECG said that the practice of retention reflects the negative client/contractor culture that has persisted for many years. In their view, the retentions system encouraged an atmosphere of distrust between contractor and client.**¹⁴ The DTI agreed that clients, contractors and subcontractors did not trust each other to deliver defect-free work and that this was an endemic cultural problem.¹⁵

13. On the other hand, the Construction Confederation perceived that retentions provided the client with some degree of comfort that defects would be corrected.¹⁶ Ms Zara Lamont of the CCC agreed, but acknowledged that retentions probably did not give clients a better product at the end of the day. However, in her view, clients needed some form of redress for inadequate workmanship or poor delivery. From the clients' perspective, retentions might not be perfect but worked in part.¹⁷

14. The Vice-Chairman of the Association of University Directors of Estates felt that, while institutions with large and continuing capital programmes could consider alternative ways of providing incentives to improve quality and reduce defects, the majority of clients in the Higher Education sector needed the retentions system to ensure that the contractor returned to complete defects within the defects liability period. The sector relied heavily on individual capital projects using traditional methods of contract and control.¹⁸ The DTI also saw a need for retentions among smaller and more occasional clients to give them some recourse when defects occurred, and considered that it would be inappropriate to place a moratorium on their use.¹⁹ Conversely, Mr C Underwood of NT Security, was of the view that all subcontractors had an incentive to provide a high standard of workmanship because they wanted to attract repeat business from their clients.²⁰ Mr Andrew Knights of Eurowindows agreed, saying that for "reputable companies, it is not the retentions that force the defects work to be completed, but a desire to be professional, to do a good job and to get repeat work".²¹ Moreover, because retentions are passed on to subcontractors *pro rata*, for many SMEs a retention can be worth as little as £10 per project — insufficient by itself to act as a deterrent to low quality work or to encourage a company to return to a site to repair a defect.²²

15. We note that, while construction clients felt that the use of retentions afforded them a degree of assurance and control over the rectification of faults and gave some level of insurance against insolvency by the contractor, it was not possible to establish how effective the current system is in practice. By and large, contractors and

¹³ Ev 91-93, Ev 95

¹⁴ Q 27

¹⁵ Ev 25

¹⁶ Q 76

¹⁷ Q 44

¹⁸ Ev 98, Ev 102

¹⁹ Ev 26

²⁰ Ev 92

²¹ Ev 93

²² Ev 60

subcontractors do not seem to believe that retentions have any practical effect on the quality of work delivered or the rate at which defects are rectified, although it could be argued that 5-10% retentions do make a contribution to the completion of work in the event of insolvency on the part of the contractor.

Security of payment

16. Whether or not the retentions system delivers the security of service that those who defend it believe, it is clear that it offers little security of payment to contractors. We were told that most clients and main contractors treat the money withheld by way of retention as part and parcel of the business operation and to all intents and purposes as working capital.²³ Such cash is not ring-fenced in a separate account.²⁴ Under most forms of standard contract used in the industry, release of half of the retention is triggered by the completion of the project and release of the other half once defects have been corrected, or at the end of the defect liability period — generally twelve months.

17. In the event that the client or main contractor becomes insolvent, companies further down the supply chain are treated as unsecured creditors and do not have first call on the cash held in retention.²⁵ In practice this often means that a company so affected has little or no chance of recovering the retention. A survey carried out by H&V News for the heating and ventilation engineering sector found that 25% of respondents, mainly building services firms, had lost more than £50,000 each over the last 10 years as a result of insolvencies higher up the payment chain.²⁶ 70% of respondents reported losing between £5,000 and £30,000 from upstream insolvencies. Statistics provided by the DTI show that there were 3,373 company insolvencies and 3,812 individual bankruptcies in the construction industry in 2001.

18. Apart from the problems caused by insolvencies, it appears the timetabling of the retention payments can cause serious problems for construction firms. The SECG provided many examples of problems that contractors and subcontractors had experienced in these respects. A major problem appears to be that, in practice, subcontractors have little or no influence over the timing of the release of their retentions.²⁷ Mr Bingham of the SECG cited his own experience as a steelwork contractor, where the time elapsed between his completion of the steel frame for a building to the eventual completion of the building could be up to three years, during which time his company had to bear the cost of financing the retention.²⁸ Payment of the retention can also be delayed by a main contractor because of problems with the satisfactory completion of work in an area entirely unconnected with the subcontractor's work. Examples given to us included unsatisfactory landscape gardening and the quality of road surfacing in the car park of a building, both of which delayed the acceptance of the projects by the clients, which in turn delayed the payment of retentions to all the subcontractors involved in those projects.²⁹

19. Another common complaint among subcontractors is the difficulty that many experience with the recovery of retentions from clients even in the event of a successful completion of the main contract. Here again, the SECG submission gave examples of problems and costs incurred by subcontractors in recovering such late payments from their customers. The DTI pointed out that legislation exists to deal with abuses of payment in the form of the Late Payment of Commercial Debts (Interest) Act 1998, which would apply

²³ Q 7, Q 47

²⁴ Q 8, Ev 35

²⁵ Q 7

²⁶ Ev 103

²⁷ Ev 35

²⁸ Q 9

²⁹ Q 8, Ev 58-65

to abuses of retentions. It is also open to those affected by disputes over retentions to seek adjudication under the Housing Grants, Construction and Regeneration Act 1996, as amended in August 2002.³⁰ Action along either line would inevitably incur additional administration and financial costs, however, and in many cases does not offer a realistic route by which SMEs can retrieve their retentions.³¹

20. We also considered whether the retentions system could be adapted to make it less onerous. One option might be to exclude temporary works from the system; another to require the release of their portion of the retention to sub-contractors who had completed their work as soon as that work had been signed off as satisfactory. But the first of these would simply redistribute the burden of retentions among the remaining contractors and sub-contractors, thus making the position worse for some SMEs. As for the second, it would result in the main contractor acquiring responsibility for an increasing proportion of the total retention; or in the client being required to pay over the retention bit by bit before the completion of the project, thus undermining the main point of the retention as an incentive to the contractor.

21. Given the doubtful benefits and the clear disadvantages of retentions, it would obviously be in everyone's interest for such an inefficient — and frequently harmful — practice to disappear. One solution suggested by some contractors has been to make retentions illegal. Abolition of retentions would presumably require legislation. We have received conflicting evidence over the effectiveness of such legislation. While Masons suggested to us that it may be relatively straightforward to draft such legislation,³² Ms Edwards of the CC felt that it would be very difficult.³³ **We are not convinced that legislation designed to outlaw retentions would have the desired effect. The practice is essentially a contractual matter between two parties, and we feel that it may not be difficult to amend such contracts to produce the same effect as a retention by another means. In any event, the fact remains that for many the present client-contractor relationship is not sufficiently robust that clients have the confidence defects will be rectified by the contractor in the absence of a specific remedy available to them. In addition, introducing legislation would take the focus of the industry away from the need to alter methods of working between clients and contractors to improve relationships and to increase productivity.**

³⁰ Ev 27

³¹ Ev 41

³² Ev 99

³³ Q 100

IV ALTERNATIVES TO RETENTIONS

22. However effective or ineffective they may be in ensuring that defects are rectified, retentions would not be necessary at all if the construction sector could deliver defect-free works, or if clients had an alternative available to them to ensure that defects were rectified within an acceptable period. Unfortunately, at present, the industry as a whole has little to offer by way of an alternative form of assurance. Some initiatives have been put in place in specialist sectors, however.

23. Retention bonds as an alternative to cash retentions were proposed by Sir Michael Latham in his review *Constructing the Team* as a means of providing a similar level of protection to clients for matters covered by the bond, usually defects.³⁴ Such a system was introduced in 1996 by the British Constructional Steelwork Association.³⁵ The BCSA claim that their bond scheme reduces costs to members and frees significant sums which otherwise would have been withheld as retentions. Within the SECG, other trade associations, such as the Electrical Contractors Association, offer warranty schemes to their members, which provide clients with the assurance that defects will be corrected through the association membership at no cost to the clients themselves.³⁶

24. Alternatives, such as bonds or warranties, offer a degree of protection to clients, but they appear to operate only in some specialist sectors. As the DTI memorandum pointed out, they have not been well tested in the marketplace and are not in common use.³⁷ One of the reasons for this might be that retentions are embedded in the standard forms of contract used throughout the construction industry. Another possible reason is that retention bonds and insurance policies impose costs on firms in the same way as retentions, and the costs of acquiring such instruments are particularly problematic for SMEs. On the other hand, Masons estimate that a universal system of bonds might require contractors to obtain bonds for 3-5% of their turnover.³⁸ **Retention bonds and warranties offer a possible alternative to retentions for specific sectors, but do not appear to provide a long-term solution to the problem. The general feeling among our witnesses was that alternatives to retentions such as these would invariably be as or more expensive to client and contractor.**

Changing the culture

25. We found general agreement that improvements in procurement practice in the construction industry would lead to improved productivity and performance in terms of significant reduction of defects on completion and other factors.³⁹ This would, in time, obviate the need for the retention system. Government and the industry have been working towards this overall objective for some time. In 1998 the Construction Task Force advocated an integrated approach to construction project design and implementation, involving clients, architects, designers, consultants and contractors at every stage in the process.⁴⁰ This approach encourages trust among all of the stakeholders in a project.

26. The Strategic Forum for Construction, chaired until recently by Sir John Egan, expands on this approach in its recent report to help bring about a significant change in the

³⁴ *Constructing the Team*, HMSO,

³⁵ Ev 93

³⁶ Ev 94

³⁷ Ev 26

³⁸ Ev 100

³⁹ Q 28, Q 59, Q 90

⁴⁰ *Rethinking Construction: Report of the Construction Task Force*. DETR Publications, July 1998

relationship between clients, contractors and subcontractors.⁴¹ The Forum recommends and sets targets for the development of an integrated supply chain for construction project management and promotes the concept of client leadership to promote trust and co-operation down the supply chain. In the view of the CCC, the integrated supply chain approach to project management, the development of client-contractor partnerships and other initiatives recommended by the Forum, were being driven by clients, who had become frustrated by the level of service that the industry was delivering in the traditional client-contractor culture that had operated within the sector for many years.⁴² The CC agreed that changes had to be client-driven in order to change the present culture.⁴³ The SECG had also been involved in the work of the Forum and in general supported its recommendations on the development of the integrated supply chain.⁴⁴

27. Some major clients have already adopted the integrated approach. Tesco Stores Ltd. provided evidence of its experience of using an integrated team approach to reduce defects and so reduce the need for retentions, to the point where they were no longer used.⁴⁵

28. Recognising that the integrated approach would be easier to implement for large or frequent clients of construction projects, the Forum recommended better access for smaller or occasional clients to independent client advice to enable them to adopt best procurement practice and to help them select the appropriate members of the team for their project.

29. The Forum advised that the development of integrated supply teams should enable risk management to be addressed by the whole team involved in a project, and therefore should make it possible to obtain project-based insurance which covered both professional liability issues and construction risks. In such circumstances the need for retentions would be removed. Some clients have already adopted this approach. The CCC cited the case of BAA and the construction of Terminal 5 at Heathrow Airport as an example.⁴⁶

30. Work is also in progress on the development of model payment mechanisms and key performance indicators for payment within supply chains to establish benchmarks for best practice. The Forum had set itself a deadline of April 2003 for completion of this work. The DTI has produced performance indicators covering, among other issues, contractor satisfaction on payment and in relation to payment of retentions. We were told that work on the identification of performance indicators in relation to defects and the improvement of contractor performance was well advanced.

31. We believe that the reforms to the ways in which construction clients and contractors work that are being developed by the Strategic Forum for Construction should eventually lead to better working practices, better performance by contractors and a better culture within the industry. In such conditions, retentions will become obsolete. We note that some clients have already adopted new working arrangements which do not include retentions; we recognise that such changes may be easier for major or frequent clients to embrace. Until such time as the Forum's objectives have been attained and the required culture change effected, small or infrequent clients will still feel the need for some form of assurance that defects will be rectified. There does not appear to be any practicable alternative to the retention system for such clients at present.

⁴¹ *Accelerating Change: A Report by the Strategic Forum for Construction*. August 2002

⁴² Q 52

⁴³ Q 90

⁴⁴ Q 28

⁴⁵ Ev 97

⁴⁶ Q 59

V THE ROLE OF THE PUBLIC SECTOR

32. The public sector is the largest client group for the construction industry. Publicly funded construction projects account for 40% of business in the construction sector, so the potential for Government Departments and other public bodies to influence working practices in the industry is significant. The DTI is aware of the concerns within the construction industry over the use and abuse of retentions and broadly accepts that there is a problem.⁴⁷ It has adopted a long-term strategic policy of encouraging wider changes in the industry which, it argues, will eliminate the need for retentions by development of the integrated, partnering approach to project management and implementation, as advocated by the Forum.⁴⁸ DTI officials assured us that the department responsible for co-ordination of government procurement, the Office of Government Commerce (OGC), is committed to this strategic approach. It is perhaps not surprising — given the light touch, gradualist approach adopted by the OGC — that there is no co-ordinated guidance for Government departments on their construction procurement policies with specific reference to retentions.

33. Nevertheless, we were surprised that the policies adopted by individual central government purchasers varies so much across Government departments. Some major construction clients, such as NHS Estates, Defence Estates, the Department of Work and Pensions and the Highways Agency, have adopted working arrangements which have allowed them to remove retentions from contracts for much of their business, and are looking to replace retentions with an incentive-based approach wherever possible. Even in these cases, retentions are often applied to contracts for small works. Others, such as the Home Office are committed to phasing out retentions for their contracts. The DTI does not have any standard practice on retentions at all and considers the need to withhold them on a case-by-case basis.⁴⁹

34. We heard that the OGC aims to encourage best practice among the major public sector clients in an informal way through its Central Government Construction Task Force, which provides the forum for government departments to share best practice and their experience of implementing the Forum's recommendations and principles.⁵⁰

35. We recommend that a more proactive approach is adopted to the co-ordination of construction procurement practice across government departments than has been taken so far. It seems odd that there is such variation in departments' policies on retentions, and we wonder if this is symptomatic of other procurement issues. Consistency of approach would reduce the scope for confusion between clients and contractors. Given the size of the public sector as a client and the influence that it can exert upon practices in the construction industry, it should be taking the lead in adopting procurement practices which should render such anomalous features as retentions redundant. Although some government departments and agencies are taking the lead, this is not yet happening on an even basis across government and its executive agencies.

36. The SECG suggested that Government departments should be given a target date of 2007, by which time retentions should be phased out of their procurement contracts.⁵¹ Given the wide variation in practice across departments, this would be

⁴⁷ Q 108

⁴⁸ Ev 26, Q 119

⁴⁹ Ev 72

⁵⁰ Q 120

⁵¹ Ev 30

a challenging target. We see no reason why it should not be attempted, particularly for major procurement contracts.

37. We asked whether retentions were a feature of Private Finance Initiative projects. The DTI evidence suggested that PFI contracts do not involve client-held retentions.⁵² That may well be the case, but the SECG informed us that in their practical experience retentions were applied to PFI contracts.⁵³ This presumably stems from the fact that in a PFI project the public sector client is not buying the building being constructed, merely the use of that facility for the period specified in the contract. **In the negotiation of future PFI contracts, the Government should insist that its principal contractors agree not to require retentions from their contractors and sub-contractors engaged in construction works associated with those PFI projects.**

38. Taken together, other public sector clients such as local authorities represent a major source of construction procurement. We have been told that the performance of local authorities varies widely in terms of moving away from the old standard procurement practices to the new integrated approach to construction project management.⁵⁴ Several current initiatives should address this problem, at least in part. The Local Government Task Force and the OGC are working with local authority groups to encourage changes in procurement and client project management practices. The proliferation of representative bodies within local government may act as a barrier to the spread of best industry practice,⁵⁵ but work is underway within the industry to change client behaviour. The CCC has developed a toolkit, the Clients Charter, to help them become best practice clients. We were told that this has been adopted by housing associations and is now being rolled out to local authorities, and that it is also suitable for use by small and occasional clients.⁵⁶ **Within the context of the promotion of responsible competition, initiatives such as the Clients Charter toolkit are to be commended.**

39. As the Forum acknowledged in its Report, some clients may be concerned that the principle of integrated project management might appear to conflict with the principle of competition. The National Audit Office has advised that this method of procurement did comply with EU and government procurement rules, provided that it was undertaken in an open and transparent way with appropriate measures taken to ensure that best value was being delivered.⁵⁷ **We recommend that the DTI undertakes a study to assess the impact of the integrated approach to project procurement on competition in the construction sector.**

40. Another initiative designed to encourage a common approach to procurement came from central government. To assist public sector clients in the task of selecting contractors and subcontractors for their projects, the Government launched its *Constructionline* service in 1998 as a public-private partnership. The original aim was to create a single national database of construction companies vetted for their capacity and expertise according to standards already used in the public sector. Construction firms pay an annual registration fee, which is calculated on a sliding scale relating to their annual turnover. The intention was that clients could access the *Constructionline* database instead of carrying out their own prequalification process prior to works procurement.⁵⁸ The system was intended to offer advantages to clients in savings on administration and assessment costs, and to construction firms in reducing the necessity to prequalify for individual clients.

⁵² Ev 72,73

⁵³ Qq 20-23

⁵⁴ Q 68

⁵⁵ Q 71

⁵⁶ Q 62

⁵⁷ National Audit Office, *Modernising Construction*, HC [2001-02] 87

⁵⁸ Ev 84

41. Unfortunately, the service does not seem to have lived up to its initial promise. We were told that some major government construction clients will not use the database, preferring to use their own.⁵⁹ Delays in delivery of the service allowed time for the development of other commercial registers. We were told that local authorities used several such databases.⁶⁰ The net effect has been that contractors must qualify for several *Constructionline*-type registers and pay annual registration fees, in order to ensure that the whole of their potential public sector client base is aware of the services they offer.

42. The DTI is currently considering ways of updating the *Constructionline* service to reflect the integrated approach to construction projects advocated by the SCF. If the service is ever to fulfil the function that was originally envisaged, this upgrade must be completed as a matter of urgency. The Department should also do all it can to encourage Central Government to use the service to reduce the duplication of effort for contractors trying to prequalify for government procurement exercises.

⁵⁹ Q 94
⁶⁰ Ev 75

LIST OF CONCLUSIONS AND RECOMMENDATIONS

Reasons for retentions

- (a) **The SECG said that the practice of retention reflects the negative client/contractor culture that has persisted for many years. In their view, the retentions system encouraged an atmosphere of distrust between contractor and client. The DTI agreed that clients, contractors and subcontractors did not trust each other to deliver defect-free work and that this was an endemic cultural problem. (paragraph 12)**
- (b) **We note that, while construction clients felt that the use of retentions afforded them a degree of assurance and control over the rectification of faults and gave some level of insurance against insolvency by the contractor, it was not possible to establish how effective the current system is in practice. By and large, contractors and subcontractors do not seem to believe that retentions have any practical effect on the quality of work delivered or the rate at which defects are rectified, although it could be argued that 5-10% retentions do make a contribution to the completion of work in the event of insolvency on the part of the contractor. (paragraph 15)**

Making retentions illegal

- (c) **We are not convinced that legislation designed to outlaw retentions would have the desired effect. The practice is essentially a contractual matter between two parties, and we feel that it may not be difficult to amend such contracts to produce the same effect as a retention by another means. In any event, the fact remains that for many the present client-contractor relationship is not sufficiently robust that clients have the confidence defects will be rectified by the contractor in the absence of a specific remedy available to them. In addition, introducing legislation would take the focus of the industry away from the need to alter methods of working between clients and contractors to improve relationships and to increase productivity. (paragraph 21)**

Alternatives to retentions

- (d) **Retention bonds and warranties offer a possible alternative to retentions for specific sectors, but do not appear to offer a general long-term solution to the problem. The general feeling among our witnesses was that alternatives to retentions such as these would invariably be as or more expensive to client and contractor. (paragraph 24)**
- (e) **We believe that the reforms to the ways in which construction clients and contractors work that are being developed by the Strategic Forum for Construction should eventually lead to better working practices, better performance by contractors and a better culture within the industry. In such conditions, retentions will become obsolete. (Paragraph 31)**
- (f) **We note that some clients have already adopted new working arrangements which do not include retentions; we recognise that such changes may be easier for major or frequent clients to embrace. Until such time as the Forum's objectives have been attained and the required culture change effected, small**

or infrequent clients will still feel the need for some form of assurance that defects will be rectified. There does not appear to be any practicable alternative to the retention system for such clients at present. (paragraph 31)

Role of the public sector

- (g) **We recommend that a more proactive approach is adopted to the co-ordination of construction procurement practice across government departments than has been taken so far. It seems odd that there is such variation in departments' policies on retentions, and we wonder if this is symptomatic of other procurement issues. Consistency of approach would reduce the scope for confusion between clients and contractors. (paragraph 35)**
- (h) **Given the size of the public sector as a client and the influence that it can exert upon practices in the construction industry, it should be taking the lead in adopting procurement practices which should render such anomalous features as retentions redundant. Although some government departments and agencies are taking the lead, this is not yet happening on an even basis across Government and its executive agencies. (paragraph 35)**
- (i) **The SECG suggested that Government departments should be given a target date of 2007, by which time retentions should be phased out of their procurement contracts. Given the wide variation in practice across departments, this would be a challenging target. We see no reason why it should not be attempted, particularly for major procurement contracts. (paragraph 36)**
- (j) **Opinions differed as to whether retentions were a feature of Private Finance Initiative projects. The DTI suggested that PFI contracts do not involve client-held retentions, but other witnesses informed us that in practice retentions were applied to PFI contracts. This presumably stems from the fact that in a PFI project the public sector client is not buying the building being constructed, merely the use of that facility for the period specified in the contract. In the negotiation of future PFI contracts, the Government should insist that its principal contractors agree not to require retentions from their contractors and sub-contractors engaged in construction works associated with those PFI projects. (paragraph 37)**
- (k) **Within the context of the promotion of responsible competition, initiatives such as the Clients Charter toolkit are to be commended. (paragraph 38)**
- (l) **We recommend that the DTI undertakes a study to assess the impact of the integrated approach to project procurement on competition in the construction sector. (paragraph 39)**
- (m) **The DTI is currently considering ways of updating the *Constructionline* service to reflect the integrated approach to construction projects advocated by the Strategic Forum for Construction. If the service is ever to fulfil the function that was originally envisaged, this upgrade must be completed as a matter of urgency. The Department should also do all it can to encourage Central Government to use the service to reduce the duplication of effort for contractors trying to prequalify for government procurement exercises. (paragraph 42)**

MINUTES OF PROCEEDINGS RELATING TO THE REPORT**TUESDAY 26 NOVEMBER 2002**

Members present:

Mr Martin O'Neill, in the Chair

Mr Roger Berry
Mr Richard Burden
Mr Jonathan Djanogly
Mr Lindsay Hoyle

Dr Ashok Kumar
Mrs Jackie Lawrence
Linda Perham
Sir Robert Smith

Draft Report (The Use of Retentions in the UK Construction Industry), proposed by the Chairman, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 42 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Second Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select committees (reports)) be applied to the Report.

Several papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

[Adjourned till Wednesday 27 November at Ten o'clock.]

LIST OF WITNESSES

Thursday 17 October 2002

THE SPECIALIST ENGINEERING CONTRACTORS GROUP

Mr Trevor Hursthouse, Mr Derrick East, Mr David Bingham and Mr Ted Pearson Ev 1

THE CONFEDERATION OF CONSTRUCTION CLIENTS

Ms Zara Lamont Ev 8

THE CONTRACTORS CONFEDERATION

Mr Trevor Walker, Mr Stephen Ratcliffe and Ms Clare Edwards Ev 12

THE DEPARTMENT OF TRADE AND INDUSTRY

Mr John Alty and Mr Rodger Evans Ev 16

LIST OF APPENDICES TO THE MINUTES OF EVIDENCE

Memoranda submitted by:

1. The Confederation of Construction Clients	Ev 22
2. The Construction Confederation	Ev 22
3. The Department of Trade and Industry	Ev 25
4. The Specialist Engineering Contractors Group (SECG)	Ev 28
5. Supplementary memorandum by the Construction Confederation	Ev 70
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8. Mainland Contractors	Ev 91
9. NT Security	Ev 91
10. Eurowindows	Ev 92
11. The British Constructional Steelwork Association Limited	Ev 93
12. The Electrical Contractors' Association	Ev 94
13. Frank Griffiths Associates Limited	Ev 95
14. Tesco Stores Limited	Ev 97
15. UMIST	Ev 98
16. The University of Cambridge Estate Management and Building Service	Ev 98
17. Masons	Ev 99
18. The University of Leicester Estates Office	Ev 102
19. H & V News	Ev 103
20. The Joint Contractors Tribunal	Ev 105

LIST OF MEMORANDA RECEIVED BUT NOT PUBLISHED

Memoranda submitted by:

BSIRA Limited

Neil Smith

Federation of Master Builders

Fenwick Elliott

Construction News

Select

Federation of Small Businesses

Heating and Ventilating Contractors' Association

Holly Park Electrical Services Limited

CPS Manufacturing Company

The British Property Federation

The National Specialist Contractors Council

MINUTES OF EVIDENCE

TAKEN BEFORE THE TRADE AND INDUSTRY

THURSDAY 17 OCTOBER 2002

Members present:

Mr Martin O'Neill, in the Chair

Mr Jonathan Djanogly
Linda Perham

Sir Robert Smith

Examination of Witnesses

MR TREVOR HURSTHOUSE, Managing Director, Goodmarriott & Hursthouse, MR DERRICK EAST, Managing Director, Accolade Building Services Limited, MR DAVID BINGHAM, Chairman, Caunton Engineering Limited, and MR TED PEARSON, formerly Commercial Director, Defence Estates, examined.

Chairman

1. Good morning, ladies and gentlemen. Welcome here this morning. We are going to start a few minutes early, a couple of minutes early, because we have got quite a list of witnesses this morning. Perhaps we could start, Mr Hursthouse, if you could introduce your colleagues and we will move on from there.

(*Mr Hursthouse*) Thank you very much. If I may I will introduce myself and perhaps my colleagues will introduce themselves. I am here principally as Chairman of the Specialist Engineering Contractors Group. That is a group of engineering specialists in the construction industry which represents a sector comprising over 60,000 companies with a workforce of more than 300,000. I am also Managing Director and owner of a business in Nottingham, we are electrical and mechanical engineers, and we have a turnover of approximately £20 million and employ 200 people. I am here to represent the industry and an understanding of my own business as well. My colleagues will introduce themselves.

(*Mr Pearson*) My name is Ted Pearson. Until a year ago I was Commercial Director of Defence Estates, so that, unlike my colleagues, here I have the experience of being a major client of the construction industry.

(*Mr East*) I am Derrick East. I am the Managing Director and proprietor of an SME in the construction industry, a specialist sub-contractor based in the South of England with a turnover of about five million a year.

(*Mr Bingham*) I am David Bingham. I am the Chairman of a family company, Caunton Engineering Limited, based in Nottingham. We fabricate structural steelwork. We have a turnover of 22 million and a permanent staff of 140.

2. Thank you so much. We have been told that retentions provide an incentive to contractors to avoid or eliminate defects. This is often an argument that is provided for various payments and things like that. Is there any evidence that retentions actually achieve this? Would any client or anyone be justified in not paying a retention on the basis that they do not think it works? What do you perceive as the

justification, if any, for retentions? How would you view it? I know that a lot of you are agin it but can you perhaps put it in context for us?

(*Mr Hursthouse*) There is an element of, "we would say that, wouldn't we?". There is no evidence that retentions deliver what is apparently their objective. If the intention is to withhold some money from somebody and use it to repair defects which have not been repaired or which they will not address, as far as I am aware, certainly from personal experience and from what I know of the industry, it just does not happen as a matter of fact. An example of that in my own business is, in 30 years, 30 years of having most of our major contracts with retentions in them, that has never applied once, the retention has never been used for that purpose. It simply does not work, it does not serve that purpose. In my view it is an archaic and pointless imposition on the industry and it has an effect, which you have seen in our presentation I am sure.

3. I realise that you chaps are from the construction industry but there are other people involved in the construction business, architects, consultants and the like. Are they involved in the retentions loop as well?

(*Mr Hursthouse*) Absolutely not, no, they just are not. It is an historical thing as far as I understand it. It is imposed on the contractor and the sub-contractor and that is all, presumably on the somewhat bizarre assumption that you have employed somebody to do a job and he is not going to carry it out properly, which is a heck of a way to start a job.

4. Either that or architects and consultants were not involved in the construction of railways and canals in the 19th Century.

(*Mr Hursthouse*) Exactly.

Chairman: We might explore that one later.

Sir Robert Smith

5. What use do you think is made of the cash that is held by way of retention by both public and private sector clients?

(*Mr Hursthouse*) It is perhaps not for me to say, although I could speculate. What I would say to you, and again I think it is referred to in the presentation,

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[Continued

[Sir Robert Smith Cont]

is when members of SEC Group, for example the British Constructional Steelwork Association, the Lift and Escalator Industry Association, put in place arrangements where they offered a bond as a group rather than cash retentions the OFT were invited to become involved in that because of a complaint made by—it is an open fact—a local authority who presumably found themselves deprived of cash that they use for whatever purpose.

6. Maybe Mr Pearson will have experience.

(*Mr Pearson*) I have not had the experience, I am glad to say, but one can only assume, and I tend to agree with Trevor, that it is used for working capital.

7. So in a sense if the company went insolvent would there be any protection of the retention money?

(*Mr Pearson*) There normally is not and if you are asking, “does it go into a separate ring-fenced account”, I think, generally, the answer is no.

8. Therefore, you just queue up with all the other creditors. When are retentions required to be repaid? What is the normal condition that triggers the repayment of retentions?

(*Mr Hursthouse*) There is a very contentious issue here as far as people in the industry are concerned. Sometimes that is difficult to define. It is broken into two halves. The first half of the retention is released at practical completion when it is said that the building is complete and usable. The problem with the second half is that it is theoretically a 12 month defects liability period, as it is called, and at the end of that period somebody will certify that the entire project is completed and defect-free. If it was not so serious it would almost be humorous, the fact that, for example, the steelworker who puts up the steel frame is in a position where if a plant has died in the front garden and somebody will not replace it he cannot recover his retention, which is absolutely bizarre as far as he is concerned and significant sums of money can be involved.

(*Mr Bingham*) We are a steelwork contractor so we are the first in. The foundations are laid and then our frame goes up. No-one can work unless our steel frame is correct so any problems are ironed out immediately and retention as far as we are concerned is a no-go area. Having said that, being the first in, it can be three years before the building is practically complete, like this building, I do not know how long it took but it took a long while. The steel frame contractor is the first in line having retentions stopped and until the front door push works the building is not complete. The guy who fits the front door, his retentions are only held for probably six weeks or something like that and we have been on the line with our money for three years.

9. All the contracts build the retentions up the top to the overall contract and when you contract to do the steel work you cannot put into your contract a different date for the retention?

(*Mr Bingham*) Over the years we have built into our financial budget the fact that we are going to have to finance retentions. Financing the retentions in our company works out in interest to a matter of £4.45 per week per employee, just financing retentions.

That is a lot of money, £32,400 a year just to finance retentions. It is ridiculous because we can do a lot with that like training, all sorts of things.

Chairman

10. What is the hourly rate you pay your employees?

(*Mr Bingham*) The hourly rate currently is about £7.50 and then they earn a bonus on top.

11. So it is about half an hour's pay per worker?

(*Mr Bingham*) Yes.

12. Which is about one-eightieth of the weekly work, 1.25 per cent of your wage bill?

(*Mr Bingham*) Yes.

Mr Djanogly

13. Good morning. Are there changes that could be made to your industry practices which are more likely to have an impact upon defects than the current system of retentions?

(*Mr Hursthouse*) Yes, very much so, and that is the heart of the matter, that is the procurement of construction generally. The procurement of construction in the past has proved very unsatisfactory. Over the last eight, nine years there has been a lot of investigation into construction procurement, reports starting, I suppose, with Sir Michael Latham's report and then through two reports from Sir John Egan and the most recent report, *Accelerating Change*, which you have probably seen. What that is all about is a completely different approach to the procurement of construction based on employing companies who are properly qualified, who are registered as qualified, can deliver quality and performance, employ people who are qualified. In a way these are very obvious things that you would expect anybody to do. I mentioned earlier the word trust, so there is trust between the parties that (a) as the contractor that you get paid and (b) to the client that you will perform. In those circumstances, and there are many examples of it, the fact is zero defects is frequently achieved because there is that commitment and trust between the two parties. Certainly from SEC Group's point of view and from the industry's point of view Government have committed themselves to being a best practice construction procurer and that could be the most likely thing to drive out defects.

Mr Djanogly

14. Might that not have the effect of cutting out smaller companies?

(*Mr Hursthouse*) My own view is no. You can have a quality small company and a quality large company, the company that is suited to the type of project and the size of the project. In that case I do not think that small is necessarily not quality. The Government initiative the Quality Mark Scheme, which has been introduced for domestic contracts, domestic work, to try and drive cowboys, as they are called, out of the industry is very much targeted at the small company but small companies that deliver good quality.

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[Continued

[Mr Djanogly Cont]

(*Mr Pearson*) Can I just add to that. There has been a consistent move in recent years within the industry to improve its procurement process. By that I mean establishing long-term relationships, working together in integrated project teams, good partnering arrangements, fair payment arrangements, a reasonable allocation of risk, etc. With that sort of established procurement process you really do not need retentions. As an ex-major client I looked to deal with prime contractors and main contractors who wanted to come on board with an established supply chain and that meant right down the supply chain to the smaller companies and the SMEs within that supply chain.

15. Some people do say that the problem is not actually retentions, it is the way that final payments are actually made. I think Mr Bingham touched on this in what he had to say, that the job is done but it could take two to three years to sort out the retentions. It is not the problem of the retention itself, it is the problem that it takes two to three years to sort it out. Do you think there could be room for looking at a more set or generally agreed timetable?

(*Mr Hursthouse*) The answer to that is yes, there could, but I also think the evidence is that whilst I hear what you say about the retentions themselves, they can be eliminated and you can produce zero defect work. I think the point is, again as you may have seen in our submission, people are doing it and we have evidenced those results. In the public sector, as Ted said, Defence Estates, NHS Estates and Highways Agency now do not have retentions. There are significant parts of government which do not bother with retentions. In the private sector: Tesco, Sainsbury's. My own company works with the Boots Company and we work on arrangements where there are no retentions and they will testify that we deliver zero defects on completion.

16. Presumably, that is more related to the element of repeat work. It is more likely to be the case where you are getting job after job so there is going to be a continuous series of bills and payments rather than a one-off.

(*Mr Hursthouse*) There is an element of that but the reason we do get that is because we deliver quality. They did not just pick us out of the *Yellow Pages*, we were clearly vetted to prove that we could deliver quality. We can, we have, and therefore the relationship continues.

17. Finally, retentions deal with security for the customer but are there any issues of security of payment that you would like to have addressed from your point of view?

(*Mr Hursthouse*) Yes, very much so, there are. There is no security of payment. In my own company three or four weeks ago a client went into receivership and we had finished the job, a production unit for them, we made a good job of it. It is a serviceable building, we put a lot of time and effort into it, but they have £15,000 of our retention. There is no dispute it is our money, nobody would deny that, but it will just go into a pot and we will never see it. Certainly for those sorts of sums of money to be in some way ring-fenced would be desired. The insolvency issue is a big issue, the way that catches the sub-contractor and the sub-sub-contractor. For

that to be in some way ring-fenced would be a tremendous advantage. I do not think it is a very technical and difficult thing. The Government in their construction procurement contracts could just decide to do it; it is not something that needs major legislation.

18. The Government is not going to go bust, I hope.

(*Mr Hursthouse*) You are quite right. However, the Select Committee must recognise that the real risk of insolvency that usually arises is due to the main contractor rather than the client failing.

(*Mr Bingham*) The problems with non-performance or shoddy workmanship are addressed during the contract anyway. The client's quantity surveyor will not pass work that is not fit and you do not get paid for it until it is put right. That is a fact. You do it yourself. If a new kitchen is fitted and the door does not fit and your wife is banging the table and saying, "I am not paying for this", that is better than retentions because you get the job done and you want it done right.

Chairman

19. You have been talking about the public sector but what about this new creature in the public sector, the PFI? Is there any experience of this hybrid, if I can put it that way? What are becoming the increasingly normal public sector rules relating to retentions being applied in PFI or because of the partnership and the private element retentions involved there?

(*Mr East*) We have recently finished a large PFI project. PFI works and it is strong where there is a construction team who are totally unified. The problem with the retention principle is that it devolves down through the construction team and causes tensions. In a very real way the PFI concept is undermined by the existence of retention within that arrangement. Partnering and PFI all are towards having a unified construction team all trying to do their best to produce what the client really wants and retentions are very divisive of that.

20. I can see that they are potentially divisive but do they take place, that is the point? Is this a new hybrid way of acquiring public assets? I will move away from what has become the public sector procurement process that we have had described already this morning.

(*Mr East*) On PFI our experience was that on the two projects undertaken both of them had retentions on them.

21. So you are going back, as it were?

(*Mr East*) I view retentions as an inertia that we have got to overcome. People are very conservative in the way they go about things and they are viewed as the norm. At the moment the view is "of course there will be a retention unless you can demonstrate otherwise" and that is why we are seeking a new approach.

(*Mr Pearson*) Could I just add something to that. Of course in a PFI situation, the public sector client will actually be buying a service for a period of time, he is not actually buying a facility. That facility is provided by the special purpose company specifically

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[Continued

[Chairman Cont]

for the purpose of delivering the service. The special purpose vehicle will actually carry out procurement and it is up to that company to determine the downstream contractual relationship. Very often in my own experience the SPV—special purpose vehicle—does actually impose retentions.

22. It does?

(Mr Pearson) Yes.

23. So we, the public taxpayer, are in fact paying for the retention in this new set-up whereas if it had been in a non-PFI arrangement we would not have been paying?

(Mr Pearson) Not necessarily. It depends entirely on the contract relationships. Some clients, both public and private sector, will impose or seek retentions and some will not: it depends on the circumstances and it depends on the strength, if you like, of their selection and evaluation process as part of their procurement operation. It may well be that some PFI situations, for example, do not have retentions in them but some certainly do to my knowledge.

24. That would be contrary to what would have happened had the facility been procured under the old contract?

(Mr Pearson) It is mix and match, it can be either way. The slightly contrary thing about PFI, of course, is very often the SPV will have, as one of its owners, the main contractor which is actually providing the facility in the first place, so in a sense they are applying a retention to themselves.

Chairman: Thank you.

Linda Perham

25. First of all can I thank you for your evidence, it is very comprehensive and I spent a happy hour or so reading it. Can I ask you, if the practice of retentions was stopped what would happen to the consequent savings that the industry would then make? Is it the case that people are rather cynical at the outset? I think somebody wrote to us saying they literally wrote it off at the beginning when they made their quote, given the difficulty of getting it back. Do you think there would be cash available in the industry if that practice was stopped?

(Mr Hursthouse) Yes, I do. It is estimated that, withheld in retentions in the industry at any given point in time, there are over £3 billion. That is an awful lot of money which is not being put to good use or put to proper use. You asked the question where is it and nobody is quite sure. I think we operate in a business which is very competitive and works on tight margins; it is a relatively high risk business. There are companies out there who are borrowing money at a cost to them and if they had their retentions then that borrowing would be reduced, if not eliminated. We were talking about insolvencies and there is no question that it can drive people nearer the edge of insolvency within the industry because money which is rightfully theirs is held by somebody else. What would happen to it? My personal view is if we go back to the fundamental principle that we are talking about employing companies in construction who are qualified companies, businesses committed to delivering a quality product and to developing their

businesses, on the assumption that people are not going to go off and buy a yacht in the Bahamas—I do not think they would do that in the SMEs; they are hard working people who want to produce a good result—it will be reinvested. It will be reinvested in equipment systems, training and other resources which will grow their businesses. In a way what else would they do with it if they got the money, assuming they are not going to run off and do something silly with it.

(Mr Bingham) In our association we have a lot of smaller companies as well. There are 500 companies making structural steel ranging from companies employing hundreds down to a matter of three or four but in every case the retention fund—we have done a big survey on this—equates to half their bank facility but the bank will not recognise retentions as an asset on the books because you cannot prove you are going to get paid within three or four months; it is years. The bank manager just puts a line through the retentions and says “no, I am not allowing that at all”. This is a very difficult problem for particularly the small to medium sized companies in arranging their banking facilities.

(Mr Hursthouse) I just add to that statistically, if it will help you, that, as of the day before yesterday, in my own business nearly £455,000 was held in retentions against our business. The annual net trading profit would probably be in the order of £800,000. So more than half of our annual profit is held by somebody else and probably getting up to £100,000 of that would be overdue at any one time.

26. Can I ask you about a suggestion you have made in your evidence in paragraphs 63-68 about payment bonds. In paragraph 68, you talk about retention bonds, which I think certainly the Construction Confederation said would be costly to administer, and you say the smallest contractor's contract costs are still prohibitive. How would this payment bond work, because you said that as far as the British Constructional Steelwork Association is concerned, their members have said that it costs seven times less to fund bonds than to fund cash retentions, which I thought was an interesting suggestion. Could you just explain that to me?

(Mr Hursthouse) It is not an ideal solution but if retentions are here there are different ways of dealing with them. We have talked about getting them released in a more civilised fashion. The bond is, I suppose, rather like an insurance policy so you keep your cash but you make an arrangement between two parties to call on that bond if it is required and if there is a problem with retention it needs funding. Within the SEC Group, members have in place warranties and in my own trade association, the Electrical Contractors Association, we have a warranty. If I, in working with a client, do not do what I am supposed to do, my association will come along and tell me I should do it and if I do not do that they will send somebody else to do it at no cost to the customer. Bonds are a substitute and really, I suppose, an insurance policy but, therefore, they have a cost and the smaller companies might have a problem bearing that cost.

(Mr East) They are another form of retention really. Retention in practice is a big problem for the industry. It is a levy on it. It is like trying to drive a

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[Continued

[Linda Perham Cont]

car with the handbrake on continually being pulled back financially. The figure for our company is £170,000. You asked earlier what that could be used for and the answer is more vehicles, more employees and, above all, more training. We could double our training budget if that money was available to us. That would be undermined if there were such an alternative used in the industry as the retention bond. It still is the same message, which is as a client we do not trust the person we have selected to do the work properly and that moral basis for working together totally flies in the face of modern construction practice. There is a high cost of taking out a bond. In some cases, if it was through the bank it would take up some of the company's borrowing facilities. It is not a satisfactory alternative to retention monies.

27. So you would rather retention was abolished?

(Mr East) Absolutely. The benefit for the client of having a working together way of construction is so great. All I can do is come here and say never mind what the theory might look like from the outside, in practice retentions continually undermine attempts to make people work together. All the time it is "the client owes us money and the client does not trust us". I cannot understate how much of an influence that has on the construction process.

28. Depressing really, is it not? I think in an answer to Mr Djanogly you did talk about Sir John Egan's Strategic Forum for Construction and I think you covered some of the progress towards a change in working processes. In the report, *Accelerating Change*, I was interested that he does mention the payment system and says the Forum will produce models for payment mechanisms by 2003, so I think we all await to see what is delivered. He also talks about project insurance products. I do not know if you have had any input into this process. Is that something which you have seen in the report as well or had any input into?

(Mr Hursthouse) SEC Group were very much involved in the production of the report and in the Strategic Forum and some of the report, certainly the integrated supply chain element of the report, was very much supported in general by SEC Group. Project insurance is a slightly different subject. Rather than individual companies being insured for a risk, you come to a particular project and then an insurance company insures the risk on the project. The idea being that it will create significant savings. It will also require for an insurer to take that risk to be certain that he is insuring a competent team that can deliver a successful project. Again, forgive me for keep returning to it but, when we talk about retentions and other alternatives and all the rest of it, yes, the alternative is for people to procure construction on the basis that they are dealing with people who will deliver a more than adequate quality project. Who else would go anywhere and start off by saying "I am going to give you the order but frankly I think you are going to let me down"? You would not buy a car on that basis, you would not buy anything on that basis, but in construction for some reason we do. The opportunity of *Accelerating Change* and for the Government to be a best practice client will eliminate that.

Chairman

29. Mr Bingham, do you want to come in on that?

(Mr Bingham) With Sir John Egan, we worked closely in the motor industry for many years with Rover Cars and we first started working for them probably 20 years ago. When they got very close in working relationships with Honda Motors they changed completely and went to procurement groups and they investigated the suppliers of the main contract. They would come and visit our works annually, they would check our accounts and if we were losing money they would want to know why and we probably would not get any orders. In the early 1990s most people were losing money so it was difficult to explain to them that you were not on your own. They have changed completely. The trust was such that we built the new Land Rover factory six years ago and the contract had gone from a 50mm thick contract to two sides of a piece of paper. By then we were working for BMW of course. They said "the contract, as far as we are concerned, is you will give us a picture of the building and you will highlight in colour where you will be every Monday morning". They erected a tower and the guy took a digital photograph of the building as it stood, e-mailed it to Munich, they compared it with our drawings and we carried forward like that. We finished two weeks ahead of contract, no retentions, no problems. They also asked us to look at the design, which was a German design, and said "Can you improve on this design? If you can we want to know". We looked at the production run and they extended the production line so instead of going round in circles they were going straight. We said the roof will carry a Land Rover conveyor anywhere but these conveyors are going straight. "Why is it designed to carry Land Rovers anywhere in the roof?" "We do not know". We redesigned it and saved them £60,000: that is working as a team. That is the way you are going to save money in building in the future. We have been more than happy to work in that environment.

30. Presumably the difference between a car and a construction project is that when you buy a car you can see it, you know what you are getting.

(Mr Bingham) You also know it is going to breakdown probably.

31. That is true. I think you take my point, with construction projects there are imponderables. I do not think in many cases it is a question of trust. I think, particularly for smaller companies and indeed individuals doing work on their home, say, it would be a question of, once the job has been done, the good contractors who they are using will be on to the next job, and therefore it is a concern that snagging matters that come up will not be dealt with, which is slightly different from the question of overall trust, the confidence of the contractor's ability.

(Mr Bingham) In our industry in the last 10 years we have quality assured investments in people, everything we have done is to make the product 100 per cent when it arrives on site. Clearly no one can attach anything if the steel work is wrong, it has just got to be right and you cannot leave site until it is right.

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[Continued

[Chairman Cont]

32. Is there something we can go away with from this meeting, to take to the person wanting to redo their house, that will give them more confidence that their snagging lists will be completed if retentions are taken away?

(*Mr Bingham*) Are there retentions on houses? I have never heard of one.

Mr Djanogly: If people work on homes there can be retentions, there certainly was the last time I—

Chairman

33. Mr Djanogly is a solicitor.

(*Mr Bingham*) Firstly, I would be open-minded not to have retention if I was persuaded there was another way that the problems could be addressed, which in my case would not be the fact that there is going to be a lot of repeat business. I am sure I speak for many millions of people in this country.

(*Mr Hursthouse*) I think that is perfectly reasonable but again it is all the more reason to make sure you are contracted with the right company who are going to deliver what you want. You rightly say with a car you can see the product and with a building you cannot, well it is all the more important to be dealing with the manufacturer or the constructor who is going to deliver. Earlier I mentioned a government-sponsored scheme, and that is about people having warranties. I think it is interesting for myself, for example, qualifications for the construction industry are taking off but they need driving a lot harder by central government and local authorities. I would not book a holiday with somebody who was not a member of ABTA, I do not know why I would not but I just would not. I do not know what the warranty is but I know there is some protection there. That is really what you are looking for. If you procure the extension to your house in the local pub you have a problem. If you do it through the process of appointing qualified companies who will warrant the work they are doing then you should get the right deal and if you do not you have a fallback position.

Sir Robert Smith

34. Presumably, the warranty goes back to the bond which you have with your customer. Your analogy with the car was interesting. Of course, the car industry went through a period of great distrust by the customer and they got round that by putting in long-term warranties—you have to use their servicing contract to get the warranty—but what Jonathan was saying, the analogy with the kitchen, is, if you have paid the full bill on the kitchen it is much harder if the door falls off six weeks later to get the door put back on, however intuitively if there is a 5 per cent retention sitting there waiting to be paid. There is a different working relationship with a commercial contractor contracting with a large business that understands how to procure and get a good deal, whereas for the domestic market there is a different road to go down to get the customer educated enough to cope without a retention as a way of giving them some kind of guarantee.

(*Mr Hursthouse*) I think, yes. I do not want to lose my way here, but if I went to buy a car and only gave them 95 per cent of the money and said I would give them the rest in a couple of years' time I doubt they would deal with me. Perhaps the analogy starts to get lost on us here. Yes, in terms of the domestic market one sees difficulties but there are solutions provided. What we are saying here is, our plea to you is that Government should take a lead and it is on Government contracts that we are looking for the phasing out of retention. I take your point, the domestic market is probably slightly different and needs a different approach, but we are asking this Committee to recommend that the Government take a different view.

(*Mr East*) Can I just say, your starting point on your view of retention is very interesting and very candid. You are, of course, starting off believing the contractor is not going to return and fix the kitchen door, or whatever it is wrong in principle, never mind in the effect on the culture of the contract.

Sir Robert Smith: We get casework and there is a reasonable background of casework of people who have that experience in construction.

Chairman

35. We are talking about different orders of magnitude here.

(*Mr East*) What we do actually, is we put our trust in you. We start doing the work for you, say on 1 January and we ask for some money at the end of January, please, and by the end of February, when we have done two months work, investing our trust in you, you then might pay us and then you want to keep five per cent back. That is wrong. It is wrong in principle, never mind in the effect of the culture of the contract.

36. You mentioned the public sector and, perhaps, giving us a lead we have some information provided by the DTI, which we got very late last night. I think it is fair to say it is patchy and inconsistent across the public procurement process. Mr Pearson, given your background in Defence Estates (you and your colleagues were responsible for something like 40 per cent of all construction work in the United Kingdom), could you have given the public sector a better lead to the rest of the market?

(*Mr Pearson*) As I indicated earlier, Chairman, I think best practice clients in both the public sector and the private sector are giving the lead. It is true to say that it is inconsistent, and I accept the word "patchy". I think I would expect to see best practice eventually extending over time as experience is gained and clients become more content with the results. It does all depend on the strength and the robustness of the procurement process that is put in place. As I indicated earlier, best practice as evidenced in Egan's Report, is about long term relationships, it is about working together, it is about a partnering basis and the fair allocation of risk, and so forth. In that situation, you generate a change in the culture of the industry. Ultimately, it is how clients can be convinced about the benefit of getting rid of retentions.

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[Continued

[Chairman Cont]

37. Let us stay with it—we will be talking to the clients in a minute—since you are poacher-cum-gamekeeper or vice-versa, depending on the way you look at it—

(*Mr Pearson*) I understand that, Chairman. I think the Confederation of Construction Clients actually take a very similar view, that this is something to be worked towards. It may not come in immediately but we are on the way.

38. I accept that there are clear goals which you want to work towards. What I am concerned about is whether or not we are moving quickly enough. What are the obstacles in your experience within the public sector to pushing forward this best practice approach? Is it because in different parts of the public sector they do a different scale of procurement. Obviously, some are builders and others are not, and the ones who are not, perhaps when they visit a major contract once a year, they are rather different from the people who are signing up for contracts every two or three weeks.

(*Mr Pearson*) I think that is part of the answer, yes. Clearly, there is a difference between, if you like, experienced clients and occasional clients. There is a difference when people start down the road, some start earlier than others, and some wish to phase it in over a slightly longer period than others. I think that is just human nature. Across both the public and private sector there is certainly a move in this direction. I think that it is generally now recognised and it is generally now accepted that there are benefits to the clients and to industry generally and ultimately to UK plc because money can be freed up and used for investment purposes.

39. Would it be right to say, in relation to the public sector in your experience, not only is there a variable amount of work procured but the professionalism of the people involved in the procurement process may be variable because they are not dealing with it daily and you might get the kind of career civil servant doing his three or four years in some “gulag” involving procurement before they go on to do something of a higher level of attractiveness in their career pattern, if I can put it that way?

(*Mr Pearson*) I seem to remember using exactly the same word actually. I think you are absolutely right, that is quite true and it is the inevitability of life that some people would actually push through an enormous amount of procurement in a year and others may not.

(*Mr Hursthouse*) One of the difficulties is perhaps the experience and the skill of the client, the procurer, in being able to identify best value. There is a culture which is running through Government and at local authority level, particularly in my experience, that there is only one best value and that is the lowest price. It is quite ridiculous and it has been proved to be ridiculous. There is plenty of evidence for local authorities to understand and assess what best value is. Again, going back to *Accelerating Change* and what Sir John Egan said, there are available, and increasingly available, tools/facilities for people to be able to measure best value on a project and not use lowest price. Lowest price leads us to where we

finished up, with retention, because there is no trust, because the guy is going to let you down if he has given too cheap a price, and so on.

Sir Robert Smith

40. Is there any sense of joined-up experience across the public sector? Is there any sense of a common theme behind procurement? Further back there has been an exchange between departments.

(*Mr Pearson*) There is, but probably not enough. It is difficult to say how you would ever get enough, to be realistic about it. In my experience, we used to have dialogue with other government departments who were treading the same route but that was insufficient at the end of the day. That was not for the want of trying, the imperatives of the day job always intervene. Now, of course, the Office of Government Commerce seeks to extend that best practice immediately. Before I left Defence Estates I initiated a series of discussions with the OGC in order to help spread the best practice we were initiating across government procurement and I believe that continued after I left.

Chairman

41. It is the case, I think, in Scotland that they have a best value concept now involved in a lot of public sector and local government.

(*Mr Hursthouse*) I am not so sure I know that. It is so here. There is a commitment at local authority level to provide evidence to central government of the fact that procurement right across the whole of their procurement activity is carried out on the basis of best value. It is their inability to manage and implement it. The easy way out, for them is to say best value is cheapest, and we all know that is not true. There is a commitment to best value but we are not seeing it happening fast enough.

42. This is, in some respect, your chance to publicly say what you think Government should or could do to help move away from retentions. Short of waving the magic wand and saying, “it finishes at five o’clock tonight,” what would you say would be the first steps to move away from retentions?

(*Mr Hursthouse*) Six o’clock would be fine. There has to be a commitment. Of course it cannot be done overnight, we know that. We suggested that a target date of 2007 or earlier would be appropriate for the phasing out of retentions on public sector contracts, because that is when other things begin to come together in *Accelerating Change* and a different approach to construction procurement in Government. In terms of how that would be delivered, in principle, the fundamental thing is that Government has said that it is committed to being a best practice client, that is implementing what is an accelerating change, integrated teams, early involvement of specialist contractors, trust between the parties, and so on. If they do that, it will happen. We talk about cost and the cost of procuring public construction, one has to remember all of these proposals are put there to save money on construction costs, never mind about retention, but to save money. When you look at the Government’s construction programme, the opportunity to save an

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enormous amount of money is tremendous. What we are saying is that we want Government, who say they want to be a best practice client, to see it implemented and, if they are going to get a result in the next five years, they need to be doing it in practical terms now rather than talking about it. In some cases they have become such, as Ted Pearson says. That is what we are looking for: a best practice client.

43. We have already had examples, Mr Bingham gave one of the Rover plant construction programme, where better quality assurance and good working relationships seemed to be the alternative to retentions. If that were to develop across industry as a whole, surely retentions would become obsolete?

(*Mr Bingham*) Retentions are becoming obsolete now, clients are working more and more in partnerships. We have partnerships with five main contractors at the moment, one of which is building

another Rover factory as we speak now on that same basis. I think that the private sector is moving very quickly down that direction, but government departments are not.

(*Mr East*) I put a word of warning in there. There is a lot of inertia about the construction industry that has to be overcome, the idea that retention will wither away would be a dangerous thing to take away from our evidence today. I do not believe that is the case. People will always default back to their bad habits. I think we need energy through the Committee to encourage the abolition of retention which will then allow good practice to happen. Retention is a bad practice, it needs to be out of the way in order for good practice to flourish.

Chairman: On that point, gentlemen, thank you very much for your evidence this morning, it is very helpful.

Examination of Witness

MS ZARA LAMONT, examined.

Chairman

44. Good morning, Ms Lamont, can I welcome you this morning. We are going to cover some of the ground that we went over with the SECG. We know you are coming at this as the client. One of the reasons that this is cited for retentions is that they provide an incentive to contractors to avoid and eliminate defects and, as you represent the clients' organisation, do you think that that actually achieves the aim; that as a consequence of retention you get better quality service? There is an element of guarantee, you have a whipped hand, as it were, in the relationship? Would that be a justification for retention?

(*Ms Lamont*) I think the clients are very well aware retention is an imperfect system. It is a system that is there, they know it, they understand how it operates and does it give them better quality product at the end of the day? Probably not. I think that is the fundamental problem. They need some form of redress which they have through retention for inadequate workmanship and poor delivery of the product. It may not be perfect but it works in part. It gives them some form of comfort.

45. The impression we got from the last evidence was that it is only partial protection, partial comfort in the sense that if the architect has made a pig's ear of the thing there is no redress against them because they are not subject to retention we were told.

(*Ms Lamont*) On the consultant side it works slightly differently, they do have PII which can be drawn upon.

46. PII?

(*Ms Lamont*) Professional Indemnity Insurance which can be called upon if there is a fundamental failure of the building to perform. The previous group said that consultants are not subject to retention. My understanding—and I should make it clear that while I am the Chief Executive of the Confederation of Construction Clients I am on

secondment from Carillon, a major contractor, and while I was there I was contract director on their professional services division, so I have knowledge from the consultant, contractor and the client perspective. While the general method of operation has not been to hold retention against consultants over this past few years, particularly with the introduction of PFI and design build contracts, if you like, where the contractor is the prime contracting organisation or the prime interface with the client, then consultants are more and more being asked to be party to retention.

Sir Robert Smith

47. You might be better placed to answer a question I asked earlier, what use is made of the cash withheld by way of retention?

(*Ms Lamont*) It is part and parcel of the business operation. I think it is important to understand from a client's perspective they are well aware that the cost of retention, the cost of negative cashflow is built into the bid that they accept from the outset. I suppose from a client's perspective if retentions, imperfect as they may be, are done away with would there be a decrease in the cost of the bid, the cost of the project to them? The general feeling is, no, there would not be but there would have to be some other system of insurance or warranty put in place which would invariably be more expensive.

48. Why do they believe there would not be any drop in the cost of the contract?

(*Ms Lamont*) That is just their general perception. I think from the answers you heard earlier about what they would do with the retention monies that is held, et cetera, invested in training, all very admirable things, but at the end of the day would there be a reduction in the cost to the client for the project. I think the inference was, no, there would not be.

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[Continued

[Sir Robert Smith Cont]

49. What is your view of the point that because it is just treated as part of the general cash there is no protection at all in terms of insolvency?

(*Ms Lamont*) From a client's point of view there is equally no protection against insolvency from the supply-side and contractors, suppliers and subcontractors become insolvent equally as frequently as clients do.

50. When are retentions required to be repaid?

(*Ms Lamont*) As was said previously, parts are paid on completion and then the remainder is paid usually at the end of the defects liability period, which in general is 12 months.

51. From your perspective do the clients hang on beyond that?

(*Ms Lamont*) It is important to remember from a client's point of view really construction is not their core business; it is not the reason that they are there and they would quite like to get rid of the construction industry and its input into their business as quickly and efficiently as possible. The fundamental problem that we have at the moment is the majority of projects are not handed over defects-free. While we can look at the abolition of retentions, I think we are skirting round what the core problem is: that clients want buildings handed over on day one which operate efficiently, effectively and with some form of guarantee.

Mr Djanogly

52. Listening to what you have to say it is interesting the different stance you are taking from the previous group. You were talking about encouraging partnership working arrangements and clearly there are different sorts of jobs to be done and different relationships involved. What you are saying is that most of your clients want contractors in and out rather than a long term partnership. Do you think that there are any ways in which this could be bridged? Are there any alternatives which you think could be worked? What is your view on warranties or the increases of warranties?

(*Ms Lamont*) If I can just clarify my last point. Yes, I think all of the partnerships, the arrangements which are happening in the industry frameworks, agreements, etc, have actually been driven by the client because they were so frustrated with the level of services they were getting and they have been the ones who have been instrumental in partnering supply chain integration, etc. All of those things happened within industry and they are extremely frustrated at the rate of change. With regard to warranties and assurances, or whatever description they get for their finished building: yes, they do want them. They are also very aware, from the insurance market point of view, they have little or no confidence in the construction industry either. I think that has been very evident over the past few months where the whole issue of PII insurance and contractors' liability insurance, as have been reported in the press, have increased by anything up to 300 per cent.

53. This is an important point, one thing we have not yet discussed this morning is the risk to the client of insolvency of the contractor or subcontractors. Can you just explain that to the Committee? I just noted it has not been mentioned yet.

(*Ms Lamont*) Well, yes. If a contractor becomes insolvent at any stage throughout the contract the client has very little course to redress with regards to getting someone new in to pick up the contract. Also after the project has been handed over, if there are defects which need rectifying the cost can be quite significant. I know from my own experience where we had a project where 30 per cent of the glazing had what was called nickel sulphide inclusions which caused the glazing to smash in effect, it was a fairly major problem. If the contractor or the specialist supplier or subcontractor or installer goes insolvent during the process of resolving the problem then whatever is held in retention is never going to adequately cover or recompense the client for the inconvenience as well as putting the base problem right.

54. This might be a question for the DTI later on but do you have any idea of the figures of insolvency?

(*Ms Lamont*) No, I do not.

Chairman

55. Your clients, they express concern about the issue but how often do such considerations come across your desk? How often do people go bust?

(*Ms Lamont*) In the construction industry?

56. Yes?

(*Ms Lamont*) Quite often. I would have to say probably more so than clients. I think there is one point which has to be remembered, which is that while clients are building up a very good relationship between probably their first point of call in the supply chain, the majority of the problems, the majority of the mistrust, etc, happens down through the supply chain, so it is between the specialist suppliers, the main contractors, the subcontractors, the sub-subcontractors and so it goes on. Really, what the clients want is for all of those players to come together as an integrated team and, whether they are repeat clients or, as the majority of the clients in the industry are, small and occasional one-off clients, is actually to bring them an integrated service with guarantee and surety that they have worked together over a number of projects and hence understand the product that they are delivering.

Mr Djanogly

57. The one-off job would never have had an understanding of those relationships?

(*Ms Lamont*) Well, part of the work that we are trying to do within the Confederation is to educate those clients so that they actually become more aware of the questions they should be asking, the type of component routes that they should be using so that they can ensure that they are selecting an integrated team.

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MS ZARA LAMONT

[Continued

Linda Perham

58. It is going to be very difficult, is it not, Ms Lamont, for firms employing just a few people, even by a few I mean not just one or two but even a dozen or 20 perhaps, to get in on this integrated team, do you not think?

(Ms Lamont) Well, no, because from a client's perspective, a client is not buying an individual or disparate array of services, they are actually buying an asset, a building or whatever, and it is that building that they want. They want that relationship with the team who can deliver that. It is really the various parts of the supply chain who need to work together so it is working together with the people who you are supplying the goods to and the people who supply the goods to you and pulling that all together so that you can come to a client with a stable repeat supply chain. There are lots of examples of it already happening in the industry; we just have to make it more widespread.

59. Yes, I understand that. Have you any views about Sir John Egan's agenda, the Strategic Forum and the report on *Accelerating Change*? The report, *Accelerating Change*, talks about models for payment mechanisms being produced by April 2003 and they talk also about project insurance bonds. I asked the previous people also about the bond system which I think you said in your evidence would be costly to administer. Those kinds of changes, you think from a client's point of view, would be more costly than keeping a retention system?

(Ms Lamont) At the present moment in time I would have to say we are very supportive of the work of the Strategic Forum and particularly the *Accelerating Change* report. Under the clients' action in there we have set out what we want to do with regard to the education of small and occasional inexperienced clients and help them ask the right questions to get the right team on board. Yes, I do believe that, as the industry changes, and we have stable supply chains working together, the abuse of the payment systems, particularly throughout the supply chain will diminish. Also, as we have stable supply chains who are working together and can better understand their own processes, which are driving out the defects on their projects, which you can only really do when you are working together as a team on project after project, really driving out those defects, learning from one project, passing that learning on to the next project, then the insurance market will increase its confidence in the construction industry's ability to perform. I do think bonds and warranties, single project insurance, things like that will become realistic. I have to say the best example we have of that at the moment is one of our members, BAA on Terminal 5, has worked together with the insurance industry to get project-based insurance on it. It is through their ability to demonstrate how risk is being identified and managed, the fact that they have very stable supply chains that they have worked with repeatedly over the last five to seven years, all those things, and they have brought the insurance industry into the project also as a team player within that so that they can bring their knowledge of past claims on to the

project. So there is evidence that it can work but it does take the supply chain to come together as an integrated team to really get the benefits from it.

60. Do you see that as a gradual change with retentions being phased out or would it be—you may have heard the previous witnesses actually mentioning two words—major legislation? From the client's point of view, I know you want to retain the system as it is at the moment but, if these other systems came into play, would you see that as a gradual process?

(Ms Lamont) I think it has been slowly eroded over the last five years with the introduction of the Latham Report initially and then the Egan Report. I think the momentum for change is picking up and it will increase further through the introduction of the *Accelerating Change* objectives and targets, changing the culture. That is basically what we are trying to do, change the base culture of the industry but it will take time. I think to introduce major legislation at this point would actually take the focus away from the key activities that the industry has to concentrate on delivering, which are integrated teams and zero defect projects. If they do those then retentions, like many clients have demonstrated, and like the previous group have said, clients who have been driving this out of their own frustration are actually doing away with retentions because they are no longer an issue.

61. Would you not have thought that zero defect certainly in the construction industry is impossible? Even the wonderful building we are sitting in at the moment has had its defects.

(Ms Lamont) I suppose from a client's point of view they are quite pragmatic. There are an increasing number of projects which are being handed over defect-free but the realism is that yes probably there will be minor irritations always, if we can call it that. The part and parcel of the change in the construction industry is about how those minor defects are resolved efficiently and effectively. While clients see the construction industry as being very technically competent, whenever it comes to customer care they just have not grasped that issue yet; that it may be a dripping tap and it may be, from their perspective, quite insignificant because they are off on the next big project but, to the client, it matters. It is those irritations that really do cause clients great concern because it impacts on either the users of their building, their own staff, their ability to perform and function.

Chairman

62. You conveyed the impression that part of your responsibility is to educate your members to become, as it were, sharper clients. Do you have the Government, the public sector, within your membership as well?

(Ms Lamont) Rather than being sharper clients, I think it is better clients, so that they become clients who understand and operate in a best practice manner. Yes, we have both local authorities and central government. Within central government we have the Highways Agency, Defence and NHS estates; so, three of the major players. Within local authorities, we have people like St Helen's, Medway,

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Birmingham City Council, etc. Also, we are working very closely with other groups like the Local Government Task Force and OGC who are both working very, very hard to change procurement practices and client practices within the industry. As part of the work that we have done within the Confederation, we have developed what is called the Clients' Charter, which is a very comprehensive tool kit to help clients along this transition of becoming best practice clients. That has been very much adopted by housing associations, etc, and is being rolled out now to local authorities. We have developed it for the small and occasional clients as well. Really, within the Confederation we are trying to have a forum where clients exchange best practice but also to take that from just the Confederation members out to the wider industry and ensure that the small and occasional inexperienced client has access to that best practice as well.

63. The big procurers, the ones that you have mentioned, Defence and others, do you see them as being potential leaders here in trying to establish best practice or do you think that even within these departments there is a degree of inconsistency that is patchy?

(*Ms Lamont*) I think that the industry views them as leaders. I think they have done a lot and have come a long way in a very short period of time. NHS Estates, in what they are rolling out with regards to Procure 21, is seen as being very, very beneficial and again, within that, it is their view that they want to remove retentions. Provided the supply chain performs, then they will do away with retentions over the framework period. Again, prime contracting with regard to Defence Estates is seen as adopting all the best practices. I think everyone agrees that they have big cultural changes and cultural problems to overcome internally as well, but they are working very hard to achieve that. I think they should be applauded for the efforts and the amount of progress they have made.

Mr Djanogly

64. The question of trust arose in the last meeting. If you have used someone five times then clearly you have built up a relationship and a trust and, say there are no retentions in that relationship, and then you move on to another contractor who you have not used before, would it be realistic in those circumstances to say "Well actually I want to go back to retentions for the first one to see if we get on and then move on from there"?

(*Ms Lamont*) I think as the confidence of clients grows, that the industry has the ability to deliver and can deliver when it is working at its best. They will look to find other ways and I think to get rid of a contractor who you have worked with very successfully for five years or over a series of projects, the new contractor coming in will have to be able to demonstrate that he is equally as confident, if not bringing something even better to the table than the previous contractor or supply chain.

65. In the last meeting, what was mentioned was that the main determinant was going to be cost: that was the ultimate arbiter. I am not sure if that is true,

and you may have a view on that, but, even if it is, when cost cutting starts that is when people can start cutting corners sometimes. Perhaps it is more important that you want to protect your interest in the event of a cost war.

(*Ms Lamont*) I disagree that the public sector on the whole are going for bottom price on all their contracts. Yes, that was what happened on a consistent basis a few years ago but now there has been a great shift away from that and they are looking for other quality price mechanisms to be able to determine best value. I think from our members' point of view, I know their view is very much that, quite frankly, the profits on contracts are so minimal that there is no point in trying to put those down any further, but it is about driving out waste and inefficiencies. If you look at the Egan Report, it talks about 30 per cent waste. I have to say, in my own experience, and this is both from the contracting/consultant and clients' point of view, if someone told me it was 50 per cent that would not surprise me. The inherent waste, duplication of effort throughout the whole of the supply chain and, when you do not have everyone working together for a common goal at the end of the day, is phenomenal and that is what clients want to focus on: driving out the waste and inefficiency, not just trying to snap someone's profit.

Chairman

66. Could we spend a moment on PFI? As I said earlier, it is a kind of hybrid in the sense that there are people who are both clients and consultants at one and the same time. Is there a danger that within PFI they might almost be reinventing the wheel every time they start because it is a different group dealing with a different client, perhaps coming together in a strange sort of relationship? Are retentions relevant in these circumstances? Is it inevitable that people will hide behind retentions because they are not very sure of where they are?

(*Ms Lamont*) Having spent yesterday with someone very close to the whole Private Finance Initiative on the supply side, I think the general view is that where they have done a number of repeat projects, and that is what the majority of them are trying to do, specialise in a particular sector, they have maybe done two or three prisons or one or two hospitals, and they keep the same team, then they build up that knowledge and retentions become less of an issue. Again, it is equally as applicable in PFI as it is in just ordinary construction activity, that it is the experience of the team working together that makes the difference and that learning, and that cascading of that learning from project to project is absolutely crucial and that is what will drive out retentions.

67. At the end of the day, then can we sum up at least in part what you are saying to us is that good practice, partnership and trust are the best ways of driving out retention rather than legislation which will probably not catch everything and cover every corner, would that be your view?

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MS ZARA LAMONT

[Continued

[Chairman Cont]

(*Ms Lamont*) Yes, that is very much the approach that our members are taking. If you legislate to drive out retentions you are not addressing the core problem of the supply chain's ability to deliver with consistency a good quality defect-free product.

68. One last point then. If we do not go down the legislative road and there is a responsibility in government to grasp this nettle, is the public procurement process at the moment showing sufficient leadership to the rest of industry as it could do to carry through the processes so that retentions become irrelevant?

(*Ms Lamont*) I think in parts the area where it could be strengthened would be all local authorities. Local authorities are still a bit of a hybrid. There are some excellent ones but there are still some which are not yet off the starting blocks with regards to the sort of operations that we are talking about.

69. Are you concerned that you have relatively few local authorities? There are 435 local authorities in the UK, how many do you have?

(*Ms Lamont*) We have maybe got half a dozen.

70. A job for the recruitment officer.

(*Ms Lamont*) Again, as I said earlier, we work very closely with the Local Government Task Force who are very close to local authorities and who have done some excellent work in driving through changes in local authorities.

Sir Robert Smith

71. Have you considered the relationship with the Local Government Association and COSLA instead of individual local authorities?

(*Ms Lamont*) We have looked at relationships with APSE, SOLACE, CIPS, to name but a few and I think therein lies the problem. There are so many representative bodies within local government, trying to find the right one who will take the right message to the right people within local authorities is very difficult.

Chairman: I think on that note we will finish. Thank you very much for your evidence this morning.

Examination of Witnesses

MR TREVOR WALKER, Deputy Chairman, MR STEPHEN RATCLIFFE, Chief Executive and MS CLARE EDWARDS, Director, Legal Services, Construction Confederation, examined.

Chairman

72. Mr Walker, could you introduce yourself and your colleagues and then we will proceed.

(*Mr Walker*) If I start with myself, first of all. I am Trevor Walker and I am Deputy Chairman of the Construction Confederation. I am a director of Edmund Nuttall, a civil engineering contractor, where I am responsible both for business development and for railways work co-ordination. I am a chartered civil engineer. I have been in the business some 35 working years now, with operational and management experience all the way through. On my left is Clare Edwards, who is the Confederation's Director of Legal Affairs. She is a qualified solicitor and has spent a number of years in private practice. She specialises in construction or construction disputes and arbitration. On my right is Stephen Ratcliffe, the Chief Executive of the Construction Confederation. He has got significant experience of the construction industry and has worked closely with Sir John Egan and the DTI officials on the recent *Accelerating Change* report. The Construction Confederation itself represents some 5,000 construction companies who, between them carry out some 75 per cent of the total turnover of the UK construction industry. We are a very, very broad church. We represent both building and civil engineering contractors from the very largest to the very smallest although the majority of our members can best be described as small and medium sized enterprises. Issues relating to retention impact directly across the full breadth of our membership and their supply chains.

73. Very simply, could you just say how you are different from the SECG?

(*Mr Walker*) I missed the SECG's presentation. My train was an hour and ten minutes late.

Sir Robert Smith

74. In terms of membership?

(*Mr Walker*) We are representative of contractors. We relate directly to clients and pick up the responsibility for the production of a client's requirement.

75. Top of the chain?

(*Mr Walker*) We are below the client so we are in the middle.

Chairman

76. We have covered this ground with other people and we are asking roughly similar questions of you all because, I think, we are coming to this on a common basis. We have heard from other people that really retentions are necessary because there is a lack of trust. You let people down and if there are not retentions the job will not be done in the appropriate way. Is that fair? Is that an indictment on the industry or is it correct for worst practice but most people are not like that and therefore it should no longer be there?

(*Mr Walker*) I think our perception of retentions is that they provide the employer with some degree of comfort that defects will be corrected. They maybe provide this fund against the possibility that contractors could become insolvent before correction of defects. I suspect that evolved into a belief that therefore retention will be a major contributor towards the deterrence of defects occurring in the first place.

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[Continued

[Chairman Cont]

77. We have had not quite conflicting stories but we have had a different degree of emphasis on the point of view that, okay the contractors have to carry the burden of retention, but by the same token professionals do not call themselves trade associations; they are institutes and things like that but they do not seem to be subject to quite the same discipline as you guys are.

(*Mr Walker*) It is very difficult at times to believe that, as a contractor, we are not caught between a rock and a hard place, that is for sure. I could get Clare to give you perhaps a bit more detail about the contractual and legal aspects of perhaps how we see professionals caught into this.

(*Ms Edwards*) Certainly, the standard for professional appointment contracts for the RIC, RIBA, RICS and ACE do not contain standard retention provisions, which is in contrast to standard forms of contract for contractors/subcontractors which do. That is probably the historical division which is the distinction between a profession and a trade. It is a division which really, as we are moving towards integrated supply teams and integrated delivery of services, we would like to see removed. It is very hard to justify having retention on certain elements of the supply chain and not others if it is really a mechanism for delivering a defect-free building. I think the perception originally was that was what it was for, but there is no evidence that it delivers that in the market place at the moment.

Sir Robert Smith

78. I think it is fairly established now from the other witnesses that the cash withheld for retention is part of the cash for the client and there is no protection if the client goes insolvent. What I wondered, from the evidence submitted earlier, was the point made about someone providing the steel frame for a building. They are very early in the process and if there is a defect in the steel frame the next stage of the process will not be happening, so clearly their product is up to scratch and yet the retention is held against them right until the very last bit of the project is finished and that person does not have the same cash flow problem. Is there any way you, as a main contractor, should consider actually passing on the full payment for that part of the project and recognising that retentions should not be held against the work being done later?

(*Mr Walker*) There is a presumption there that of course it is all right.

79. Yes.

(*Mr Walker*) Sometimes it does not become clear until later on when something else goes, to fit in the process. I think you have highlighted what is essentially illustrating the real complexity of our industry. We have many layers between a client and an end product, that is the way the industry has evolved and become; layers of contracting, subcontracting, suppliers, all of whom produce enormous complexities of relationships into the problem of construction. I think it is fair to say that perhaps a very minor defect at an early stage, like, for example, a non-opening window, could ultimately delay occupation of a building. A minor defect can have an enormous impact somewhere further down

the line. I think the system of retentions, as currently understood and exercised, has probably evolved as the industry's best pragmatic solution so far to those sorts of complexities. To answer the second point of your question, yes, personally as a contractor when I was running sites directly I would not always hold up all subcontractors' retentions until the last one was completed and the product was accepted. I would release individual subcontractors retentions as they had completed and satisfied me that their defects were rectified. That is one of the measures which I think we probably as an industry could work on more. Probably we can probably modify our conditions of contract to cope with that sort of arrangement.

80. What is your experience in terms of when retentions are repaid and to what extent there are delays in repayment from your client?

(*Mr Walker*) I think there is a perception floating around that abuse is from main contractor to smaller subcontractor but my personal experience is that there are equal elements of abuse both up and down the chain in all stages. I think that, from a main contractor's perspective, sometimes it is very difficult to convince a subcontractor to return to a project to sort out defects if they become apparent anyway. You can understand that, perhaps because he is quite a small man usually. He has got a considerable number of pressures on his small workforce, on his time and on his finances and it is difficult for him to programme. It is the case also that, at the top end of the spectrum—it is perhaps the nicest way I can phrase this—once somebody has got their hand on your wallet and is trying to reach a financial conclusion in a discussion, you are at an extreme disadvantage. All the way through this chain there are problems.

Mr Djanogly

81. Just leading on from that: is there a better way of doing this?

(*Mr Walker*) I think that there is certainly a better way to evolve and that is one of the key topics which I suppose Latham and *Accelerating Change* has addressed. If we could get to better relationships we would find ourselves with, and I heard this bit, more trust, but on the other hand we have to operate in the real world. Trust, as somebody identified, comes from long term relationships and I and my members have found very few clients who are able to deliver a long term relationship which really allows trust to grow. It is government at the top of our problem.

82. In terms of the contractual side of it, is there a better way? Use of warranties rather than retentions?

(*Mr Walker*) This is the bond issue I guess. It strikes me that the introduction of bonds can fall into two particular solutions. One would be bonds related to on demand so that the money is instantly available to rectify it.

83. Which is a bit like your retention.

(*Mr Walker*) Yes, and you could argue that it costs as much because the bond has to be bought. There is some doubt I think that the bond market

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could sustain a rapid increase of demand. It might ultimately limit contractors' ability to go chasing work because bond deliverers will see a natural limit to the amount that a contractor will be allowed to have. If you go for the non on demand bond, it strikes me that we are going to end up with a series of litigation measures because they are going to be looking for avenues as to why they should not release that bond. Overlying all of this, I think we are going to find ourselves with immense volumes of red tape, bureaucracy and the like against a backdrop where I think we have got a Government which is trying, on behalf of the small and medium enterprises, to remove red tape from the equation, not to introduce it. I am not really going to advocate, I think, that we move into a bond scenario to solve this problem.

84. What about the timing issue? Some people seem to say that it is not so much a question of retentions but it is the fact that you can have these things outstanding for two or three years and what you want is a system whereby there is a generally accepted timetable so that these things are sorted out.

(Mr Walker) There is a generally accepted timetable which is written into the contract, of course.

85. Twelve months.

(Mr Walker) If people wish to make that timetable work then what they have got to do is rectify the defects.

86. Could there be a faster way?

(Mr Walker) I am sure there could and we have talked briefly already about the fact that we could release retentions individually rather than making all of the trades, the suppliers, the subcontractors depend upon the last one in the chain. I think there is a strong case for not holding retention on items like temporary works, which are usually substantial elements of construction contracts. In other words, focus just on the permanent works element of the chain. I think that, in the spirit of partnership, co-operation and generally improving the culture of the industry, if clients are to concede that there are grounds for improving the timescale for release of retentions then that will be mirrored all the way down through the supply chain.

Linda Perham

87. You say in your evidence that you prefer your members to work in a retention free environment, but where clients insist on retention the main contractor should be free to apply through the supply chain to all subcontractors and consultants. I think you said also at the beginning that the majority of your members are SMEs. Are they not the ones who are most disadvantaged by this retention system, SMEs?

(Mr Walker) I think I said also that right across the chain we all seem to be disadvantaged in this process. I do not know.

88. You do not want it changed? You do not think the bond system would be any better?

(Mr Walker) I do not think the bond system is any better. In an ideal world, in utopia, it would be lovely to operate simply on trust and not to have to worry about retentions and contracts. The reality of operating in real life is that we do need contracts for when things go wrong, and I suspect clients will always want the comfort of retentions to make sure in their mind that defects will be able to be corrected.

89. Something we asked the SECG, if the practice of retentions was stopped would there be savings and, if so, how would they be used? They said that they were going to be able to use it for training more staff, etc. Do you think realistically, if any other system was put into place, there would be savings to the industry?

(Mr Walker) If any other system was put in place, such as bonds which we have talked about, then I do not believe there would be any real savings to the industry. If we abolish retentions I suspect, because some of the contractors and small and medium enterprises have of late tended to include for perhaps a delay in retention payment, then you would expect there to be a saving if they did not have to any longer. At the top end of the chain, from the managing contractor's point of view, from the big contractor's point of view, from the main contractor's point of view, I guess you have to say that, if we did not have to finance jobs and we did not have a gap with waiting for a three, four or five per cent return, then work would give better value.

90. You mentioned at the beginning that Mr Ratcliffe is involved with the Strategic Forum for Construction and there is the report *Accelerating Change*. Do you think there is any progress being made towards working practices which would enable the industry to move away from retentions following the work on this report?

(Mr Walker) I think so. We were part of the report. We helped to formulate its recommendations. If I disagree with Egan in any way, shape or form, it is the fact that I believe we are already a world class industry. I do not believe that we are second rate. I think that we are world leaders and when I look at my personal experience of the work that goes on in the USA, in France and in Holland, we are clearly ahead of those countries in our practice and culture in construction. Egan's direction—and I cannot disagree with this—is focused on client change. These changes have to come from clients and that is one of the biggest challenges which the industry faces, because clients have operated for so long and their cultures have developed over so long that, for some of them, it is at best a major exercise to change direction and at worst, for some of them, it is proving almost impossible.

91. You mentioned other countries. The retention practice goes back to the mid 19th century in this country. What is the practice in other countries? Do they have a similar system of retention?

(Mr Walker) I do not know the answer to that question. My comments were really referring to the quality of construction, to safety and to technical matters.

Linda Perham: Perhaps it is something we could pursue with the DTI.

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[Continued

Chairman

92. We now have European-wide procurement processes. We have Italian firms maintaining motorways and things like that. Do you have no exposure to their practices?

(*Mr Walker*) Personally we have had, and other members have had exposure to European construction processes and practices, but I simply cannot answer your question about the retentions in that particular instance.

93. Given that a lot of work is done for the public sector, some 40 per cent of construction work in the UK, do you get the feeling that the public sector is giving a lead in trying to improve partnerships, trying to improve the trust, to show by example that perhaps the need for retentions is not as great as once it was perceived?

(*Mr Walker*) Yes. I think that the public sector is clearly a leader and has taken on the mantle of leadership and is looking for change and improvement. If you come back to the comment I have just made about culture among client organisations and the sort of animal that we are looking to change and modify, there is at the moment a big gulf between the reality of theory and desire and the practical limitation on their ability. We must not forget that whilst 40 per cent of the work is public, 60 per cent is coming from private clients, many of whom are one-off, and if we are going to seek to change substantially a system which, at the moment broadly speaking, is in balance, then we have to pull those private clients along with the public clients.

94. What we were looking at however was that we hear talk of joined-up government which, frankly, is more spoken about than seems to be in action, but it is an area where you might well get a more coherent approach from a big client like government and I think that was what we were looking for there. Do you think that there is anything that government can do to help the shift away from retentions?

(*Ms Edwards*) I think it is a very nice thought. Just sitting where we sit, we see the development of best value within central government, or we have value for money in local government. We have different issues. We cannot even use the same terminology between local government procurement and central government procurement at the moment. Although they are probably trying to achieve the same thing, they are certainly coming at it through different phraseology. From our point of view, it would be very nice to see a greater cohesion between central and local government procurement, and even within central government procurement because, although the defence estates and NHS estates are leading the way, they are using different mechanisms of procurement. There is no single procurement strategy coming out of OGC. The departments are using their own strategies for developing them and, although they are very good things, they are different.

(*Mr Walker*) Another example of that is that about three or four years ago we were encouraged by central government to adopt a unified system for the qualification process. The Government recommended a database system called Construction Line and, were we to all sign up under Construction

Line, none of us would individually have to respond in pre-qualification terms to any particular department or organisation of government. What has actually happened is that there are now some departments of government who refuse to use that centralised database system, so we have ended up as an industry having to respond to two or three different database systems in order to achieve qualification. We are back to this gulf at the moment that we perceive.

95. Could you identify the departments which are in the loop and the ones that are outside?

(*Mr Walker*) The Environment Agency are on record as saying that to use Construction Line conflicts with the system that, as a department, they have already bought and they already use.

(*Ms Edwards*) NHS Estates do not use Construction Line. Neither do Defence Estates.

96. So who does?

(*Ms Edwards*) It is a shorter list.

97. Could you maybe send us a note on this issue?

(*Mr Walker*) We will do that. It is a bigger and more complex problem because when you move to local authorities they are operating now on about six different database systems.

98. Just one last point on this issue of the public sector: PFI. Does that mean that each one is a one-off? We have heard that there are repeat orders for prisons and hospitals and things like that, but do you see the PFI being a problem or is it bringing together the best of public and private partnerships?

(*Ms Edwards*) I think we need to re-establish that PFI is not a means of procuring construction; it is a means of procuring service or facilities. Retention only becomes relevant in the underlying construction contract, which would be possibly between the SPV and the construction company. Retention may or may not form part of that. However, because the consortium under PFI only get paid once, the facility and the service are delivered, there are other financial mechanisms for driving out defects, because until the building is working you do not get any money, so it potentially becomes less of an issue.

99. So this may be deemed to be an alternative to the retentions in some ways?

(*Ms Edwards*) What it acknowledges is that there are other mechanisms working together to drive out defects. The financial effect of not getting paid until the service is delivered is a key factor.

100. If government is to change this, if government is to adopt the leadership role in the removal of retention, would you see that down the legislative route of outlawing it, or would you see it through an accelerated best practice promotion approach?

(*Ms Edwards*) What you are trying to change is the culture of the industry and I cannot see a way of doing that through legislation. To try and draft legislation to outlaw withholding of a payment from a lawyer's perspective is going to be very difficult. People will draft round that. We have already looked at alternatives in terms of bonds which we think will be more expensive; the insurance market cannot cope with it and it would be disadvantageous to us, so I think it is a question of driving forward the momentum that is taking place following Egan and

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instilling this change in the culture that retention has a perception that it is doing one thing but the reality is that it does not deliver that. To replace a system which is seen to be failing with an alternative seems bizarre. We can accept that retentions do not deliver what they are intended to deliver and do away with them, but to put an alternative in their place seems slightly contradictory if we accept that retentions are not delivering.

(*Mr Walker*) The other point is that we have already embarked on processes of change in the culture of procurement and construction anyway. In the last two or three years there have been significant steps along the road to better procurement processes, better selection processes, the re-establishment of trust. I think that the industry itself is already part way down one of these routes where it uses encouragement back-up to help it go the rest of the way.

(*Ms Edwards*) Retention is a very blunt tool and encouraging clients, if they want to keep it, to use it more flexibly will certainly be an improvement. This

phased release of a client's retention, once certain elements of the work are seen to be defect-free and moving on, and some of the newer standard forms of contract, particularly within the JCT sub-contract, acknowledge that retention can be released once it is clear that that element of the sub-contractor's work is defect-free, so you do not have the ridiculous situation of a steel framework contractor not having his release because there are weeds coming through the tarmac in the car park, which is an unjustifiable position for everybody in the supply chain.

Chairman: That is very helpful. The picture is beginning to come together. We are very grateful to you for that information. If you could send us a note we would be intrigued, I think is the expression, to read that. It is unfortunate that we do not have it before the next witnesses but we will pray in aid your statements.

Examination of Witnesses

MR JOHN ALTY, Director, Business Relations, and MR RODGER EVANS, Construction Sector Unit, Department of Trade and Industry, examined.

Chairman

101. Good morning, gentlemen. Mr Alty, would you like to introduce yourself and your colleague?

(*Mr Alty*) I am John Alty. I am the Director of Business Relations in the Department of Trade and Industry. I have responsibility for DTI's interests in a number of sectors ranging from aerospace to bio-science but including construction. My colleague, Rodger Evans, is from our Construction Sector Unit and Rodger has been on the Secretariat of the Strategic Forum for the Construction Industry.

102. The Strategic Forum has referred to retentions. Has the Department made any assessment of the impact of retentions on the construction industry or on the contractors?

(*Mr Alty*) I think it is fair to say that we have not made a specific impact assessment of retentions. We have tended to see this problem in the wider context of our work to help the industry improve its performance, help clients to improve their performance, so we are certainly very well aware that there is an issue here. It has been picked up in some of the initiatives that *Rethinking Construction* and *Accelerating Change* have taken, but I do not think we have got an assessment per se of the retentions.

103. Given that SMEs are a significant part in this process, one would have thought that perhaps some of the other bits of the DTI might have been looking at the impact of retentions on small businesses, for example.

(*Mr Alty*) You mean like the Small Business Service?

104. Yes.

(*Mr Alty*) Again I am not aware there it has been a specific area that the SBS has looked at. The work that we have done in the construction sector where,

of course, as you say, many of the companies are SMEs and the work to try and get more of a partnership between contractor and clients and down the supply chain, we certainly hope would benefit SMEs but, as I say, I think we see retentions as part of that programme rather than looking at it as an issue in its own right.

105. This is slightly away from retentions as such, but the construction industry has just become part of the remit of the DTI since the last machinery of government reform, the last PM's whim. It is one of the perks of the job of being Prime Minister that very few people actually realise that it is down to the Prime Minister to make the change. The construction industry has come into the DTI. Is it perhaps a wee bit early yet to see whether or not it has been properly integrated?

(*Mr Alty*) I would hope it is integrated. As you know, the DTI has itself gone through quite a major review over the last year or so and that has led to quite a major re-vamping of our sectoral work as a whole but construction is firmly placed, I would say now, within the sectoral part of DTI. It has huge links with other parts of our sectoral work—materials, engineering, environmental issues. I am sure it does take a bit of time but I would hope that, particularly following the review, we have now aligned what we are doing on construction with what we are doing elsewhere.

106. Would it be fair to say that since you have not really had an assessment made by the Department of the impact of retentions on the construction industry, you really have not given much thought to alternatives to retentions?

(*Mr Alty*) No. I think that would be going a bit too far. We are aware, because of what industry bodies feel, such as the evidence that you have had, that it is

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[Continued

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an issue. It has been picked up in the best practice work which we have been sponsoring, if you like, and so our broad view of what is the best alternative to this practice is, that if the industry can get itself to the vision that it has set itself through *Rethinking Construction*, I think it has been made pretty clear that that should mean that retentions are not necessary and that is the direction in which the industry wants to go and in which the DTI wants to encourage the industry to go.

(*Mr Evans*) In a sense, perhaps it is the starting point here, that we have not needed to be persuaded too much about the concerns of the industry regarding retentions. We accept that as a given. We are aware of the substantial concern in the industry and we are aware not only of the use of retentions but also the abuse of retentions and that is a matter of significant concern to us. In a sense, where we have directed our efforts, as John says, is in looking not so much at analysing the question but perhaps trying to focus on what the long term strategic approach should be in trying to create a situation and an industry where the need for retentions diminishes over time and where the industry is becoming a more productive and more competitive process. Broadly, we have accepted that there is a problem but we have been focusing in a sense on a strategic approach to trying to identify a solution.

107. What does that mean then?

(*Mr Evans*) There was a discussion this morning within the context of *Accelerating Change*. We have worked very closely with the Strategic Forum for Construction in developing that particular document. I acted on behalf of the DTI in providing the secretariat for that body. That body is now taking ownership of that report and I think that is quite an important transition that has just occurred because Sir John Egan has now vacated the chair. The new Chairman is Peter Rogers who is Director of Stanhope, a major figure in the industry. The DTI has now relinquished the secretariat of that because the industry has taken on ownership of the document and the programme of work which is identified. We were very fortunate to have Sir John Egan in the chair at that time, not least because he was the driving force behind the *Rethinking Construction* report which was done for the Deputy Prime Minister a few years ago now and, in a sense, set the scene for what the industry needs to do in order to become a profitable industry delivering quality projects for clients, indeed, getting projects that are right first time. That is the strategic context within which we have been trying to operate.

Mr Djanogly

108. What progress do you feel has been made towards working practices that would help the construction industry move away from retentions?

(*Mr Alty*) We feel that progress is being made, particularly by larger clients and those clients who have significant repeat business, and who are therefore in the vanguard of pioneering a new, more integrated team approach, a more partnering approach which is consistent with the sorts of best practice coming out of John Egan's work. I think it would be fair to say, having looked at some of the

evidence you have had, that smaller clients and clients who are less frequent procurers of construction projects have not got as far down that road, but in those cases also there are quite practical things which we think will come out of *Accelerating Change*, which will tend to push them in that direction. For instance, one of the recommendations is that there should be more use of independent advice by smaller clients and so we would hope that that, together with guidance and toolkits, will encourage a change throughout the industry both by clients and suppliers, so I think there is progress.

109. In terms of this building a relationship of trust, this has been mentioned by everyone who has spoken today in one way or another, but there is the other side of it, is there not, which is ensuring that the public, particularly the smaller people, are kept away from the cowboys? How are you intending as a department to deal with the cowboys?

(*Mr Alty*) Our main initiative there is the Quality Mark initiative. I do not know if Rodger wants to say a bit more about that.

(*Mr Evans*) Quality Mark was a manifesto commitment which is being taken forward very successfully on the basis of pilot schemes, which have been run, and it is designed really particularly for the domestic market, where the recognition was that, in a sense, the domestic customer of construction is potentially perhaps less able to protect themselves against the abuses that one so often sees, unfortunately, from what one loosely calls cowboy builders, and I think we understand what we mean by that. The Quality Mark scheme is designed to give assurance to the domestic customer that the work will be done in a professional way and that there is a method of redress through a warranty scheme which underwrites the whole Quality Mark, so that if work is defective the customer will have an appropriate means of redress. That scheme is now in the process of being extensively rolled out across the country.

110. There is to be something that builders sign up to?

(*Mr Evans*) Yes. It is a pre-qualification process and pre-assessment against benchmark criteria. When they can demonstrate that they meet a certain standard they can join the scheme and that is monitored. I am not directly responsible for that, but that is basically my understanding of how it works.

111. Has it been advertised?

(*Mr Evans*) It has where the scheme is being used. One of the difficulties that we have with a scheme like this, is managing both the demand and the supply. You have got to have the demand and there is then the difficulty of creating the number of companies signed up to meet that demand. It is about managing that expectation and that is being done progressively and has been done in two trial areas quite successfully.

112. Could I ask for some sort of statistics, because one thing that came out of the previous session was the extent to which building companies are likely to go into insolvency. Do you have any figures in relation to that? One hears of building contractors going bust as part of cowboy operations and what-have-you. Can you enlighten us?

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MR JOHN ALTY AND MR RODGER EVANS

[Continued

[Mr Djanogly Cont]

(Mr Alty) We do fortunately have some figures because we heard that this was something that you were interested in pursuing, and we can no doubt supplement this information if necessary. Last year, the figures we have are that there were 1,509 construction insolvencies, which was just over 10 per cent of total UK insolvencies, and there were 168,000 construction companies overall, of whom 8,000 were one-man bands. That gives you some sort of figure. As I say, if you want to pursue that further I am sure we can help.

Mr Djanogly: I think the other statistic that might be interesting is to know the average periods of how long these companies run. It is one thing that people often complain about, that they are in the market and a company is being set up for single jobs with the inherent risks.

Chairman

113. I think construction accounts for about seven per cent of GDP, does it not?

(Mr Alty) Seven or eight, something like that, yes.

(Mr Evans) Part of the difficulty in the answer to your question, and I think you are absolutely right, is that it is an industry where there is a very low entry threshold. If you take an extreme example, you can hire a van and you can hire a ladder and you can become a construction company tomorrow, and you can do a couple of jobs. You can possibly do a rather bad job and you can disappear into the dark very quickly and it is very difficult with any form of statistics to keep a handle on exactly the churn that you get at the bottom end of the industry. That goes to the heart of the problem that we have in retentions, which is focused in a sense on building relationships based on trust. Whilst our policy is quite clear; that we want to create an industry where the need for retentions disappears, we have also heard this morning that, in the real world, there are difficulties with that, because in some cases building up a relationship of trust is simply not people's experience.

114. If the view of the Department is that that is to be done through the Quality Mark scheme, I have to say, from what you have said so far, that I am not enormously impressed if you are pushing this Quality Mark out as far as you can. You seem to be doing it in a pretty relaxed way. Maybe that was how it came across in what you said before.

(Mr Alty) What perhaps we need to explain is that the decision on the national roll-out is a relatively recent decision. I do not know how long the pilots were running but there is certainly no lack of commitment to do it, but it is still a fairly recent decision and therefore perhaps not yet as widely known as you would be looking for.

115. Chairman, it may be of interest to the Committee if perhaps the DTI could be asked to prepare a short paper on this part of our report.

(Mr Alty) Sure.

Chairman: It would be published along with the other evidence.

Sir Robert Smith

116. For the record, could you confirm that it is the DTI's understanding that the money for retentions is not held in any special way and that it is part of the cash flow of the client?

(Mr Alty) It would depend on how different clients operate. From what I have read, that seems to be the way it often is. There is the option that people put it in a trust fund or something, but it does not always seem to happen that way.

117. And therefore, obviously, in a situation of insolvency at the moment there is no special protection. Can you see anything the Government could do to improve protection of the retention monies?

(Mr Alty) This is something which *Accelerating Change* has picked up and there is a programme of work to look at construction insolvencies. Again, I suspect that that is not exclusively in the context of retentions but I do not see why that aspect should not be picked up. Is that fair, Rodger?

(Mr Evans) That is right, yes.

118. At this stage you cannot say that there is any specific initiative you can see?

(Mr Alty) I take the point that this is something that might be worth looking at. That is the mechanism I would suggest as the way to do it.

119. Given that the public sector accounts for more than 40 per cent of all construction work in the UK, it could give a very good lead to the rest in terms of best practice. Why is there essentially no co-ordinated policy for government departments on the use of retentions in their contracts?

(Mr Alty) As you will appreciate, the central government co-ordination is done by OGC, so what I say is based on our discussions with OGC (the Office of Government Commerce). Broadly, OGC is working along the same lines as we described earlier, in encouraging a sort of integrated partnering type approach. However, my understanding is that it has not given specific guidance on the issue of retentions. A number of the bigger public sector purchasers, like the NHS, Defence Estates, the Highways Agency, are moving to a situation where much of their business does not attract retentions, so I think those parts of the public sector are giving a lead. I guess that the situation for government is, on the ground, no different from the situation for other construction purchasers or clients and that is that we have not yet reached this nirvana where we have trust and partnership working and so forth, and some clients see retentions as being a way of achieving their objectives in terms of quality and defect-free work, and the OGC has not given specific guidance saying, "You should not do that", but that is against the background of a framework where they are encouraging a partnering approach.

120. As you say, some are further ahead in developing the concept of trust. If they manage to build up trust between that part of government and construction, but is not there a way of sharing that trust? The Government in a sense, seen as a whole, is trusting in one area and the Government as the client is not trusting in this other area. What is being done to transfer that trust?

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[Continued

[Sir Robert Smith Cont]

(Mr Alty) Clearly the OGC will be aware of best practice. From my perspective, which is a sort of DTI perspective, I think that that difference reflects probably the different importance of procurement in government departments, and we would see the *Accelerating Change* programme as encouraging all clients down that road. That includes the public sector ones. I would expect the OGC, since it supports those objectives, to be encouraging that as well.

(Mr Evans) I think that is very comprehensive. We know, because we work closely with the OGC. The OGC were party to the Strategic Forum's work on developing *Accelerating Change* and somewhere in the document is a significant quotation from them about the types of contracts and so on. The deeper question there is about how government clients come together in a shared experience and so on of their experience with contractors. I am not sure that that happens directly in a formal way. There could be reasons why it should not, but, in an informal way, there is a group called the Central Government Task Force which brings in people from across different spending departments who, in a sense, share experience about how they are going about implementing what we loosely call the Egan principles or the rethinking construction principles. The client bodies themselves are sharing experience about what they see as best practice, which is not quite the same as building up a little white list or a black list of contractors that they have worked with. I do not know that that happens, but sharing best practice certainly does happen and trying to understand how it works through their supply teams and what has worked for them and what has not on a shared basis, does happen. That is all managed by the OGC.

Chairman

121. But, on the other hand, the Secretary of State repeatedly says that the DTI should be the voice of business. The construction industry, in its varying forms this morning, has expressed frustration at the way in which the state machine responds. Surely you as the DTI should be talking up on their behalf and arguing the case? I do not get the impression that you are really exercised on this issue.

(Mr Alty) I would agree with you that it is the DTI's role to champion business within government. In relation to construction, we want to see the industry succeed. The biggest initiative or effort we have put into doing that has been to bring clients and the industry together and then to encourage the industry to take its leading edge practices and support them in spreading them. Obviously, if there are particular issues where government itself is having a damaging effect on the industry, then you are absolutely right, that that is for the DTI to assess and, where necessary, to champion. As I said at the beginning, we have tackled the issue of retentions as part of a bigger issue about improving the performance of the industry. That is how it has been done.

Sir Robert Smith

122. But, in a sense, reinforcing that is not the role of improving the performance of the client in terms of government?

(Mr Alty) Absolutely.

Sir Robert Smith: And what we heard earlier, the different databases that different government departments are working to, there seemed to be a frustration there about not having a common standard.

Chairman

123. That would be the OGC's responsibility, would it?

(Mr Alty) Databases of—?

124. There seem to be databases of practice and qualification: that would be across the whole of the central government sector. It would appear that some departments as a matter of principle will not do it. Other ones cannot do it because they have bought in software systems that do not accommodate it. It may be that the OGC has not wakened up to this, or they do not think it is important, or it is not grand enough for the Treasury to take on as being significant. I am not necessarily asking you to pass comment on that; you have got careers to think of, but you know the point I am making.

(Mr Alty) Yes. You are saying that there are different departments who have got different data about their practices in different forms, and so the industry finds that confusing or unhelpful or that sort of thing.

(Mr Evans) I am not sure I fully understood the point that industry was making. Part of the answer is that the Department has sponsored a pre-qualification system called Construction Line because one of the complaints from the industry some time ago was the excessive burden of pre-qualifying suitable contractors to do the work. Construction Line was designed to try and overcome, at least in part, some of those concerns and provide a database that local authorities particularly, who use it, would be able to access. That is part of the answer. It is obviously not the whole answer.

125. The frustration was that not every government department uses Construction Line.

(Mr Evans) We have provided it for them. It is there if they wish to use it.

126. Whose job is it to drive forward that client behaviour?

(Mr Alty) Responding to your earlier question, Sir John Egan has also been extremely keen to see public sector clients operating better than they have been in the past and that is an issue which we would see as important and which the Government sees as important, not least because there is potentially—or rather actually—a forthcoming large construction programme. I would absolutely agree with that, and again I suppose that is a much wider issue than retentions, although retentions is part of it. That is what I would say.

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[Continued

Linda Perham

127. You talked about the *Accelerating Change* report, Mr Evans, you have been involved in that. That does say that Forum will produce models for payment mechanisms by April 2003 and KPIs, which I presume are key performance indicators, for payment within supply chains to help establish a benchmark for best practice by April 2003. That is not too far away. How far are you with that?

(*Mr Evans*) The work on key performance indicators has partly been done already. The DTI published a few weeks ago an additional set of performance indicators, which I have with me and I could leave for you if you wish, which set out a series of indicators for the industry to use, listing, amongst other things, contractor satisfaction on payment and contractor satisfaction in relation to retentions. There is now in place at least some benchmark information and some indicators that can be used to start to track payments and how satisfied people are in the supply chain with the system of payments and repayment of retentions. Similarly, linked to that there has been a lot of work done to identify key performance indicators, particularly in relation to defects. That is part of the wider context of this issue. The retentions, in a sense, are a symptom of a wider malaise, I think, and that malaise is the ability of the industry to deliver defect-free projects for clients. The measurement of defects and the improvement of performance and understanding what failures give rise to defects, again, is a very important element of the overall strategy. I think that work is quite well advanced. The important thing to say, in relation to all the work in *Accelerating Change* now, is that of course the Department is supporting driving that forward, but also that the industry has ownership of this. This is the industry's report and it is now the industry's Forum. There are many people across the industry who are already working to develop those sorts of indicators and take that work forward across the whole range of the actions identified in that report. It is not just the Department doing it. It is doing it in partnership and in some areas it is being led quite substantially by the industry itself.

128. What does it mean by important mechanisms? Does it mean addressing the whole problem that we have been talking about?

(*Mr Evans*) This is work, in part, being carried out by those who gave evidence at the beginning of the morning, the specialist group, that within the context of this there is a working group as part of the Strategic Forum on integrated supply teams and ways of progressing and promoting the integrated supply team approach, and that is work which I understand that working group is actively pursuing.

129. Were you here for their evidence?

(*Mr Evans*) I heard most of it, yes.

130. Because they certainly called for major legislation but, in the DTI submission, you say that you do not think it would be appropriate to consider abolishing retentions in the meantime or to demand that central or local government clients no longer use them, so really it is the status quo at the moment. You also say that the Government has no plans for regulating this matter, so that is quite cut and dried. The Government is not taking any action. Can I ask

you about something which you put in this submission which involves legislation, and that is about the strengthening of the provisions of the Late Payment of Commercial Debts (Interest) Act 1998? People do have recourse to those provisions. As you mentioned in your report, I am just wondering if that would be a mechanism for people who are disadvantaged by this present system in making the claim.

(*Mr Alty*) I think there are two pieces of legislation which we would see as particularly relevant or of help. One is that Late Payment of Debt legislation. The other is specifically on construction contracts where—I think this is 1996 legislation—we have specified certain provisions that we thought should or should not be in contracts. There was not a specific reference to retentions but there was, for instance, part of the legislation which said that there should not be pay when paid clauses in contracts. In other words, if you fulfil your part of the contract you should get paid whether or not somebody else up the chain has got paid for fulfilling their part of the contract. This is the wider point on retentions, and that part of the problem, the abuse problem, we would see as payment abuse. There are other payment abuses that take place and so we would see those provisions as providing some recourse, some protection, to people, although, obviously, they then have to decide for themselves whether they are going to pursue breaches of contract or whatever.

131. But from what you said there are plans to strengthen that particular Act.

(*Mr Alty*) I think it has been strengthened. I do not think there are new plans to strengthen it. I think it was strengthened.

(*Mr Evans*) It came into force on 7 August.¹

Chairman

132. You are conducting an inquiry into retentions. What is the timetable for it? When do you anticipate reporting on it? In your own evidence here you have said that you were looking at this area, have you not?

(*Mr Alty*) There was no specific inquiry.

133. What I am getting at here, is that I am not quite clear where you stand in relation to the OGC on these matters. You represent the industry and you are trying to co-ordinate the industry. The OGC talks about the public sector. You have already told us that in some respects it is only five per cent; it is not really important, it is not effective, so why should the public sector bother?

(*Mr Alty*) I did not actually say it is only five per cent.

134. I said it is only five per cent.

¹ *Note by Witness:* This is something of an ambiguous opinion as John Alty's answer to the previous question covered two Acts: Late Payment of Commercial Debts (Interest) Act 1998; and Part II of the Housing Grants Construction and Regeneration Act 1996. John Alty and Rodger Evan's answer to the question related to the amended and supplemented Late Payment of Commercial Debts (Interest) Act 1998 which came into force throughout the UK on 7 August 2002.

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MR JOHN ALTY AND MR RODGER EVANS

[Continued

[Chairman Cont]

(*Mr Alty*) I take your wider point: why should the public sector bother? Again, I have read some of the letters that universities wrote in to you and so forth. It is clear that for some clients they do not feel that without retentions they will have, if you like, sufficient grip on the contractor either to deliver the project defect-free in the first place or to ensure that it is put right afterwards. That is clearly their experience. They believe that this will help them. I do not think we have said that it has no effect. What we are saying is, that it is not the sort of framework that we think the industry should be working towards or should be working to retain over the long term. For the larger clients, it is pretty clear, in both the private and the public sectors, that change is taking place. For the smaller clients, whether they are in the public sector or not, that change is not so significant, but we think that some of the measures that the industry, with our help, is putting in place, both on the client's side and on the industry's side, will help move things in that direction for the smaller clients as well, but we are not there yet.

Sir Robert Smith

135. But, presumably, being the public sector, smaller clients are part of a bigger organisation and it should be possible to give them the back-up to go down this road.

(*Mr Alty*) I take the point you are making. It comes down to the degree of co-ordination and the issues on which OGC gives detailed guidance as it were. At the moment, as we said earlier, OGC guidance is not specific about retentions, so I am telling you where we are at the moment. I understand the point: this is an issue for the industry, should we not be trying to change that? Yes, we are trying to change it, but we have got to do it in a balanced way. It is not just the client. John Egan's report says there are big problems in the construction industry in terms of quality. That has got to be improved alongside changes on the client side from our perspective.

136. Do you have any comparative information from other parts of the world as to how defects are dealt with—in writing later perhaps?

(*Mr Alty*) I heard that question. I do not here. We would obviously see whether we did have but I do not at the moment.

Chairman

137. You gave us figures for contractor insolvencies. Do you have any figures for client insolvencies?

(*Mr Alty*) I gather that was also mentioned. I do not know whether we would.

(*Mr Evans*) I am not sure whether we actually have. I have never seen data that says when a company went insolvent whether it was, at that time, a construction client or not. We have global figures about all kinds of insolvencies but whether they were construction clients at the time I am not sure that I have seen any anywhere.

138. We are at the stage now where we are just about finished, and colleagues have asked all the questions they want. Since we have covered the whole thing this morning, you see heads nodding at different times in agreement and disagreement. It is just to say to the people who have already provided us with what, in some instances, was voluminous information which we were happy to read, if there was anything in addition that you would want us to have, within fairly short order, we would be very happy to receive it, because sometimes in the process of interaction and questions and answer in sessions of this nature, where we are doing only a very brief survey of the area, people feel that there is something else they wish they had sent in or in the light of evidence, they would like to do so. We can demand it of civil servants but we can only ask it of you. Thank you very much.

(*Mr Alty*) Thank you.

APPENDICES TO THE MINUTES OF EVIDENCE

APPENDIX 1

Memorandum by the Confederation of Construction Clients

The Confederation of Construction Clients (CCC) would be grateful if the following observations would be taken into account in your committee inquiry into the use of retention's in the UK Construction Industry.

The Confederation of Construction Clients was established to represent the interests of construction clients collectively by:

- Encouraging clients to achieve value for money through best practice.
- Seeing major measurable and consistent improvement in performance across the industry.
- Promoting policies aimed at achieving a safe and skilled industry which is competitive and competent.

In all its representations the Confederation emphasises that clients look for solutions to their construction requirements that meet their business requirements and add value to their business.

The membership of the Confederation (list attached) covers all types of public and private sector clients. An approximate annual value of collective demand by clients who are members of CCC approaches £50 billion.

The long-term aim of construction clients is to achieve their optimum business solution through the use of integrated teams, which include the clients. This means the delivery of a quality product centred on meeting the end users' needs.

The recommendations for improving quality and efficiency in the industry, defined by the Construction Task Force in Rethinking Construction and further developed in the Strategic Forum for Construction's Accelerating Change report, reflect the clients' views about how this higher quality product can be achieved. Progress towards integrating the supply teams, the growth of partnering and framework agreements as the basis for contractual relationships, concentration on pre-planning and the role of design, and the adoption by all clients, including the public planning sector, of an approach to procurement based on whole life performance rather than on lowest initial cost, are all directed towards achieving the long-term client objective.

However, we are still some way off these delivery processes being the norm throughout the industry.

Until these improved practices are widely implemented, and the Accelerating Change report sets out strategic targets, with time-scales for delivery of tangible change, the existing system of retention's is the most effective way at present open to clients to ensure that defects are rectified before payment of the final account. While clients would be keen to see the misuse of the system, which currently exists within the supply chain eliminated, in the short term clients would not wish to see retention's abolished.

These observations summarise general response from CCC members. In addition NHS Estates, one of CCC's public sector members has described their current policy in relation to their objective of proceeding towards a phasing out of retention's for some of their long-term suppliers, and I enclose a copy of their letter.

I hope that you will find the above helpful.

Zara Lamont OBE
Chief Executive

30 September 2002

APPENDIX 2

Memorandum by the Construction Confederation

The Construction Confederation represents the interests of over 5,000 construction companies who carry out 75 per cent of the total turnover of the UK construction industry.

We are grateful to you for allowing us an opportunity to put our views forward in relation to the use of retention in the construction industry. We attach a copy of our comments, which we trust you will find useful.

Construction Confederation

26 September 2002

BACKGROUND

Most standard forms of Building Contracts, including the JCT standard forms of contract that are used significantly by Local Authorities, and the GC/Works suite of contracts for use by Government, provide for the deduction of retention from sums otherwise due to the main Contractor/Sub Contractor. Although this sum has been earned by the Main Contractor it is not yet payable because of other contract provisions providing for its deductions.

As the retention fund is intended to provide the Employer with some protection against the failure to remedy defects in the work it is usual for one half of the Retention to be released on Practical Completion of the works and the second half following the making good of any defects, normally one year after completion.

Retention is an important feature of the construction industry. As the industry has traditionally operated on low margins a retention of 3 per cent on a contract can represent or even exceed the profit on a particular project. Failure to release the retention at the appropriate time can, therefore, have a significant effect on the profitability and solvency of companies. This is particularly true in relation to SME's as well as all the other parties in the contractual chain for example sub contractors. Retention is deducted first by Clients and then the deduction of retention is usually mirrored in all subsidiary contracts throughout the supply chain. Main Contractors are, therefore, to a large degree the "middle man" in this chain of deductions.

The issue of who owns the retention causes particular problems for the industry. As the retention is money already earned than most standard forms of contract provide for the retention to have trust status. The importance of trust status relates to the rights of the respective parties if the party holding the retention becomes insolvent. If the retention has been segregated from other funds then it is separately identifiable as trust property and the claiming party has first call on the fund. Difficulties arise because the retention is rarely set aside into a separate fund and the clauses relating to trust status are frequently deleted. For all parties subject to retention this means that their retention is often at risk in the event of insolvency.

Recently the problems surrounding retention have been increasing particularly in relation to certain sub-contract trades; piling, pre-cast concrete flooring, and structural steelworks. These trades are refusing to accept retention as a sub contract term, because their trade association bodies have registered agreements with the Office of Fair Trading allowing them to recommend such action to their members. These trades offer so called retention Bonds as a substitute for retention but these unilaterally worded documents are rarely of the "on demand" type and thus their benefit is illusory as any attempt to call the bond will almost certainly result in resistance from the surety leading to unavoidable court action. Such "anti-competitive" measures have been the subject of a recent investigation by the OFT into the lift and escalator industry resulting in the restrictive measures being withdrawn.

[see <http://www.offt.gov.uk/news/press+releases/2002/pn+32-02+escalator+trade+body+lifts+anti-competitive+rules.htm>]

The situation in which Main Contractors presently find themselves, therefore, is one where they are having cash retention deducted up the contractual chain, but in certain sectors are unable to deduct cash retention down the contractual chain. Main Contractors are therefore in effect financing 3 per cent of those sub-contract works during the contract period and up until the final release of retention. Some standard forms of contract such as JCT Minor Works and IFC 98 require 5 per cent retention prior to practical completion and 2.5 per cent following practical completion. The Highways Agency's Design and Build Conditions of Contract, clause 60.3 (Long Form with Lane Licence) requires 5 per cent retention to be held until the issue of a Taking Over Certificate, when 2.5 per cent is released. The remaining 2.5 per cent is not released until issue of the Maintenance Certificate. The maintenance Period is typically five years, although the contract does cater for a retention bond against the second half of retention.

DOES THE RETENTION SYSTEM PROVIDE AN INCENTIVE TO AVOID OR ELIMINATE DEFECTS?

The retention system has been part of the Construction Industry for over 100 years. In recent years, however, Government funded reports into the industry have indicated an increasing dissatisfaction with the level of defects in construction projects. In Sir John Egan's report there was a call for a move towards a "zero defects" culture. This sea change in performance is not assisted by the existence of a retention system. Retention by its very nature presupposes that defects will exist at practical completion or will materialise in the defects liability period.

Retention also underpins the old historical divisions of the construction industry where the supply chain is not perceived as "partners" in the production process. In a true partnering arrangement the need to withhold payment on the basis that defects may appear, and such a fund is needed to secure a contractor's performance, is anachronistic.

ALTERNATIVES TO RETENTION

For a number of years retention bonds have been offered as an alternative to retention. However, such a bond does not remove the difficulties of operating a retention system it simply shifts the mechanism by which the security is provided. Any bond offered in such circumstances must provide the equivalent security to "cash" and therefore such bonds are usually on demand. This creates unfair competition as smaller

companies will be unable to provide the collateral required to secure such bonds. Also cost and risk are increased by bond release dates being tied to the issue of the Certificate of Making Good Defects as opposed to Practical Completion. The use of Retention Bonds also increases the paperwork on jobs and as experience has shown, this is often viewed unfavourably by the industry. We have also seen the recent spectre of companies issuing such bonds themselves becoming insolvent. The JCT Standard form of Building Contract 1998 now provides as an option for the provision of a Bond by the Main Contractor as an alternative to having retention deducted from certified payments. This is mirrored in the new JCT Domestic Sub Contract.

However, the standard forms of contract are adapting to mirror the changing construction market. Whilst PPC 2000 provides for the deduction of retention the new, shortly to be published, JCT Major Projects form is retention free. It is intended to mirror this position in the form of sub contract to accompany this form, which is presently being drafted.

In addition the JCT domestic sub contract form provides for a new approach to the release of retention. Historically release of retention on sub contracts has been linked to the practical completion and the Making Good of all Defects at the end of the Defects Liability Period of the main contract. Whilst this is justifiable from a Clients perspective, as they wish projects to be delivered as a working whole with a single defects liability period, this has caused problems for sub contractors because the issuing of the Certificate for Making Good Defects may be delayed by the failure of a single Sub-Contractor to perform. Under the new JCT form the sub contractor's retention will be released upon the expiry of the main contract defects liability period, even where no making good defects certificate has been issued, provided those sub contract works are not the reason for the certificate being withheld. This is certainly a move in the right direction and a significant concession by the Construction Confederation.

COST TO THE CONSTRUCTION INDUSTRY

Based on anecdotal evidence there is strong support for the argument that the Retention system increase tender prices and imposes on the industry substantial administrative costs. Very little independent research is available, but even taking the most simplistic analysis the use of Retention will affect costs.

Taking as an example contractors output for public sector the annual construction spend is in the region of £25 billion. If sub contractors routinely increase tender prices to provide a contingency against the non-release of retention then that 3 per cent of total spend equates to £750 million the financing of which must cost at least £15 million per year. If this is interpolated to total construction spend and recognises that some clients demand higher percentage retentions then the figure increases accordingly.

As detailed below the Defence Estates Prime Contracting Model Terms and Conditions do not provide for retention. As the Annual DE spend is approximately £1 billion this previously equated to an annual retention fund of £30 million.

Why should the practice of deducting retention not apply to supply only contracts for example Consultants?

This anomaly is hard to explain except on a historical basis. In the past the appointment of a Consultant has been seen as a "professional" appointment, where the actions of the individuals involved are also governed by professional codes of conduct. As such the terms and conditions of appointment have been different from those governing so-called "trade" appointments. In a post Egan construction industry such distinctions are divisive to the supply chain working together to meet the needs of the Clients. Retention should apply to all or to no one.

What obstacles exist for public sector Clients wishing to abolish retention?

Legally and contractually there are no obstacles to the removal of retention. The existing standard forms of contract could be amended very easily and indeed in the case of the JCT Major Projects form no amendment is necessary. However, the cultural change that such a shift would require should not be underestimated. Clients perceive the system of retention as one that provides security rather than simply a mechanism for increasing costs. Additionally few clients "ring fence" the retention and simply use monies properly due to Contractors as working capital—a dangerous procedure unless properly accounted. Adopting a retention free culture will involve clients relying on the mutual beneficial commercial arrangements between them and their supply chain; a "carrot" rather than a "stick" approach.

IMPACT ON SME'S OF RETENTION

SME's are the type of firms affected by the financial implications of retention. At any period of time a significant portion of money earned and owed is held by way of retention. With low margins retention can represent the total profit margin on a project and affect cash flow. Maintaining cash flow and certainty of payment was the prime motivation behind Part II of The Housing Grants Construction and Regeneration Act 1996. However, this act does not address retention, because no consensus would be reached within the

industry at the time of enactment. With the recent changes in public sector procurement practice and a move toward best value and quality taking precedent over price maybe public sector Clients should lead the way in promoting a further sea change in the industry by the abolition of retention?

SUMMARY OF THE POSITION OF THE CONSTRUCTION CONFEDERATION

The Construction Confederation (“CC”) has always maintained that this is a pan industry issue and therefore should be addressed by all interested parties, in particular clients. The CC welcomes the opportunity to have a pan industry debate on the issues as any changes must be led by Clients and this affords the public sector the opportunity of leading the way in promoting a new payment culture within the industry.

The CC would prefer its members to work in a retention free environment, but where clients insist on retention the main contractor should be free to apply retention through the supply chain to all sub contractors and consultants.

Whilst supporting the abolition of the retention system the CC would not wish to see the system replaced by an alternative compulsory bond system. The construction industry is already beset by the provision of bonds, which can be costly to administer. In addition although retention bonds have been available for some time they have not been widely adopted by clients and although offered by a number of sub contractor bodies the forms in current circulation do not provide the equivalent security to a cash retention fund. Therefore, whilst the CC acknowledges the difficulties with the retention system, if no agreement can be reached to abolish retention then at least the present regime has the benefit of being clearly understood and recognised for what it is “warts and all”.

Construction Confederation

26 September 2002

APPENDIX 3

Memorandum by the Department of Trade and Industry

With apologies for our delay, please find enclosed the Department of Trade and Industry’s submission of evidence to the House of Commons Trade and Industry Select Committee for this inquiry. Brian Wilson MP, the Minister of State for Energy and Construction at the DTI has approved this submission.

If for any reason, you wish to contact the Department with any question relating to the submission, please contact me at the above address. I hope that the committee find this evidence helpful.

Paul Smith

INTRODUCTION

The Trade and Industry Committee has announced a short inquiry into the practice of retentions in the construction industry and whether such practice should be perpetuated, particularly within the public sector.

GENERAL POSITION

This reply encapsulates what DTI considers to be the most important points that the Select Committee might wish to consider. Namely:

- The Government’s current strategy, to promote the principles of Rethinking Construction and Accelerating Change (see annex C) is intended to encourage a culture of continuous process improvement on construction projects, leading to a radical reduction of defects on completion. The Construction Taskforce, chaired by Sir John Egan, believed its recommendations could achieve a 20 per cent year on year reduction in defects. Since the taskforce reported in 1998, the Government has promoted the implementation of its recommendations in the industry through the Rethinking Construction demonstration projects programme and the work of the Construction Best Practice Programme. These initiatives seek to tackle the underlying problems that lead to the perceived need for retentions in the industry.
- The practice of retaining money to offset the cost of remediation of defective work is commonplace throughout the construction industry. Many clients, contractors and subcontractors do not trust one another to deliver defect free work. DTI sees this as an endemic cultural problem arising from the difficulty that the industry commonly has delivering defect free construction.
- This practice is not a requirement of legislation and neither is it illegal. Government has no plans to regulate in this matter. Neither has any Department of State taken action to ban the use of

retentions in its contracts. It is open to individual clients, contractors and subcontractors to agree whether or not to engage in this practice. Its use in one part of the supply chain does not necessitate or preclude its use in another. It is a matter of civil freedom of contract and requires all sides to acquiesce at the outset. Many contractors and subcontractors do so and, for reasons of cash flow, transfer the retention down the chain to their own subcontractors. It is often held that, were they refuse a retention, they would lose valuable work.

- DTI considers that the need for retentions should diminish in direct proportion to the industry's ability to deliver defect free work. A number of major clients are addressing the problem of defective work as part of a programme of improved procurement practices. This enables them to progressively replace the practice of withholding a retention with a more robust system of quality control. Examples from the public sector include the Highways Agency's system of framework contracts, the Procure 21 programme being taken forward by NHS Estates and Defence Estates' Prime Contracting initiative.
- However, smaller and more occasional clients do not necessarily have access to a widely accepted standard alternative to retentions. If they are to secure the value for money, clients need to be confident they have some recourse when defects occur. In the absence of any other readily available practice, retentions do provide some assurance. It would therefore be inappropriate to place a moratorium on their use.
- DTI is concerned by any incidence of abuses of payment in the construction industry. Part II of the Housing Grants Construction and Regeneration Act 1996 provides access to a contractual adjudication mechanism to tackle the problem and the DTI is committed to maintaining its effectiveness. The Government is also taking action to strengthen the provisions of the Late Payment of Commercial Debts (Interest) Act 1998.

This general position is reflected in the DTI's response to the representations it has received during the recent campaign on retentions. All MP's who have forwarded letters from their constituents to the Department have received replies along the lines of Annex A.

This evidence now expands on the following points:

- Excellence in construction and alternatives to retentions.
- Abuse and use of retentions.
- Trade and Industry Select Committee—next steps.

EXCELLENCE IN CONSTRUCTION AND ALTERNATIVES TO RETENTIONS

1. The reasons for the continued use of retentions in the construction industry are complex but primarily include:

- the persistent problem of defects on completion and the need for some simple assurance that there is a mechanism by which they might be rectified;
- the lack of a widely accepted standard alternative to retentions which is available to the whole industry. Finally:
- At present the construction industry has little to offer by way of an alternative form of assurance against defects.

2. The DTI is working with the construction industry to encourage improved productivity and performance in part through the radical reduction of defects on completion. The framework for improvement is set out in *Rethinking Construction* and built upon in *Accelerating Change*. Both envisage new and improved contractual approaches to projects bringing about the integration of the project supply team. In practice many of these approaches do not include contractual provisions on retentions. Such a framework might cover relationships between the whole of the construction supply team on a number of consecutive projects to allow contractors to gain experience of a new system and fully make use of it. A strict performance measurement framework usually enables the client, or project manager, to address instances of failure.

3. Some public sector clients have abandoned retentions as part of procurement methodologies involving more rigorous selection processes, integrated project teams and better quality assurance. These methods are not usually appropriate for occasional clients as they depend upon clients providing the opportunity of continuity of work, and thus an incentive, to those contractors who meet the client's performance criteria. The "right first time" principles used in these projects could be applied more broadly however.

4. There are some alternatives to retentions available more readily within individual sectors. A number of firms affiliated to particular trade associations offer contractual tools such as bonds or insurance policies covering liability for defects. These have not been well tested in the marketplace and, compared to retentions, they are not in common use.

5. Most recently the government has brought together the Strategic Forum for the Construction Industry, initially under the chairmanship of Sir John Egan, to increase the industry's commitment to the recommendations he made in 1998 in *Rethinking Construction*. The Forum represented the whole of the industry and its report on *Accelerating change* (September 2002) makes recommendations and sets targets on

integrated teams and Client leadership , to promote trust and cooperation down the supply chain. In particular the Forum has recommended:

- better access for clients to independent client advice;
- project insurance for the whole supply chain; and,
- benchmarking of payment practices and promotion of model payment mechanisms.

6. The Strategic Forum for the Construction Industry has become an independent organisation fully in the ownership of the construction industry and chaired by Peter Rogers. The forum is tasked with the implementing the recommendations and achieving the targets set in *Accelerating Change*. The DTI is committed to helping the industry do this.

ABUSE AND USE OF RETENTIONS

7. It is important to distinguish between the abuse and the use of retentions. Many of the problems associated with the use of retentions in the construction industry are in fact caused by their abuse. Abuses of retentions are part of the wider problem of abuse of payment in the industry, whereby late and non-payment is common and often used as a means of securing additional cash flow.

8. It is clear that the practice of withholding a retention is largely one of the industry's own making and it seems that the client is not its only (and possibly not its main) proponent. Contractors and subcontractors often claim that they cannot resist the pressure from clients and contractors to agree to a retention, despite their skills being in high demand. It is notable that most of the sector specific alternatives to retentions have been developed in the highly skilled specialist sector. However, many contractors in all sector use what power they have to add the price the liability of non-payment of retentions into the price of the contract. This all serves to increase the overall project price paid by the client.

9. The DTI continues to support moves by the construction industry to address abuse of payment more broadly. All of the steps that the Government has taken to reduce payment abuse, apply to retentions just as much as they do other payments. After completion, it is no longer open to contracting parties to suspend delivery but it is open to them to refer disputes to adjudication under Part II of the Housing Grants, Construction and Regeneration Act 1996. DTI has recently worked with the industry to review the process of adjudication under the construction contracts legislation and has supported the production of guidance to adjudicators. The legislation also outlaws the practice of invoking pay-when-paid clauses. These were previously a popular means of reducing exposure to the damaging effects of late and non-payment as these could be transferred down the contract chain leaving small subcontractors with serious cash-flow problems. It is also open to parties claiming a retention to make use of the terms of the late payment of Commercial Debts (Interest) Act 1998. Generally while retentions are open to abuse in the same way that other payment practices are, the legislation to deal with abuses of payment applies in the same way to abuses of retentions.

10. The DTI supports the construction industry's initiatives to improve project management reduce defects and address abuses of payment. It believes these will make the case for alternatives to retentions where they are available and lead to their development where they are not. To continue to aim for excellence in construction, clients need to have the freedom to adopt retentions where there is no alternative. The DTI will continue to encourage clients to move away from the practice of withholding a retention, where they reasonably have the confidence to do so through a better means of quality assurance.

TRADE AND INDUSTRY SELECT COMMITTEE—NEXT STEPS

The DTI invites the Trade and Industry Select Committee to:

- support the Government's Strategic approach to promoting the principles to *Rethinking Construction* and *Accelerating Change* and working with the industry to tackle the underlying causes of the perceived need for retentions;
- welcome the recommendations of the Strategic Forum for the Construction Industry in *Accelerating Change* to encourage improved quality of delivery of projects and a more collaborative approach to construction;
- endorse the steps taken by several major clients (including a number in the public sector) to introduce effective quality assurance systems, building a team based approach to construction and improving upon common payment practices; and,
- encourage the various sectors of the construction industry to work together and to involve clients to identify alternative standard forms of quality assurance.

Annex A:**THE DTI'S RESPONSE TO TYPICAL CAMPAIGN LETTERS ON RETENTIONS**

The use of retentions is common, resulting from decades of adversarial relationships between the players in the industry and we are taking a range of steps to address the root cause of the distrust.

Through the Rethinking Construction initiative, run in partnership by Government and the construction industry, we have developed and disseminated policies that promote a culture change in the industry and across clients. These are based on partnering and long-term relationships between the parties where they cooperate to maximise efficiency and benefits, and to drive waste out of the project. This approach was strongly endorsed by the National Audit Office in the report "Modernizing Construction" published in January 2001 and was recently endorsed by the Local Government Task Force board.

More specifically the Achieving Excellence initiative set challenging targets for Government Departments to become best practice clients through the use of integrated procurement routes and performance-based, incentivised contracts which will reduce the need for retentions in the future.

The Local Government Task Force, which was formed to promote "*Rethinking Construction*" in local government, has concluded that retentions are not compatible with a collaborative approach such as partnering. The Task Force is encouraging authorities to work with suppliers and use robust quality control assurance systems, which would reduce the need for retentions. Retentions do not feature in Defence Estates' Prime form of contract used in support of partnering relationships.

Through *Rethinking Construction* we have undertaken considerable work to address the causes of retentions and to support constructive procurement principles. However the whole construction industry must support these changes by providing quality, defect-free work which fully meets the needs of contractors and clients. This is an ongoing process requiring a culture change across the industry and it will take some time to become fully embedded. OGC has asked the Constructors' Liaison Group to look at the issue of defects and what may be causing them and to provide a report.

In the meantime I do not think that it would be appropriate to consider abolishing retentions or to demand that central or local government clients no longer use them.

Annex B & C

A copy of the reports of the Construction Taskforce (*Rethinking Construction*) and of the Strategic Forum for the Construction Industry (*Accelerating Change*) are attached for the Select Committee to consider.*

APPENDIX 4**Memorandum by the SEC Group****CONTENTS**

- Statement by the President and the Chairman of the Specialist Engineering Contractors Group.
- The Specialist Engineering Contractors Group.
- Suggested Recommendations for Consideration by the Select Committee
- Background Note on Retentions.
- Responses to the Questions from the Select Committee in the Press Notice dated 29 July 2002.
- Annex A matrix of retention provisions in construction industry contracts
- Annex B Evidence received from firms within the Specialist Engineering Sector
- Annex C Experiences of clients who have abolished retentions

We, the undersigned, are the President and Chairman respectively of the Specialist Engineering Contractors Group. Details about the role of the Group follow on the next page.

We welcome this inquiry by the Select Committee into the use of retentions in the construction industry which, for many years, has soured relationships in the industry and has been the subject of countless disputes. As proprietors of electrical and mechanical contracting firms, we are only too aware of the burden of retentions and the abuse associated with this practice. Much of this burden falls on small and medium-sized businesses, which comprise the vast majority of the firms in the industry.

We begin our submission by proposing a number of recommendations for action by both Government and industry which the Select Committee is invited to consider. We will be of help to the Committee. We then

* Not printed.

proceed to address the questions listed in the press notice issued by the Committee on 29 July 2000 (PN32 2001-02).

When this inquiry was announced we informed our member trade associations which invited their member firms to write in with their experiences of retentions. Not surprisingly there was a substantial response and we have attached as one of the annexes extracts from some of the letters received. Originals of all the letters received are available to the Select Committee on request.

We invite the Committee to hold an oral hearing to which we would be delighted to send witnesses.

It is our earnest belief that the phasing out of retentions in the public sector would revitalise small and medium-sized businesses within the industry. This will, in turn, help to transform the performance of the industry thus ensuring the success of current initiatives designed to secure improved value for money.

John Harrower
President

Trevor Hursthouse
Chairman
The Specialist Engineering Contractors Group

The Specialist Engineering Contractors Group (SEC Group) is an umbrella body in the UK construction industry representing six trade associations:

Association of Plumbing and Heating Contractors

British Constructional Steelwork Association

Electrical Contractors' Association

Heating and Ventilating Contractors' Association

Lift and Escalator Industry Association

SELECT (representing electrical installation contractors in Scotland)

Together these organisations represent a sector with over 60,000 companies and a workforce of more than 300,000. The specialist engineering sector now accounts for over 25 per cent of construction output. The sector comprises telecommunications, power and lighting, heating and ventilation, air conditioning, air movement and refrigeration, acoustics, ductwork, plumbing, lifts and escalators, constructional steelwork, service and maintenance, commissioning and testing, information technology, data transmission, security systems, automation and control systems and facilities management.

The mission of the SEC Group is to promote an efficient and profitable specialist engineering sector comprising qualified firms and a skilled workforce which are able to meet the business needs of their clients through delivering high quality engineering systems, services, products and structures as part of integrated supply teams.

The UK construction industry comprises a complex blend of specialist engineering and technological expertise. The specialist engineering content of buildings and structures can represent as much as 60 per cent of their capital costs. This percentage is higher if whole life costs are taken into account. Thus the role of the specialist engineering contractor becomes increasingly critical to the quality of the built environment and the ultimate satisfaction of clients.

The SEC Group, therefore, aims to raise awareness, especially amongst clients and their professional advisers, of the importance of specialist engineering to the overall construction industry, and to promote productivity, profitability and best practice throughout the construction process.

Suggested Recommendations for Consideration by the Select Committee

1. The SEC Group invites the Trade & Industry Select Committee to consider the following suggested recommendations:

- The phasing out of retentions by 2007 or earlier in all public works contracts (at all levels of contracting) and on those construction projects wholly or partly funded by the public sector. The proposed timescale should be aligned with the *Accelerating Change*¹ strategic targets.
- The endorsement and monitoring of the initiatives in the *Accelerating Change* report to improve payment security and address retentions abuse;

¹ Launched on 12 September 2002 by Brian Wilson, Minister for Energy and Construction and Sir John Egan, Chairman of the Strategic Forum for Construction. *Accelerating Change* includes a number of targets for the achievement of long-lasting improvements in the performance of the construction industry. The Specialist Engineering Contractors Group was fully involved in the work of the Strategic Forum.

- An approach to the Chancellor of the Exchequer to review the status of retention monies in business accounts.

PHASING OUT OF RETENTIONS BY 2007 IN ALL PUBLIC SECTOR WORKS CONTRACTS

2. Since the Government is committed to being a best practice client it is axiomatic that it should dispense with a practice that reflects a lack of trust and an adversarial approach to contracting. The *Achieving Excellence*² programme and the recently launched *Accelerating Change* report have confirmed the Government's continuing commitment both as policy maker and as a client to improve relationships with (and within) the industry and secure value for money through promoting teamworking and partnering arrangements. Moreover, the National Audit Office Report, *Modernising Construction*³, has endorsed this approach. In the main body of our submission we argue that retentions do not add value but, on the contrary, undermine efforts to obtain improvements both in performance and in relationships between all parties.

3. Moreover, in macro-economic terms, the practice of retentions represents substantial inefficiency and waste. The standard practice is to deduct 5 per cent from payments that become due. This represents a total of £3.25 billion per annum based upon a current annual output of £65 billion. There will be outstanding retentions from previous years, which must be added to the £3.25 billion, although there will be some reduction in the resulting figure to reflect the amount of retentions recovered in the relevant year. Since the UK construction industry is primarily financed bottom-upwards the burden of retentions falls on small businesses at the end of the payment queue. This position was adequately summarised in the W S Atkin's Final report for the European Commission in 1994, *Strategies for the Construction Sector* (at paragraph 2.47):

“Many small firms close because of cash flow problems which may be outside their control. This results in re-work, delays and social hardship. The overall result is that it is the weakest and smallest firms that bear the financing burden, and they have poor access to bank credit. They frequently depend upon trade credit from suppliers and builders' merchants, which puts up materials—costs. As a result, the total financing costs of construction is much higher than it should be, with additional costs resulting from business failures.”

4. Local authorities are now subject to a statutory duty⁴ to achieve best value in all their activities including construction procurement. In July 2000 the DETR (as it then was) and the Local Government Association established a Taskforce chaired by Sir Ian Byatt to review local government procurement in England. One of the recommendations in the Taskforce's report, *Delivering Better Services for Citizens*⁵ was that local authorities should review their standing orders to ensure that these promoted efficient and effective procurement.

Standing orders should be used “positively” to encourage good practice. This recommendation was supported by both the Office of the Deputy Prime Minister and the Local Government Association in their joint response to Sir Ian Byatt's report.⁶

5. Unfortunately many local authorities seek refuge behind the excuse that their standing orders prevent them abandoning cash retentions by requiring the use of certain standard forms of contract that impose cash retentions. We suggest that it is now opportune for the Select Committee to urge the Office of the Deputy Prime Minister to put in place specific measures⁷ that will help in implementing the following recommendation from the Local Government Task Force.⁸

“[The Board of the Local Government Task Force] concluded that retentions were not compatible with the collaborative approach to contract relationships, such as partnering, which the LGTF advocates. They concluded that authorities should be encouraged to work to a position where the parties replaced retentions with robust quality control assurance systems in the partnering style.”⁹

6. We propose that the timing for the phasing out of retentions in the public sector should be aligned with one of the strategic targets in *Accelerating Change*. It is recommended in paragraph 3.5 of that report that by the end of 2007, 50 per cent of construction projects by value should be undertaken by integrated teams and 50 per cent activity by value should embrace the Client's Charter (which incorporates principles of good practice for construction clients). *Accelerating Change*¹⁰ emphasises that: “It is important that the public sector demonstrates that it is a best practice client.” Therefore, it is appropriate that the public sector, as a

² Launched by Alan Milburn the (then) Chief Executive to the Treasury in March 1999. It is endorsed by eighteen Government clients. *Achieving Excellence* was intended to implement the recommendations contained in Lord (then Sir Peter) Levene's Efficiency Unit Scrutiny, *Construction Procurement by Government* published in 1995.

³ Published by NAO in January 2001.

⁴ Under the Local Government Act 1999.

⁵ Published in June 2001.

⁶ Published by the Office of the Deputy Prime Minister in July 2002.

⁷ We develop this suggestion at paragraph 7.

⁸ The Local Government Task Force is responsible for encouraging local authorities to adopt the principles of the *Rethinking Construction* report, 1998.

⁹ Extracted from a letter dated 22 March 2001 from Ted Cattle, Chairman of the Local Government Task Force to John Harrower, Chairman of the (then) Constructors Liaison Group.

¹⁰ At paragraph 4.10.

whole, leads the way so that by the end of 2007 public works construction is free of retentions. Insofar as central government clients are concerned this target should not prove too onerous since three major spending departments have already indicated their willingness to discontinue the practice of retentions.¹¹

“The Highways Agency procures £2 billion of construction business per annum. The Agency is already implementing many of the recommendations in Accelerating Change including delivery by integrated teams. This involves developing longer-term relationships with suppliers and a target cost approach to pricing both of which makes retentions unnecessary. We would not have any difficulties with a target of phasing out retentions by the end of 2007.”

(Steve Rowsell, Procurement Director, Highways Agency)

We propose therefore that the Select Committee invites each spending department and agency to provide it with a brief annual update of the progress made in phasing out retentions so that the target (end of 2007) is achieved.

7. Whilst some local authorities have already abandoned retentions, the vast majority of authorities in England continue to demand them. In order to ensure that progress is made, the Office of the Deputy Prime Minister should be approached to take the following actions:

- Request that each local authority, within a defined timetable, puts in place the necessary amendments to its standing orders where they currently impede the adoption of best practice in construction procurement, including the removal of retentions.
- Request that each local authority addresses in their annual best value performance plans how they intend to progress the *Accelerating Change* report, including the removal of retentions.

“In a relationship of collective responsibility, responsible behaviour and mutual interest, as characterised by integrated teams, retentions cease to be a significant issue.”¹²

The Select Committee will, of course, wish to be kept informed by the Office of the Deputy Prime Minister of progress on these actions, aimed at meeting the target of the end of 2007 for phasing out retentions.

8. We are very conscious of concerns that are expressed in relation to the quality of performance of the industry and the incidence of defects. On balance there is no evidence to link the existence of retentions to the elimination of defects or enhanced levels of performance. On the contrary, there is now significant evidence to show that enlightened procurement approaches embracing teamworking and partnering arrangements and selection based upon achieving value for money rather than lowest price, are more likely to achieve far greater satisfaction for clients. With support from the National Audit Office and practical help and guidance from the Office of Government Commerce these changes are already underway in spending departments and agencies. Within the local authority sector they will take longer to achieve.

9. Within the public sector there are one-off or occasional clients who will be reluctant, for a variety of reasons, to abandon more traditional approaches to procurement. They will, generally, require rather more help and guidance. This is acknowledged in *Accelerating Change*; the Report urges the Strategic Forum for Construction to develop a long-term communications strategy that provides these clients with a greater awareness of effective procurement methods. The Office of Government Commerce is urged to give priority to its work on developing simple “How To” guides.¹³

10. Nonetheless, we recognise that more can be done to help one-off and occasional clients particularly in relation to the procurement of specialist engineering works. The successful operation and use of buildings and structures are highly dependent upon specialist engineering works particularly the performance of engineering systems. To help such clients the SEC Group will work closely with the Office of Government Commerce and the Local Government Task Force to develop practical guidance and “toolkits” for such clients. The SEC Group is currently involved with the Building Services Research and Information Association (BSRIA) in developing a toolkit that will provide clients with a step by step approach to successful partnering. Other projects could include:

- The development of models to help in evaluating bids for specialist engineering works from the standpoint of both quality and price that are both objective and auditable.¹⁴
- The development of a series of gateways (reflecting the broad procurement gateways already developed by the Office of Government Commerce) that will help public sector clients assess whether they are adopting best practice in relation to the procurement of specialist engineering works.

¹¹ Defence Estates Organisation, NHS Estates and the Highways Agency.

¹² Paragraph 5.24, *Accelerating Change*.

¹³ *Accelerating Change* proposes that there should be an independent client adviser (ICA) akin to an independent financial adviser. The ICA would help one-off and occasional clients address their business needs and if the services of the construction industry are required the adviser will provide advice on assembling the necessary team. Whilst this proposal is primarily aimed at private sector clients, there would appear to be little objection to this facility being used by public sector clients.

¹⁴ The SEC Group together with the Construction Clients Forum (now replaced by the Confederation of Construction Clients) sought funding for such a project three years ago but was unable to secure funding from the Partners in Innovation Scheme. The SEC Group will renew its efforts to secure such funding in order to re-commence the project. In the meantime the AIE, a pan-European body representing the electrical installation sector has carried out some work in an endeavour to develop this project.

11. Additionally, organisations in receipt of public funds for construction works should not be exempt from applying best practice principles in procurement. Their entitlement to public monies should be conditioned by the requirement to demonstrate best practice including a commitment to phase out the use of retentions.

ENDORSEMENT AND MONITORING OF CURRENT INITIATIVES TO IMPROVE PAYMENT SECURITY AND ELIMINATE RETENTIONS ABUSE

12. In the main body of our submission we discuss in some detail the lack of protection for retention monies held by parties higher up the payment queue. The lengthy periods during which retentions are held increase their vulnerability to the risk of insolvency. Many other jurisdictions have provided a statutory framework of insolvency protection aimed specifically at the construction industry.¹⁵

13. At Annex B we have included extracts from correspondence received from firms which include numerous examples of retentions abuse. These include, *inter alia*, the following:

- Lengthy delays in the recovery of retentions, often in excess of two years from the date of completion of the works to which the retention relates.
- Refusal to reimburse retentions because of alleged shortcomings in the work of other parties involved in the project.
- Main contractors holding back retentions in order to pressurise sub-contractors into an unfavourable agreement on their final accounts.
- Refusal by main contractors to reimburse their sub-contractors' retentions because of the late or non-issue of relevant main contract certificates for reasons unconnected with the sub-contractor's work.

14. The *Accelerating Change* Report recommends that key performance indicators for payments within supply chains should be developed by the end of April 2003 to establish and benchmark best practice. Furthermore, this Report purposes that the SEC Group in consultation with the industry and Government, should carry out a study to examine the impact of insolvency law and practice on construction supply chains and make recommendations for change by July 2003.

15. We would welcome the Select Committee's endorsement for these actions and, in addition, would invite the Select Committee to recommend the following:

- That all these initiatives embrace retentions;
- That the Insolvency and the Small Business Service be asked to support the insolvency study including help with the funding of any necessary research to underpin the study.
- That the results of the insolvency study and any proposals for action be forwarded to the Select Committee in order to ensure that they are progressed.
- That, following the introduction of the key performance indicators for payment, the Department of Trade and Industry monitors them in relation to retentions. The Department could be asked to monitor whether or not there is an overall improvement in the time taken to repay retentions and report the results of such monitoring to the Select Committee on a regular basis.
- On the assumption that retentions will be phased out within the public sector, these measures will be of greater relevance to construction contracts in the private sector that continue to impose cash retentions.

AN APPROACH TO THE CHANCELLOR OF THE EXCHEQUER TO REVIEW THE TAX STATUS OF RETENTION MONIES IN BUSINESS ACCOUNTS

16. The Government's policy is to create a tax regime for business "that is modern and competitive and reflects the realities of the business environment"¹⁶ In developing this policy the Inland Revenue published its *Review of Links with Business* in November 2001 which contained a number of recommendations to improve the interaction between the Inland Revenue and business including a need for the Inland Revenue to gain a better understanding of the way business operates. The Government has also carried out a review of small business taxation and is currently consulting on general corporation tax reform. The overall aim is to reduce differences in taxable and commercial measures of profit.

17. This activity presents an appropriate opportunity to consider the treatment of retentions in business accounts for tax purposes. For the purpose of both income tax and corporation tax retentions are considered as income to business even though the retentions are still outstanding and irrespective of whether or not they are ultimately recovered. The tax treatment of retentions, therefore, substantially exacerbates the cost to

¹⁵ In his report, *Constructing the Team* (a joint Government/construction industry review of procurement and contracts) in 1994, Sir Michael Latham recommended that his proposals for legislation on contracts should include trust funds to protect monies from upstream insolvency. This was not implemented.

¹⁶ *Reform of Corporation Tax*: a consultation document, August 2002, published by HM Treasury and Inland Revenue.

businesses of financing retentions. The recent Treasury consultation document: *Reform of Corporation Tax* acknowledges that the current tax code does not provide a general definition of income or profits. The current treatment of retentions for tax purposes comes under the oft-quoted aphorism that refers to “rubbing salt into the wound”.

18. Whilst the SEC Group will be making its own representations to the Treasury and Inland Revenue on this issue, we believe that a recommendation from the Select Committee to the Chancellor of the Exchequer on this matter would carry considerable weight. Therefore, we invite the Select Committee to recommend to the Treasury that until retentions are actually received by firms, they should not be treated as income for tax purposes. Such recommendation would fully accord with the Government’s professed desire to align tax laws with commercial reality.

Background Note on Retentions

Origin of Retentions

19. The system of retentions has its origins in the beginning of railway construction in the 1840s. The sudden boom in railway construction in the first half of the nineteenth century led to the employment of a vast number of construction firms, many of which were established in the “heat” of the boom to take advantage of the available work. The extremely high number of insolvencies of contractors at that time led to the deduction of a retention (often a high percentage) as a way of ensuring that there was a fund available to help defray the costs of completion.¹⁷ Nonetheless this anachronistic practice has been kept in place because it has come to represent easily accessible¹⁸ interest-free cash.

20. The practice of retentions in the UK construction industry has attracted criticism from all sides including the industry’s clients.

“Retentions are not an ideal way of working.”

(*Ted Pearson*, ex-commercial director of the Defence Estates Organisation quoted in *Construction News*, 8 March 2001).

“After similar steps by BAA, Tesco, and John Lewis, the industry is exorably moving towards the eradication of this antediluvian practice. As we have long argued, the arbitrary withholding of 5 per cent of the contract sum to cover possible defects is utterly at odds with attempts to integrate the supply chain and engender greater trust. No buyer of cars or computers has that luxury, and nor should building owners.”

(Editorial in *Building Magazine*, 9 August 2002)

“Archaic form of insurance”

(*Steve Elliot*, MD of construction client, Overbury, describing retentions in *Building Magazine*, August 2002)

“Retentions can impair business development”

(*Alan Johnson*, ex-Competition Minister quoted in *Construction News*, 13 July 2000)

EARLY DAY MOTION IN THE HOUSE OF COMMONS

21. 153 Members of Parliament representing all the parties have signed Early Day Motion 428 (laid on 15 November 2001) advocating the phasing out of retentions in the public sector (ie both central and local government). A substantial number of MPs have written to this constituents supporting the aims of the EDM but, for a variety of reasons, have not signed it. Instead they have written to Ministers querying the need for retentions. Consequently almost a third of MPs have supported the call from many small and medium-sized businesses in the construction industry to phase retentions out of public sector procurement.

22. In recent years many key public and private sector clients have either abolished retentions or have begun the process of phasing out retentions. For example, guidance addressed to NHS Trusts advises:

“The objective during the existence of the [framework agreements] is to remove the requirement for retention unless [there is] a failure to perform, particularly in the area of achievement of zero defects or failure to rectify defects efficiently and effectively.”

¹⁷ In *Calvert v London Docks* (1838) 2 Keen 638 the court viewed the function of retention as applying “a particular sort of pressure to urge (the Contractor) to perform the work, and to leave in the hands of the company a fund wherewith to complete the work if he did not”. At the time the concern was that contractors would not remain solvent long enough to complete the work. WM Lester in his book, *Victorian Insolvency* (Clarendon Press) records that: “Between 1831 and 1914 almost one hundred bankruptcy bills were introduced in Parliament. Nearly a third of them became law.”

¹⁸ However, preliminary research indicates that many clients and client advisers (and indeed contractors and sub-contractors) regard retentions as a kind of “construction common law” that is, because, they have been part of construction contracts for so long, retentions are just accepted and imposed. Source: Darren Gill, Bouygues Ltd, from research into the move from cash retentions to retention bonds undertaken as part of an MSc degree.

23. The practice of retentions continues to apply to most contracts in the industry although, as long ago as 1964, the Banwell Report recommended the abolition of retentions. In making this submission to the Select Committee it is the view of the SEC Group that the practice of retentions:

- causes immense harm to the competitiveness and the viability of small and medium-sized firms (SMEs) which comprise the vast majority of businesses in the UK construction industry;
- detracts from the performance of the UK construction industry;
- is now outmoded within the public sector where changes in procurement practices have sought to outlaw adversarial practices through encouraging non-confrontational relationships thus securing best value for the client; and
- has no place in a modern construction industry dependent upon the most advanced skills in technology and engineering.

DEFINITION OF RETENTIONS

24. The normal practice in the construction industry is that payment is made on account following interim valuations of the work. This is usually based on measuring work actually completed together with materials specifically allocated to the project. Whilst these payments reflect the work completed at the time of valuation, they are nonetheless and of necessity approximate. This process is probably unique to construction. Other industries usually make on account payments by way of stage payments which are pre-agreed lump sums triggered by reaching a particular milestone. They are not necessarily related to the value of work completed at the time of payment.

25. Retention is part of the valuation process. It comprises applying a reduction to the gross valuation and is usually 5 per cent of that valuation sum but a larger percentage can be (and often is) required.¹⁹ This aggregates during the course of the construction period such that at completion there is a retained sum of 5 per cent of the construction cost. When the building is certified as being practically or substantially complete, half of this retention is released to the contractor with the remaining half being held until the end of what is variously known as the “defects liability period”, or “maintenance period”. These procedures are enshrined in the majority of the construction industry’s standard forms of contract.

26. Retention is an integral part of a complex valuation process and is held for a number of reasons. The most commonly cited are the remedying of defects and “snagging” problems occurring after handover of the works. This does not apply to the period during which the works are carried out: defects discovered during the construction period would be reflected in the interim valuations. As mentioned earlier, valuations are approximate, and are usually accepted to be within a margin of + or –5 per cent. During the construction period, therefore, retentions act as a “buffer” in the valuation process thus essentially offering some protection to the valuer. Other reasons that retention is held might include the need to encourage the performance of the contractor at the time of valuation or to offer some protection against contractor insolvency. However, it should be emphasised that these reasons are not made explicit in contractual documentation.

All sub-contracts will reflect the main contract retention requirement irrespective of:

- the value of the sub-contract;
- the duration of the sub-contract works;²⁰
- the type of sub-contract works;²¹ and
- the sub-contract payment arrangements.

In practice retentions provided by a main contractor are an aggregate of the retentions collected from all sub-contractors (and sub-sub-contractors) on the project. Although the deduction is generally sanctioned by contract (though not necessarily referred to as retentions in the contract) there are many instances where retention is deducted as a matter of course without any express contractual sanction.²²

27. Retentions are a feature of contracts involving the carrying out of construction works (including, it seems, works of maintenance) but they are not required in other contracts which are germane to construction. Standard terms of appointment for architects, engineers and other consultants working in the construction industry do not contain express requirements for retentions. Additionally the manufacturers and suppliers of components, materials and other generic products used in the construction industry are not subject to retentions. It may be argued that manufacturers or suppliers offer warranties in respect of their products and

¹⁹ Railtrack (soon to be Network Rail) insist upon 10 per cent retention for contracts under £50,000! In the public sector Northamptonshire County Council, for example, requires a retention of 10 per cent.

²⁰ The sub-contract may be of short duration involving a one-off payment that is not necessarily dependent upon a valuation procedure.

²¹ Retentions are often demanded for sub-contracts involving, for example, scaffolding, cleaning, maintenance works and temporary works.

²² In the legal case of *D R Bradley (Cable Joining) Ltd v Jefco Mechanical Services Ltd* (1989) 6 Construction Law Digest 07-21 the court held there was no implied contractual entitlement to make a deduction by way of retentions. (The contract in question was an oral contract for electrical works on a local authority project and retentions had been deducted by a main contractor without the agreement of the sub-contractor.)

materials but the vast majority of manufacturers will limit these to the replacement or repair of any defective product provided that notification of the relevant defect is given within a certain period (usually a maximum of three months). The warranty either takes effect on delivery or even earlier at the date of order. A contractor or sub-contractor will be expected to assume the risk of defective products and materials even if the warranty has expired or the relevant supplier/manufacturer has gone out of business.²³

28. The system of retentions is replete with risk and uncertainty especially for firms in the role of sub-contractors lower down the payment hierarchy. A survey of specialist or trade contractors carried out by an independent research body—the Construction Industry Research and Information Association (CIRIA)²⁴ disclosed that “*the most onerous sub-contracts tie the release of a sub-contractor’s retention to the employer’s release to the main contractor*”. It has to be said that this does not just apply to “onerous” sub-contracts but to the vast majority of sub-contracts including standard forms of sub-contracts published by reputable contract-producing bodies.²⁵ Consequently, contractors (ie sub-contractors and sub-sub-contractors) further down the payment queue do not have any influence over the dates for the release of their retentions.

29. This fails to recognise that the sub-contractor would be exposed to the risk of main contractor insolvency. Once a main contractor becomes insolvent its liquidator will call in all outstanding monies including sub-contractors’ retentions for distribution to creditors. Some years ago the representative organisations for local authorities advised their members to delete provisions in the standard forms of contract published by the Joint Contracts Tribunal which required that retentions be accorded “trust status” and (at the instigation of the main contractor and/or a nominated sub-contractor) should be placed in a separate account. A local authority spokesperson at the time explained that this provision was not required since local authorities do not become insolvent. He added that, in any event, local authorities required retention monies to finance other works or to derive investment income from them.²⁶ Unfortunately, this failed to recognise the impact upon nominated sub-contractors. If the main contractor becomes insolvent the local authority is found to pay outstanding monies—including retentions—to the main contractor’s liquidator for distribution to creditors.

A matrix of retention provisions in construction industry contracts is attached at Annex A.

30. Our research indicates that the practice of retentions is absent from other industries. The closest industry to construction is shipbuilding which does not have retentions. The practice within the shipbuilding industry is that a deposit on the price is paid to the shipyard at the outset of the contract and subsequent instalments are made to reflect the stage reached in the construction of the ship. Even within the construction industry, contracts for the erection of oil rigs that, for example, free of retentions. Facilities management contracts which can involve some works of construction, by way of repair and maintenance, do not include retentions.

31. So why has the system of retention and the abuse associated with it persisted within the UK construction industry? In all probability the answer to this question lies in the widespread inequality of bargaining power which exists within the UK construction industry. As previously mentioned, the bulk of the industry is comprised of SMEs which are not in a position to successfully challenge onerous contractual requirements. This applies with greater force to sub-contractors (and sub-sub-contractors) at the end of the payment queue. Such inequality of bargaining power was acknowledged in Sir Michael Latham’s report, *Constructing the Team*, in 1994 and subsequently by Parliament when enacting Part II of the Housing Grants, Construction and Regeneration Act 1996. This Act abolished pay-when-paid clauses and, *inter alia*, introduced the right to have disputes dealt with quickly and inexpensively through adjudication.²⁷

²³ An example is the legal case of *Young and Marten v McManus Childs Ltd* (1989) 9 BLR 77. A firm of roofing sub-contractors was held liable for faulty roofing tiles which had been obtained from suppliers which, in turn, had obtained them directly from the manufacturer. The sub-contractor had no choice over the type of tile since it had already been specified. Furthermore there was only one manufacturer of the specified tile. The action against the sub-contractor had been so delayed that he had no time in which to sue the supplier. The sub-contractor would have assumed this liability, in any event, if the supplier was able to successfully limit his liability by warranty or had gone into insolvency.

²⁴ Published in CIRIA special publication SP138 in 1997.

²⁵ The Joint Contracts Tribunal recently published a form of sub-contract which, subject to certain conditions allows for the release of retentions on completion of the sub-contract works but such provision, in practice, is likely to be amended to reinstate the general practice.

²⁶ A University of Northumbria undergraduate researcher, Nick Porter, recently carried out a survey amongst clients in the North-East of England on the use of retentions. A local authority responded to the question—“If retentions were abolished, what would the savings be used for?”—as follows: “they would be retained corporately for other projects/services”. This respondent assumed that the monies formerly represented by retentions could still be used for the client’s benefit.

²⁷ Unfortunately section 113 of the Act legitimised contractual pay when paid provisions that are to apply in the event of the insolvency of a third party payer. Thus, a main contractor would not be required to make payment to his suppliers. This extraordinary provision, in effect licenses non-payment by a payee where the payer has performed his contract. It is the view of the SEC Group that this part of the Act should be repealed as soon as Parliamentary time permits.

Responses to the Questions from the Select Committee in the Press Notice Dated 29 July 2002

GIVEN THAT THE STATED REASON FOR RETENTION IS THAT THEY PROVIDE AN INCENTIVE TO CONTRACTORS TO AVOID OR ELIMINATE DEFECTS, IS THERE ANY EVIDENCE THAT RETENTIONS ACHIEVE THEIR STATED AIM? ARE THERE CHANGES THAT CAN BE MADE TO CONSTRUCTION INDUSTRY PRACTICES WHICH ARE MORE LIKELY TO HAVE AN IMPACT UPON DEFECTS THAN THE SYSTEM OF RETENTIONS?

32. The general justification for retentions is that they provide an incentive for contractors to return to site to remedy defects following handover of the works. However there is little evidence that the majority of firms in the industry (especially those at the end of the payment queue) consider that retentions provide such an incentive. This view reflects a negative culture that has affected the construction industry and its clients over many years. This negative culture comprises an expectation that defects are inevitable. Little is done to “manage out” defects as construction or installation progresses.²⁸ Testing and commissioning of systems, for example, often appears low on the agenda. Little testing and commissioning takes place as work proceeds and often the period in the programme allotted to this activity is substantially reduced by clients and/or main contractors to compensate for earlier delays. Moreover the traditional practices that are embedded in the industry’s standard forms of contract reinforce this culture. Standard forms inevitably provide for a “defects liability period” (following handover of the works) during which the contractor has the opportunity to return and remedy defects. The aim, surely, must be that the project team (including specialist contractors and key manufacturers) plans, designs and manages projects so that the likelihood of defects is substantially reduced at the outset of the project.

33. But, in this context, there are some other issues to be addressed. If retentions are required to force a contractor to return to remedy defects, this implies that there is little confidence in the contractor’s ability to perform which, in turn, may suggest shortcomings in the selection process. The selection process may have been defective if it was aimed at achieving the lowest price and ignored the contractor’s ability to deliver the requisite quality.

“If you deal with the lowest bidder, it is well to add something for the risk you run. And if you do that, you will have enough to pay for something better.”

(John Ruskin 1860)

The overriding objective should be to engage firms that are qualified under accredited qualification schemes which demonstrate that they are resourced and technically competent to carry out the work. Clients should have a reliable means of filtering out the reputable firms from firms which do not deserve to be in the business of construction. There are already established in the industry reputable schemes of qualification. In addition there is the Government-backed scheme maintained by Constructionline and the Quality Mark Scheme for the domestic sector. This issue is further discussed a little later at paragraph 43 and 44 below.

34. The fundamental point, however, is whether the massive cost to SMEs in sustaining the retentions burden (including the cost of abuse associated with it) is out of all proportion to the need to deal with the minority of firms which do not honour their obligations to attend to defects.²⁹ In any event, as the letters at Annex B reveal, the recovery of retentions is not automatic upon the delivery of defect-free work. Therefore, how can retentions be an incentive to rectify defects? On the contrary, the delays and abuse associated with the recovery of retentions act as a distinctive to firms, especially small firms at the end of the payment queue. For these firms there is no cash fund to which they can have access in the event that they are not paid. But the existence of a retention fund provides an immediate and convenient means of recovery irrespective of the degree of culpability amongst each of the contractors on site or whether or not the defect(s) in question was caused wholly or partly by other participants in the construction process.

35. Furthermore there is no evidence of any correlation between the incidence of defects and the existence or non-existence of retentions. If the proponents of the retentions system believe that it has an appreciable effect on reducing defects than the system has clearly failed.

“Clients used to providing a high level of service for their own customers are often dismayed by the high level of defects on building projects in which they have invested heavily”

(Constructing Improvement, Construction Clients’ Forum, January 1998)

On the contrary, there is some evidence that defects are reduced following the abolition of retentions. The Gosport Borough Council “partnering” trial, for example, has demonstrated that defects are significantly reduced when traditional practices are replaced by a partnering approach.³⁰

“We are firmly of the view that contractors who work with us regularly know that they need to address defects as and when they arise as they will be measured against their performance, and are aware that this can affect future work. We see this as a much greater incentive than 5 per cent of sub contract value.”

²⁸ One specialist engineering contractor has achieved zero defects on several projects where the culture has been one—down to supervisor level—of “cleaning” work of defects as it progresses (source: Martin Davis, Vice-Chairman, Emcor Drake & Scull Group PLC).

²⁹ In any event the number of justified claims upon retention funds is minimal. See paragraph 68.

³⁰ See Annex C.

(Huw Davies, Regional Development Manager for Tesco Stores)

36. The causes of defects can often be the result of factors which are beyond the control of contractors and sub-contractors, such as the procurement or delivery method used. In his report in 1998, *Rethinking Construction*, Sir John Egan was emphatic that the failure of the construction industry to deliver defect-free work consistently was due to fragmentation in delivery. In other words, the delivery process was affected by a number of discrete units, often in conflict with each other rather than performing as a team focusing on the client's needs. The process was described by a professor of architecture, Denys Hinton, in 1976 as follows:

“the so called building team. As teams go it really is rather peculiar, not at all like a cricket 11, more like a scratch bunch consisting of one batsman, one goalkeeper, a pole vaulter and a polo player. Normally brought together for a single enterprise each member has different objectives, training and techniques and different rules. The relationship is unstable, even unreliable, with very little functional cohesion and no loyalty to a common end beyond that of coming through unscathed.”

37. Research carried out by the Building Research Establishment in the 1970s indicated that the major cause of defects was the lack of information or lack of adequate information. Such a conclusion is not unexpected since communication between the various parties involved in the delivery process is often haphazard. In *Rethinking Construction*, Sir John Egan advocated a fundamental change in the procurement process so that delivery was achieved through the use of cohesive units or integrated supply teams reflecting the position in the manufacturing sector.³¹ It is now widely acknowledged that key specialist contractors eg concrete and steel specialists, mechanical, electrical and lifts contractors should be involved much earlier in the procurement process as part of the delivery team rather than later as sub-contractors and even sub-sub-contractors. If they are enabled to contribute in this way there will be greater opportunities for enhancing performance and achieving zero defects. Time and time again firms have become frustrated when they have become aware that inadequate or inappropriate components, products, methods or processes have been specified.

38. Following *Rethinking Construction* in 1998 client organisations and industry came forth with a number of projects designed to demonstrate the advantages of collaborative working, partnering and teamworking. These demonstration projects have shown that defects have been substantially reduced as a result of integrating the expertise and resources of the various participants in the construction process. A recent report of the Housing Forum has borne this out.³² Demonstration projects were performing over 40 per cent better than the industry average with 71 per cent of customers recording no defects or some defects having no significant effect on the customer. This was due primarily to improving communication within supply chains and other arrangements including incentives to improve the motivation of the supply side.

“Contracts with the private sector should be examined to see if they permit and provide incentives for innovation and continuous improvement.”³³

Retentions should be regarded as disincentives—not incentives.

39. The Housing Forum report states:

“How are contractors/sub-contractors incentivised to reduce defects?”

Holding retention is intended to incentivise contractors to repair defects in the defects liability period on traditional contracts. In reality there is little evidence to show it actually encourages contractors to produce defect-free properties. If anything holding retentions encourages contractors and sub-contractors to increase their prices accordingly because they will not necessarily receive their retention.

Several of the demonstration projects are not holding retentions on the contractors who in turn are not holding retentions on their sub-contractors. Contractors are able to offer longer defects liability periods and where there are strategic partnering arrangements, maintaining the continuity of work is enough of an incentive in itself to reduce defects.”

40. The Housing Forum lists the key lessons learnt from its demonstration projects:

- Off-site fabrication can reduce defects.
- Good communication with/between the supply chain can reduce defects.
- The parties should mutually agree what a defect is.
- Measure, act, measure again.
- Look for common recurring defects and respond through process or design changes.
- Incentivise the contractor to reduce defects.
- Trades snagging other trades can reduce defects.

41. The specialist engineering sector (like other sectors in the industry) participated fully in the demonstration projects programme which followed the *Rethinking Construction* report in 1998. When the

³¹ This is the subject of one of the strategic targets in *Accelerating Change*.

³² The Housing Forum Demonstration Projects Report, February 2002: The Challenges Ahead.

³³ Guidance on Best Value for local authorities originally published by the (then) DETR

report was launched, the Deputy Prime Minister John Prescott and Sir John Egan challenged the industry to bring forward demonstration projects to demonstrate innovation and change that could be measured and evaluated. The demonstration projects were required to measure their performance against a set of key performance indicators. The Department of Trade and Industry has collected this data and makes known on an annual basis the comparison between industry performance and that for the demonstration projects. For example, in 2001 demonstration projects scored far higher than construction generally in relation to the reduction in defects; 86 per cent of demonstration projects scored 8–10 or better to 58 per cent for all of construction.³⁴ Much of this success was achieved through teamworking, partnering arrangements and better supply chain management.

42. The aim of the demonstration projects was to pass on the benefit of the experiences gained to the rest of the industry. Unfortunately, the capacity of SMEs to carry out the necessary investment to enhance their performance and delivery is restricted by their having to fund the burden of lengthy payment cycles and retentions. Lifting the retentions burden would help such businesses take advantage of the accumulated experience of the demonstration projects. Independent research reviewing the impact of demonstration projects found that more than half of the participating organisations had made changes in eight specific areas of their businesses as a result.³⁵

43. We made reference to the issue of qualification in paragraph 33. Trade associations have invested heavily in qualification schemes. Such schemes exist within all the trades represented by the Specialist Engineering Contractors Group—electrical, mechanical, plumbing, lifts, and steel.³⁶ These schemes audit firms according to their technical expertise, financial resources and health and safety policies. Some schemes involve inspections of the work carried out. Membership of some of these schemes also allow firms to be placed upon the Constructionline list, the national qualification system supported by the public sector. Constructionline was borne out of the recommendation in Sir Michael Latham's report, *Constructing the Team* that the public sector should select its firms (including consultants and contractors) from the public sector registers known at that time as CIMIS and ConReg, the predecessors of Constructionline. Furthermore, main contractors should be required by public sector clients, as a condition of the main contract, to engage sub-contractors registered on these lists but this has not been actioned.

44. Unfortunately, the public sector has been either slow or unwilling to adopt Constructionline (with the exception of the public sector in Scotland) with the result that there is a proliferation of lists. Undue expense is, therefore, caused to firms having to get on these various lists. The fundamental principle is that construction work should only be carried out by firms which are properly resourced and have the technical ability to carry out the work, taking into account the type and volume of work involved. Schemes of qualification which are rigorous and credible should be acknowledged as such by a central authority under the aegis of the Secretary of State for the Department of Trade and Industry. Schemes of qualification should be required to satisfy a certain set of criteria and, if so, they should be accredited. Public sector clients should, then, select firms which have been accredited under these schemes. Private sector clients should be strongly advised to do so. This also addresses the problem of the public sector creating a monopoly by accepting only one scheme. Such a development would reflect similar developments abroad such as in Australia and the United States where there are requirements that contractors be licensed. In California, for example, contractors wishing to carry out public sector works have to be licensed.

We invite the Select Committee to endorse the recommendation in *Accelerating Change* that work should now commence to enable corporate competence to be readily assessed and validated.³⁷

45. Project insurance may also be an effective alternative to address the problem of defects. We invite the Select Committee to endorse the proposal in *Accelerating Change* for project insurance. By the end of 2003 it is recommended that projects should be presented for “project insurance piloting”. We further invite the Select Committee to propose to spending departments and agencies that they make available projects to trial project insurance. Traditional insurance policies in the industry such as professional indemnity insurance and contracts works insurance can be an obstacle to teamworking. They reinforce the blame culture so that there is little incentive for members of the project team to admit to errors that may lead to defects. The British Airports Authority has already introduced project insurance for the Terminal 5 project at Heathrow.

“This has significantly reduced the cost of the premiums by removing overlapping cover and introducing a non-confrontational approach which is focused around remedying the immediate event rather than trying to identify where the fault lies.”

(paragraph 5.19 *Accelerating Change*)

46. In *Rethinking Construction*, Sir John Egan proposed a 20 per cent reduction in defects year on year achieving—eventually—zero defects across the industry. An integrated supply team comprising all those having a key role in the delivery process was more likely to achieve a culture of zero defects than retentions.

³⁴ Construction Industry: Key Performance Indicators Industry Progress report www.cbpp.org.uk.

³⁵ This is referred to in *Accelerating Change*.

³⁶ eg The Register of Qualified Steelwork Contractors, Electrotechnical Assessment Scheme, Plumbers Licensing Scheme and the Qualified Contractors' Scheme in the mechanical services sector which is now being finalised.

³⁷ The target date for this work is September 2003.

The inescapable conclusion is that retentions are not “hitting the spot”. They represent a massive amount of wasted resources that can be better invested, as indicated earlier, in those areas that are more likely to help improve the quality of performance.

ARE THERE OTHER GROUNDS FOR WITHHOLDING RETENTION? IF THERE ARE OTHER GROUNDS, WHAT ARE THE ALTERNATIVES? WOULD SUCH ALTERNATIVES BE MORE EFFICIENT AND COST-EFFECTIVE FOR THE INDUSTRY AND ITS CLIENTS?

47. Since the vast majority of contracts in the industry do not define the purpose for which retentions are deducted, the payer is provided with maximum flexibility in access to and use of retention funds. Consequently, they provide client organisations and main contractor organisations with a ready means of generating positive cashflow. The feedback in the letters at Annex B suggests that this is the prime motive for withholding retentions. As we have already stated the burden of providing this free cash falls on the thousands of small businesses in the industry. This, of course, cannot be justified whether from the standpoint of the businesses concerned or from a macro-economic perspective.

48. Over the years the use of the retention fund has been expanded so that the payer is able to access it to meet claims for alleged breaches of contract by the payee. The majority of the forms of contract in the industry expressly permit this (see Annex A). But there isn't a fund available to the payee out of which he can satisfy outstanding claims or monies.

49. We have already explained that retentions are often regarded as an inherent part of the valuation process. They act as a buffer or protection for valuers in the event of any over-valuation. But, there is no compensating factor for the payee when there is under-valuation, which occurs frequently. For example, unlike other industries, it is unusual for contractors and sub-contractors to receive advance payments (as a portion of the contract price) to help defray mobilisation costs and meet the up-front costs of purchasing large value items of materials, components and equipment.

50. The abolition of retentions should be made part of an overhaul of payment practices in the construction industry. In his report, *Constructing the Team*, Sir Michael Latham recommended that the industry should move away from valuation towards alternative arrangements such as payment milestones or activity schedules. Once a milestone or activity was properly completed the allocated payment would be discharged. Sir Michael also recommended the introduction of mobilisation and advance payments. Target costs arrangements are now favoured by many clients (including public sector clients such as the Defence Estates Organisation and Highways Agency). These arrangements allow for costs transparency enabling clients to establish clearly where costs are being incurred. The emphasis is on reducing costs and adding value. In this process the profit margins of the delivery team may be ring-fenced and possibly enhanced through successes in cutting out waste and inefficiencies. In this situation retentions are unnecessary. Another example of the change that can be introduced was provided in *Accelerating Change*. Citex is the prime contractor on a Defence Estates prime contract in Andover. Citex has introduced a fully transparent payment system for the project. All those involved in the project are able to draw down their payments from a single bank account on completion of each payment milestone. Retentions are not required for this arrangement.

51. The other ground for withholding retentions relates to the insolvency of contractors/sub-contractors. This was the primary reason for the introduction of retentions in the 19th century. We do not have statistics for the incidence of contractor insolvency during the course of projects. However, it should be borne in mind that contractor/sub-contractor insolvency is often the result of payment delays and abuse. Insolvency risks can be minimised by ensuring that the contractors and sub-contractors are appropriately resourced. Evidence of this can be provided through membership of reputable schemes of qualification, a point that is developed in our answer to the first question. Nonetheless, we consider that the greater problem is the risk to small businesses of insolvencies upstream of the payment chain.

IS THERE ANY AVAILABLE COST BENEFIT ANALYSIS OF RETENTIONS?

52. At paragraph 3 of our submission we estimate the total retention burden imposed upon the industry, especially small firms. However we are not aware of any detailed research involving a cost benefit analysis of retentions. Some work on assessing the cost to industry of retentions was carried out by insurers Bowring, at the end of 1993 for the Heating and Ventilating Contractors Association and the British Constructional Steelwork Association³⁸. The report calculated that approximately £81.5 million was being withheld from heating and ventilating contractors by way of retentions (September 1993 figures). The pre-tax cost to the contractors was the cost of overdraft charges to replace the lost cash flow (assumed then to be 10 per cent); the total overdraft cost to the contractors was estimated at £8 million multiplied by three years for the average delay in payment which equalled £24 million.

³⁸ This report can be made available to the Select Committee if required.

53. The post-tax cost of retention monies was aggravated because corporation tax rules applying to contractors' profits treat retention monies as income³⁹. Tax is then paid before all the retention monies have been recovered; consequently additional overdraft costs are incurred to secure cash flow to pay the tax—this has to be added to the £24 million. These costs did not take account of other costs such as the costs involved in chasing outstanding retention monies and retentions lost through insolvencies⁴⁰.

54. We have already explained that there is little evidence of the benefits that retentions⁴¹ provide other than the obvious benefit of providing the payer with interest-free monies over a substantial period of time although this is, in fact, an abuse of the retention system. Consequently we are strongly of the view that the cost of retentions to businesses in the industry is far in excess of the claimed benefits.

ARE THERE ANY REASONS FOR APPLYING THE PRACTICE OF RETENTIONS ONLY TO CONTRACTORS AND NOT, FOR EXAMPLE, TO CONSULTANTS OR TO SUPPLY ONLY CONTRACTS?

55. The fact that retentions apply only to contractors and not consultants or manufacturers reveals the archaic nature of the practice. There is an outdated assumption that defects are likely to be caused by the contracting fraternity rather than by professionals and consultants such as architects, engineers and quantity surveyors. Today this cannot, of course, be justified. Defects are often caused by a combination of factors involving both shortcomings in design (to which architects/engineers, specialist contractors and manufacturers would all have contributed) and the works. Applying the practice of retentions to one part of the team is divisive and hampers efforts to encourage teamworking and delivery through integrated teams.

WHAT HAS BEEN THE EXPERIENCE OF CLIENTS IN THE CONSTRUCTION INDUSTRY WHO NO LONGER USE RETENTIONS? WHY DID THEY DECIDE TO DO AWAY WITH RETENTIONS? HOW HAVE THEY BENEFITED (IF AT ALL)?

56. At Annex C we include some evidence regarding clients' experiences most of which were obtained through interviews that we have carried out. The overwhelming experience of clients who have abolished retentions has been extremely positive.

"It is altruistic, it is absolutely good business. We are making lots of money by abolishing retentions because the suppliers that work for us have better cashflow and we can afford better people. We are getting an amazing response from them. The odd problem we may have with a delayed project because someone goes broke or goes away is insignificant compared to the benefits as a whole."

This statement was made by Dr Bernard Rimmer, formerly construction director at developers, Slough Estates, at an industry conference in London on 7 March 2001. We are aware that this sentiment has been echoed in submissions to the Select Committee from other clients who have abolished retentions.

WHAT OBSTACLES EXIST FOR PUBLIC SECTOR CLIENTS WISHING TO ABOLISH RETENTIONS AND HOW SOON COULD SUCH OBSTACLES BE OVERCOME? IF THE PRACTICE OF RETENTIONS WAS TO CEASE, WHAT WOULD HAPPEN TO THE CONSEQUENT SAVINGS MADE BY THE INDUSTRY?

57. We are not aware of any obstacles to public sector clients wishing to abolish retentions. In fact, as we have already indicated, there are major public sector procurers which have either abolished or are phasing out retentions. Many local authorities have already done so. The consequent savings would facilitate an enhanced performance by firms in the industry and thus, the delivery of better value for clients. We have been informed by a number of clients that such savings made by firms are reflected in lower prices but, more importantly, the consequent savings would enable SMEs in the industry to put greater investment into those areas likely to improve quality such as training and the use of IT. Evidence for this has been forthcoming in the letters attached at Annex B.

GIVEN THAT THE MAJORITY OF FIRMS IN CONSTRUCTION ARE SMES, WHAT IS THE IMPACT OF RETENTIONS UPON THEIR BUSINESSES? IS THERE SECURITY OF PAYMENT FOR CONTRACTORS AND SUB-CONTRACTORS? TO WHAT EXTENT ARE THERE DELAYS IN REPAYMENT?

58. We have already explained that the burden of financing the retention system falls, inevitably, on SMEs in the position of subcontractors and sub-sub-contractors at the end of the payment queue. The desire of firms to improve the quality of their performance and deliver their full potential is permanently undermined not only by the need to finance retentions but also in coping with the widespread abuse associated with this practice. Therefore it is not surprising that retentions are a source of myriad disputes. This point is reinforced in many of the extracts at Annex B from the correspondence received.

³⁹ Similarly income tax rules regard retentions as received income. We have already referred to this problem in one of our recommendations at the beginning of this submission. Interestingly, retentions can also appear in a payer's company's accounts as if they are the payer's own monies.

⁴⁰ Thus, the payer's balance sheet may give a misleading picture of financial standing.

⁴¹ In our answer to the first question we explained that the other alleged benefits are largely illusory.

59. The statistics for retentions abuse are startling. Twenty-five per cent of retentions are never recovered and the balance of seventy-five per cent are recovered late⁴². Retentions reflect a culture that has pervaded the industry for many years which has been characterised by lowest price tendering, adversarialism and payment manipulation often erring on fraudulent behaviour. Retentions reflect relationships that are based upon all the worst features of contracting in the construction industry. Foremost amongst these has been the desire of many companies—particularly the larger organisations representing both clients and main contractors—to generate a positive cash flow by taking advantage of the opportunities for delaying and prolonging payment.

60. Retentions provide an abundance of such opportunities. Sub-contractors at the end of the payment queue will not be in a position to recover their retentions until all work on a project is satisfactory. For example, a steelwork contractor will be one of the earliest trades on a construction site. He will have left the site long before the overall works are complete, which may be three or possibly four years later. In practice, he will not be able to claim the first half (let alone the second half) of his retentions until the whole project is satisfactorily completed. In addition there are likely to be delays (for reasons beyond his control) which will further delay the recovery of his retentions. One steelwork contractor has related the story of being informed years after he had left the site that his retentions would not be paid because problems caused by the landscape contractor have not been resolved⁴³! As a result the steelworker's retention fund (alongside that of other sub-contractors) was kept as an interest-free fund for a substantial length of time.

61. It is no wonder that this practice leads to countless disputes. The cost of chasing outstanding retentions becomes an intolerable burden upon firms. We estimate that the total of such costs is likely to run into billions of pounds! In practice, the individual amounts that are outstanding are often small which means that it would be pointless to pursue the amounts owed through arbitration, the courts or even adjudication. It is not uncommon for firms to give up their rights to the outstanding monies. Part II of the Housing Grants, Construction and Regeneration Act 1996 may provide some help to firms chasing their retentions but this does not excuse the continuation of a practice that is intrinsically adversarial. The perpetuation of a practice that provides a fertile ground for abuse and disputes is, in itself, sufficient to justify the termination of the practice.

62. The often excessive delays in obtaining outstanding retentions puts these monies at risk from insolvencies upstream. The existence of large retention deposits in main contracting organisations can, paradoxically, facilitate the first step towards insolvency. Administrative receivers are more likely to commence receivership when a company is in receipt of such funds. Furthermore, the presence of retention funds can encourage the more unscrupulous company directors and officers to dissipate them as a prelude to insolvency⁴⁴. Over the years SMEs have lost vast sums of monies as a result of losing their retentions in insolvencies upstream. One firm has already lost retention to the value of £21,578 in this year alone! (see letter no 25 at Annex B)⁴⁵. SMEs are not in a position to obtain security for these funds which are generally mixed with other assets of the payer.

63. It is for this reason that Sir Michael Latham recommended in *Constructing the Team* that monies passing along the payment queue in construction should be secured in trust accounts⁴⁶. He acknowledged that the ability of construction firms to protect themselves against payer insolvency was much reduced as compared to firms in other industries. Protective devices such as retention of title clauses are generally impossible to apply in construction. Once materials and components have become part of the building or structure, title passes to the building owner. It was recommended that trust funds should be required by legislation (ie Part II of the Housing Grants, Construction and Regeneration Act, 1996) but, at the time, there was not a consensus for this measure. However, many other countries have instituted a statutory framework for insolvency protection in construction. If retention is regarded as a form of security in relation to performance of the work, the arrangement lacks mutuality; a concomitant obligation should involve the provision of security in the event of non-payment for reasons of insolvency.

⁴² Financial Protection in the UK Building Industry published by Reading Construction Forum, November 1998.

⁴³ Some of these problems are recounted in the extracts from letters from firms included at **Annex B**.

⁴⁴ A recent example was Bickerton. This main contracting firm was acquired by new owners, who proceeded to "milk" the company's assets leaving it to go into insolvency. The assets included sub-contractors' retentions.

⁴⁵ The Federation of Piling Contractors carried out a survey in 1993 which revealed that over £10m was owed to 15 member companies as retention of which £3m was overdue for payment. Over the previous 3 years these 15 members had lost more than £1m through insolvency of companies holding retentions due to them. A recent survey on retentions lost through insolvencies was carried out by the H&V News publication. We are informed that the results of the survey will be forwarded to the Select Committee.

⁴⁶ Provisions for trust funds have existed in standard forms of main contract and nominated sub-contract documentation published by the Joint Contracts Tribunal. In practice they are usually deleted. In any event contractual trust fund provisions are not a complete answer since the payee (as the trustee) generally does not lodge retention monies in a separate account.

64. Retention bonds are considered to be an alternative to cash retentions. Retention bonding fulfils the same function as cash retention and is less oppressive to some SMEs. Replacing a cash retention by a bond to the same value as the cash retention—whether (as on larger projects) the value of the bond increases throughout the course of the project, or whether a percentage of the original contract sum is taken at the outset—provides protection to the payer for the matters covered by the bond. In most cases, this will usually be restricted to defects. Retention bonding is the approach that was favoured by Latham in *Constructing the Team* but for the smallest contracts and contractors, costs are still prohibitive. Moreover, retention bonds will overlap with performance bonds which are often demanded. To ensure mutuality in these arrangements, the payer should provide a payment bond.

65. A variation on bonding is a trade body-backed insurance scheme, whereby all members of the trade body “buy in” to a particular insurance, which pays out in the event of non-rectification of defects. The insurance scheme avoids the prohibitive costs of bonds for smaller companies. One trade association has in fact pioneered the insurance-backed approach⁴⁷. Other trade bodies such as the British Constructional Steelwork Association (BCSA) have set up schemes whereby members offer bonds instead of retentions.

66. Such schemes have been enormously successful; it costs BCSA members, for instance, seven times less to fund bonds than to fund cash retentions, even where repayment of cash retention within two years is assumed⁴⁸. LEIA can demonstrate similar success. Where retention percentages are at or near profit levels on projects, bonding frees up cash for investment in training, innovation and new technology, all areas acknowledged as vital for the health of the construction industry. Some specialist contractors also give a discount to clients for bonding; this is affordable not only because bonding is cheaper than financing cash retentions but also because uncertainty of payment is reduced.

67. Retentions are also part of an extensive armoury of commercial and contractual requirements aimed at compelling performance. To the cost of financing the burden of retentions must also be added the cost of complying with all these other requirements. They include:

- Performance bonds (which also cover the same ground as retentions).
- Third party warranties provided to funders, future tenants and occupiers which substantially extend a firm’s liabilities as well as involving legal costs in scrutinising the documentation;
- Parent company guarantees (which, again, overlap with retentions).

68. In addition the above is compounded by the cost to SMEs of financing work in progress or completed work, since interim and final payments are often made many weeks (and sometimes months) after the work—to which they relate—has been carried out. Payment cycles in the construction industry are generally longer than in other industries. The Housing Grants, Construction and Regeneration Act 1996 has encouraged payers to pay promptly on the due date for payment. Unfortunately the largest construction companies are now taking longer to pay. They now take 89 days to make payment; five years ago this figure was 75 days⁴⁹.

69. Delays in the recovery and non-payment of retentions are rarely if ever justified. This means that they are not the result of the contractor’s failure to avoid or rectify defects. There have been no calls on the lift industry’s insurance-backed guarantee scheme during the two years of its existence. Similarly, there have been no calls on retention bonds offered by steelwork companies in membership of BCSA. The Building Services, Research and Information Association (BSRIA), an independent research body focusing on the specialist engineering sector, issued a report in March 2002 entitled *Project Improvements through Abolishing Retentions*⁵⁰. For the purpose of this report BSRIA instituted a survey of firms carrying out mechanical and electrical engineering works. Between 1998 and 2000 there were 27 calls on retentions provided by 12 companies. BSRIA subsequently contacted each firm to ascertain the nature of the calls upon retention; it was established that there was only one justified call upon retentions out of this total number.

70. Outstanding retentions will often represent the profit margins for the majority of SMEs. The BSRIA report estimated that monies held as retentions equate to 3 per cent of the turnover of mechanical and electrical contractors. This percentage has been constant for the last three years. Average profitability for the 53 respondents to the BSRIA survey was 4.2 per cent in the year 2000; therefore, the monies held in retentions constituted 77 per cent of profit. This reinforces the point that retentions reduce opportunities for investing in those factors that are essential to maintaining and improving quality in the construction industry.

⁴⁷ The Lift and Escalator Industry Association (LEIA).

⁴⁸ Source: internal BCSA research.

⁴⁹ These figures were provided by Experian, the business information company. They are reproduced in an article on late payment in *Construction News*, 5 September 2002.

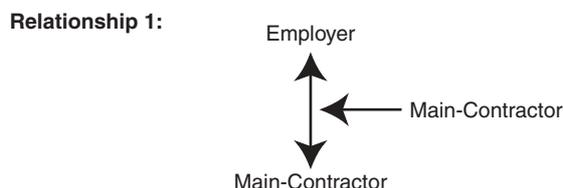
⁵⁰ We are informed by BSRIA that this report has been forwarded to the Select Committee.

Annex A

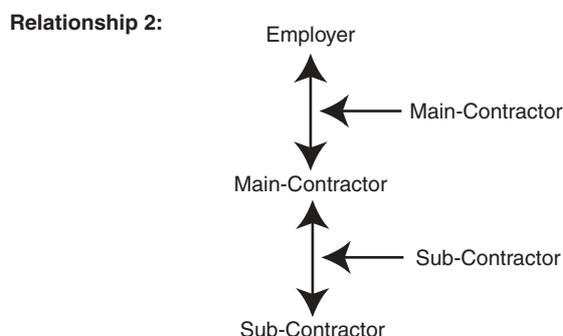
Matrix of Retention Provisions in Construction Industry Contracts

INTRODUCTION TO THE INDUSTRY'S CONTRACTUAL FRAMEWORK

1. The Main-Contracts (Annex A pp. iv-vii) are standard forms published by construction industry bodies eg the Joint Contracts Tribunal (JCT). Main-Contracts are executed between an Employer (who is usually the person at the top of the contractual chain) and a Main-Contractor. The contractual relationship is simple:



2. The standard form Sub-Contracts (Annex A pp. viii-xi) are also published by construction industry bodies. The bespoke Sub-Contracts (Annex A pp. xii-xix) are contracts produced by Main-Contractors themselves. Sub-Contracts are executed between a Main-Contractor and a Sub-Contractor, this reflects traditional practice in the industry:



RETENTION FUND

3. Every contract studied includes a retention provision. In the most of them the amount is 5 per cent.

LEGAL STATUS

4. JCT 98 (Annex A pp iv-v), IFC 98 (Annex A pp iv-v) and JCT NSC 98 (Annex A pp viii-ix) provide that the Employer's interest in the retention is fiduciary but none of the other 28 contracts considered grant any legal status at all to the fund.

PROTECTION FOR THE FUND

5. JCT 98 and JCT NSC 98 provide for the fund to be held in trust but only if the Contractor requests it and these provisions are often deleted or ignored. The other 30 contracts make no provision at all for legal protection of the fund.

CAN THE FUND BE ACCESSED?

6. In every contract (except the government ones at Annex A p. vi-vii) the Employer is entitled to withhold and keep money owing to him from the retention fund.

REPAYMENT

Main-Contracts

7. The first half of the retention is generally released at the completion of the Works and the second half when the Final Account is settled, which varies between three and nine months from Practical Completion but in most cases it is open to the parties to agree a longer period.

Standard Form Sub-Contracts

8. The first half is generally released on Practical Completion of the Sub-Contract Works. However, in practice this is often amended so that the first half is released on Practical Completion of the Main Works instead. The release of the second half is mostly linked to the Defects Liability Period of the Main Contract which is set out in paragraph 7 above.

9. It is important to note that the Main-Contract Works usually take a lot longer to complete than the Sub-Contract Works. If one considers the trades that are involved at the beginning of the construction process, their Sub-Contract Works can be completed up to three to four years earlier than the Main-Contract Works. When you add the Defects Liability Period on to this, the Sub-Contractor can be paid up to four years after the Sub-Contract works are completed.

Bespoke Sub-Contracts:

10. Repayment under most of these contracts is linked to the Main-Contract ie the first half is released upon Practical Completion of the Main-Contract Works and the second half is released at the end of the Defects Liability Period under the Main-Contract.

11. Alternatively the retention is released to the Sub-Contractor by the Main-Contractor only after it is released to the Main-Contractor by the Employer.

12. These provisions obviously produce the problems set out in paragraph 9 above, as the Sub-Contractor potentially has to wait up to four years to receive his money.

13. Furthermore agreement of the Final Account by the Sub-Contractor is often a prerequisite to the release of the retention. This means that the retention fund can be and is used to penalise the Sub-Contractor if they dispute the Final Account.

INSOLVENCY

14. If one considers Relationship 2 on the first page of Annex A. In the event of the Main-Contractor's insolvency the result is in practice the same under every contract studied:

- The retention monies will be available to the Main-Contractor's creditors.
- The Sub-Contractor (to whom the retention is owing) has the status of an unsecured creditor.
- Unsecured creditors are paid after all fees and charges arising from the insolvency procedures have been paid and after payments to preferential creditors (eg government departments, occupational pension schemes, employees and all secured creditors eg banks that hold a mortgage or other charge over property) have been made.
- Therefore preferential creditors may (and very probably will) receive payment from the retention fund before the Sub-Contractor does.

15. If one continues with Relationship 2 but considers what happens in the event of the Employer's insolvency:

- In all but one of the Standard Form Sub-Contracts the Sub-Contractor will be an unsecured creditor and will experience all the resulting problems set out in paragraph 14 above when trying to recover payment;
- The vast majority of the Bespoke Sub-Contracts (12 of the 15 contracts studied) provided that:
 - Upon the Employer's insolvency the Main-Contractor's obligation to pay the Sub-Contractor ceases immediately.
 - From then onwards the Sub-Contractor is only entitled to receive such payment as the Main-Contractor has itself received from the Employer.
 - In most cases when the Main-Contractor receives a sum from the Employer he is entitled to distribute that sum between himself and the Sub-Contractor proportionally based on the amount that is outstanding to both of them.

ALTERNATIVES

16. Only JCT 98 and JCT DSC 98 (Annex A pp. vii-ix) provide for an alternative to the retention (in the form of a bond). This is optional and to be agreed between the parties.

Annex A

**RETENTIONS MATRIX
STANDARD FORM MAIN-CONTRACTS**

	<i>Are there retentions?</i>	<i>Amount</i>	<i>Legal Status</i>	<i>Protection for the fund</i>	<i>Can the fund be accessed?</i>	<i>Repayment</i>	
						<i>1st Half</i>	<i>2nd Half</i>
<i>JCT 98 Private with Quantities</i>	Yes	5% unless the parties agree a lower amount (30.4.1.1)	Employer's interest is fiduciary as Trustee, but without obligation to invest (30.5.1) but where Employer is a Local Authority there are no express provisions ¹	If the contractor or Nominated Sub-Contractor requests it the employer is to place the fund in a separate bank account (30.5.3)	The Employer can exercise any right of set-off or deduction that arises under the contract against any amount due under an interim certificate and this may include retention monies (30.1.1.2)	Half the retention fund is released after Practical Completion of the Works (30.4.1.3)	Final Account (including retentions) paid when a Notice of Completion of Making Good Defects is issued at the end of the defects liability period (30.4.1.3 and 30.8)
JCT 98 With Contractor's Design	Yes	5% unless the parties agree a lower amount (30.4.1.1)	Employer's interest is fiduciary as Trustee, but without obligation to invest (30.4.2.1) but where Employer is a Local Authority there are no express provisions ¹	If the contractor requests it the employer is to place the fund in a separate bank account (30.4.2.2)	The Employer can exercise any right of deduction that arises under the contract from monies due or to become due whether or not any retention is included in such monies (30.4.3)	Half the retention fund is released after Practical Completion of the Works (30.4.1.3)	Final Account (including retentions) paid when a Notice of Completion of Making Good Defects is issued at the end of the defects liability period (30.4.1.3 and 30.5)
IFC 98	Yes but not called retention, referred to as the Employers right to make a deduction	5% (4.2.1)	Where Employer is not a Local Authority interest is fiduciary as Trustee, but with no obligation to invest (4.4) but where Employer is a Local Authority there are no express provisions	No express provisions	The Employer can have recourse to the retention monies from time to time for payment of any amount that he is entitled to withhold/ deduct from any sum due to the Contractor (4.4)	97.5% of total contract value released following Practical Completion of the Works (4.3(a))	Remainder of full contract sum released on issue of the Final Certificate after expiry of defects liability period (4.6.1.1)
Minor Building Works	Yes	5% but the parties are free to agree any figure (4.2(n))	No express provisions	No express provisions	Employer entitled to withhold/deduct from amounts due to the Sub-Contractor upon issue of a valid withholding notice and retention fund not excluded from this (4.4.2 and 4.5.3)	97.5% of contact sum elased upon issue of Penultimate Certificate and within 14 days of practical completion (4.3)	Amount remaining due released in the Final Certificate which the Sub-Contractor applies for 3 months after practical completion (4.5.1.1)

¹—Local Authorities will not provide security for retention monies. This means the Sub-Contractors nominated under these forms are likely to loose their retention monies on the insolvency of the Main-Contractor.

Annex A

RETENTIONS MATRIX
STANDARD FORM MAIN-CONTRACTS

	<i>Defects Liability Period</i>	<i>Employers Insolvency</i>	<i>Are there alternatives?</i>
JCT 98 Private with Quantities	To be agreed by parties but if none is stated it is 6 months from the date of Practical Completion (Appendix to 17.2)	Contractor entitled to determine contract upon Employer's insolvency (28.3.3) and Employer must repay all amounts held by way of retention within 28 days of determination (subject to any right of deduction (28.4.2)) but monies not placed in a separate fund will be available to creditors.	Contractor's bond in lieu of retention (30.4A) ²
JCT 98 With Contractor's Design	To be agreed by parties but if none is stated it is 6 months from the date of Practical Completion (Appendix to 16.2, 17 and 30)	Contractor entitled to determine contract upon Employer's insolvency (28.3.3) and Employer must repay all amounts held by way of retention within 28 days of determination (subject to any right of deduction (28.4.3)) but monies not placed in a separate fund will be available to creditors.	No
IFC 98	Agreed by parties but if none is stated it is 6 months from the date of Practical Completion (Appendix to 2.10)	Contractor entitled to determine contract upon Employer's insolvency (7.10.3) and Employer must repay all amounts held by way of retention (subject to any right of deduction) within 28 days (7.11.2) but Contractor is an unsecured creditor and monies will be available to other creditors.	No
Minor Building Works	N/A	Contractor entitled to determine contract upon Employer's insolvency (7.3.2) and Employer must pay full amount properly due within 28 days of submission of Contractor's account (7.3.3) but Contractor is an unsecured creditor and monies will be available to other creditors.	No

2

This is optional and is not available in the Local Authority edition.

Annex A

**RETENTIONS MATRIX
STANDARD FORM MAIN-CONTRACTS**

	<i>Are there retentions?</i>	<i>Amount</i>	<i>Legal Status</i>	<i>Protection for the fund</i>	<i>Can the fund be accessed?</i>	<i>Repayment</i>	
						<i>1st Half</i>	<i>2nd Half</i>
<i>GC/Works/1 Edition 3³</i>	Yes but called a "reserve" (48(7))	5% (48(2)(a))	No express provisions	No express provisions ⁴	No express provisions	Released on upon completion of the works to the satisfaction of the PM (49(1))	Released when the Final Account is settled ie within 9 months of certified completion (49(2))
<i>GC/Works/2 Edition 2³</i>	Yes but called a "reserve" (23(1))	3% (23(1) and (2))	No express provisions	No express provisions ⁴	No express provisions	Released upon completion of the works to the satisfaction of the SO (24(1))	Released with the Final Sum ie as soon as possible after the completion of the Works (24(2))
<i>FIDIC Conditions of Contract, 4th Edition 1987</i>	Yes	To be completed by the parties (60.2(a))	No express provisions	No express provisions	Employer entitled to deduct from payments to the Contractor any sums which may have become due and payable by the Contractor to the Employer and retention fund is not excluded from this (60.2(b))	On issue of Taking Over certificate in respect of the whole works, or on issue of Taking Over Certificate in respect of part of the works in such proportion as the Engineer determines will be certified for payment (60.3(a))	On expiration of Defects Liability Period or on expiration of the latest Defects Liability Period if there is more than one (60.3(b))
<i>Engineering and Construction Contract (November 1995 with Amendments)</i>	Yes	Retention fee amount and retention percentage to be inserted into Contract Data Option P	No express provisions	No express provisions	Employer entitled to withhold payment of sums due under the contract upon issue of a valid withholding notice not later than 7 days before the final date for payment and retention fund is not excluded from this (Core Clause 56.2)	Released in the assessment made at Completion of the whole of the works or in the next assessment after the Employer has taken over the whole of the works— whichever is earlier (P1.2)	Released when the Defects Certificate is issued (P1.2) either at the defect date or at the end of the last defect correction period

³—These are government contracts.

⁴—This lack of protection is not a problem for Main-Contractors where the client is a government department or agency. The lack of protection primarily affects Sub-Contractors.

Annex A

**RETENTIONS MATRIX
STANDARD FORM MAIN-CONTRACTS**

	<i>Defects Liability Period</i>	<i>Employers Insolvency</i>	<i>Are there alternatives?</i>
<i>GC/Works/1 Edition 3</i>	N/A	No express provisions	No
<i>GC/Works/2 Edition 2</i>	N/A	No express provisions	No
<i>FIDIC Conditions of Contract, 4th Edition 1987</i>	To be agreed by the parties (49.1)	Contractor entitled to terminate employment upon Employers insolvency (69.1(c)) and Employer to pay to Contractor all outstanding amounts (69.5 and 69.3) but Contractor is an unsecured creditor and monies will be available to other creditors	No
<i>Engineering and Construction Contract (November 1995 with Amendments)</i>	To be agreed by the parties (Contract Date, Part 1, 4)	The Contractor may terminate (Core Clause 95.1(b)) and the Employer must pay the Contractor any amounts retained (Core Clause 97.1) but Contractor is an unsecured creditor and monies will be available to other creditors	No

**RETENTIONS MATRIX
STANDARD FORM SUB-CONTRACTS**

	<i>Are there retentions?</i>	<i>Amount</i>	<i>Legal Status</i>	<i>Protection for the fund</i>	<i>Can the fund be accessed?</i>	<i>Repayment</i>	
						<i>1st Half</i>	<i>2nd Half</i>
DOM/1 1980 edition reprinted 1998	Yes	5% unless otherwise agreed by the parties (Appendix Part 7)	No express provisions	No express provisions	Upon issue of withholding notice (5 days before the final date for payment) Contractor entitled to withhold payment from sums due under the Sub-Contract and retention monies are not expressly excluded from this (21.3.3 & 21.9.3)	Released on Practical Completion of the Sub-Contract Works (21.5.2)	Released after Sub-Contract works have been subject of Certificate of Completion of Making Good Defects issued under 17.4 of the Main-Contract at the end of the Main Works Defects Liability Period or after certificate issued under 18.1.3 of the Main Contract (21.5.3) ¹
DOM/2 1981 edition reprinted 1998	Yes	5% unless otherwise agreed by the parties (Appendix Part 7)	No express provisions	No express provisions	Upon issue of withholding notice (5 days before the final date for payment) Contractor entitled to withhold payment from sums due under the Sub-Contract and retention monies are not expressly excluded from this (21.3.3 & 21.9.3)	Released on Practical Completion of the Sub-Contract Works (21.5.2)	Released after Sub-Contract works have been subject of Notice of Completion of Making Good Defects under clause 16.4 of Main-Contract or after deemed Practical Completion of the Main-Works pursuant to a statement issued by Employer under clause 17.1 of main-contract (21.5.3) ²
JCT DSC 2002	Yes	To be agreed by the parties (item 4 DSC/A and 4.18.1.1)	No express provisions	No express provisions	Upon issue of withholding notice (5 days before the final date for payment) Contractor entitled to withhold payment from sums due under the Sub-Contract and retention monies not expressly excluded from this (4.16.3 & 4.23.3)	Released on Practical Completion of the Sub-Contract Works (4.18.1.2)	If there are no defects balance paid after the expiry of the Defects Liability Period of the Main-Contract (4.18.2). If there are defects balance paid after making good (4.18.3)
JCT NSC 1998	Yes	5% deducted by the Employer unless the parties agree a lower amount (JCT 98 30.4 & NSC 98.4.18)	Employer's/ Contractor's interest is fiduciary as Trustee, but with no obligation to invest (JCT 98 30.4 & NSC 98.4.22)	If the Nominated Sub-Contractor requests it the Employer is to place the fund in a separate bank account (JCT 98 30.5.3 & NSC 4.19)	Employer/ Contractor entitled to exercise any contractual right of withholding and/or deduction from monies due under the contract expressly including retentions (JCT 98 30.1.1.2 & NSC 98 4.16.1.1)	When the Employer releases the retention under the Main-Contract the Main-Contractor will have to pay the full amount to the Sub-Contractor even if the Employer has deducted any amounts (4.16.1.1).	

¹ The main contract is JCT 98 and this seems to be a misprint, it should be clause 18.1.2 of the main-contract whereby if an Employer takes partial possession early the Architect issues an equivalent certificate to the Certificate of Making Good Defects. Under clause 18.1.3 there are no provisions for certification so presumably the 2nd half of the retentions would never be repaid if this provision kicked in because no certificate could be issued under clause 18.1.3.

² Again the main-contract is JCT 98 and it seems that this is also a misprint. There is no clause 16.4 in JCT 98. Therefore no certificate can be issued under this clause. Therefore the second half of the retention will potentially never be repaid.

Annex A

RETENTIONS MATRIX
STANDARD FORM SUB-CONTRACTS

	<i>Defects Liability Period</i>	<i>Upstream Insolvency</i>		<i>Are there alternatives?</i>
		<i>Main-Contractor's</i>	<i>Employer's</i>	
DOM/1 1980 edition reprinted 1998	To be agreed by parties but if none other is stated it is 6 months from the date of Practical Completion of the Main Works (Appendix to 16.2, 17 & 30)	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (31) and Contractor to pay Sub-Contractor's account within 28 days without deducting retention (30.3) but Sub-Contractor is an unsecured creditor and monies will be available to other creditors	Sub-Contractor is an unsecured creditor	No
DOM/2 1981 edition reprinted 1998	N/A	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (31). Contractor to pay Sub-Contractor's account within 28 days without deducting retention (30.3) but Sub-Contractor is an unsecured creditor and monies will be available to other creditors	Sub-Contractor is an unsecured creditor	No
JCT DSC 2002	To be agreed by parties but if none other is stated it is 6 months from the date of Practical Completion of the Main Works (JCT 98 Appendix to 2.10)	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (7.10). Main-Contractor to pay amounts properly due within 28 days of submission of Sub-Contractor's account without deducting retention (7.8) but Sub-Contractor is an unsecured creditor and monies will be available to other creditors	Sub-Contractor is an unsecured creditor	Sub-Contractor's bond in lieu of retention (4.19)
JCT NSC 1998	N/A	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (7.10.1). Main Contractor to pay amounts properly due within 28 days of submission of Sub-Contractor's account (7.10.3) but Sub-Contractor is an unsecured creditor and monies will be available to other creditors	Sub-Contractor's employment determines when Main-Contractor's does (7.11.1.1). Main-Contractor to pay retention to Sub-Contractor when Employer pays retention to Main-Contractor (7.11.1.2) but monies not placed in separate fund will be available to Employer's creditors	No

**RETENTIONS MATRIX
STANDARD FORM SUB-CONTRACTS**

	<i>Are there retentions?</i>	<i>Amount</i>	<i>Legal Status</i>	<i>Protection for the fund</i>	<i>Can the fund be accessed?</i>	<i>Repayment</i>	
						<i>1st Half</i>	<i>2nd Half</i>
JCT IN/SC 1985	Yes but not expressly called a retention	5% (19.4.1)	No express provisions	No express provisions	Upon issue of withholding notice (5 days before the final date for payment) Contractor entitled to withhold payment from sums due and retention monies not excluded from this (19.33 & 19.8.3)	Only 97.5% of the total value of payments may be retained after Practical Completion (19.4.1)	Total Contract Sum released in the Final Payment (19.8.1) which is made after the issue of the Final Certificate under clause 4.6 of the Main Contract (19.8.2) ³
JCT NAM 1998	Yes but not expressly called a retention	5% (19.4)	No express provisions	No express provisions	Upon issue of withholding notice (5 days before the final date for payment) Contractor entitled to withhold payment from sums due and retention monies not excluded from this (19.2.4 & 19.8.2)	Only 97.5% of the total value of payments may be retained after Practical Completion (19.4.1)	Total Contract Sum released in the Final Payment (19.8.1) which is made after the issue of the Final Certificate under clause 4.6 of the Main Contract (19.8.2) ³
Federation of Civil Engineering Contractors Form of Sub-contract (September 1991)	Yes	Rate to be agreed between the parties (15(3)(a))	No express provisions	No express provisions	Contract entitled to withhold or defer payment of sums due under the sub-contract upon issue of a written notice no later than the date when monies would have payable and retention monies not excluded from this (15(3)(b)&(d))	Within 35 days of the Engineer issuing a Certificate including a payment to the Contractor of the 1st half of retention monies or, when the Main Works are to be completed by sections, for any section in which the sub-contract works are comprised the Contractor will pay the first half of the retention monies (15(4)(a))	Within 7 days of the Contractor's receipt of payment under the Main-Contract (15(4)(b))
The Engineering and Construction Sub-Contract (November 1995 with Amendments)	Yes but retention provision is optional	Retention fee amount and retention percentage to be inserted into Sub-Contract Data (Option P)	No express provisions	No express provisions	Contractor entitled to withhold payment of sums due under the sub-contract upon issue of a valid withholding notice not later than 7 days before the final date for payment (Core Clause 56.2)	Released in the assessment made at Completion of the whole of the sub-contract works or in the next assessment after the Contractor has taken over the whole of the sub-contract works— whichever is earlier (P1.2)	Released when the Defects Certificate is issued (P1.2) at the later of the defects date or the end of the last defects correction period (43.2)

³. Again the main-contract is JCT 98 and it seems that this is also a misprint. There is no clause 4.6 in JCT 98. Therefore no certificate

Annex A

RETENTIONS MATRIX
STANDARD FORM SUB-CONTRACTS

	<i>Defects Liability Period</i>	<i>Upstream Insolvency Main-Contractor's</i>	<i>Employer's</i>	<i>Are there alternatives</i>
JCT IN/SC 1985	N/A	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (29). Main-Contractor to pay amounts properly due within 28 days of submission of Sub-Contractor's account (28.3) but Sub-Contractor is an unsecured creditor and monies will be available to other creditors	Sub-Contractor is an unsecured creditor	No
JCT NAM 1998	N/A	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (29.1). Main-Contractor to pay amounts properly due within 28 days of submission of Sub-Contractor's account (29.2) but Sub-Contractor is an unsecured creditor and monies will be available to other creditors	Sub-Contractor is an unsecured creditor	No
Federation of Civil Engineering Contractors Form of Sub-contract (September 1991)	N/A	No express provisions but Sub-Contractor would be unsecured creditor and monies would be available to other creditors	Sub-Contractor is an unsecured creditor	No
The Engineering and Construction Sub-Contract (November 1995 with Amendments)	To be agreed between the parties (Sub-ContractData, Part One, 4)	The Sub-Contractor may terminate (Core Clause 95.1(b)) and the Contractor must pay the Sub-Contractor any amounts retained (Core Clause 97.1) but Contractor is unsecured creditor and monies will be available to other creditors	Sub-Contractor is an unsecured creditor	No

**RETENTIONS MATRIX
BESPOKE SUB-CONTRACTS**

	<i>Are there retentions?</i>	<i>Amount</i>	<i>Legal Status</i>	<i>Protection for the fund</i>	<i>Can the fund be accessed?</i>	<i>Repayment</i>	
						<i>1st Half</i>	<i>2nd Half</i>
Wates Construction Ltd (1998)	Yes	Retention money will be the same percentage as under the Main-Contract (7(ii))	No express provisions	No express provisions	The Contractor is entitled to deduct from or set off against any money due to the Sub-Contractor, including retention monies, any sums the Sub-Contractor is or may be liable to pay to the Contractor (12)	Retention money will be released in part or in whole when the Contract receives payment from the Employer under the Main-Contract (7(iii))	
Tolent Construction Ltd (1999)	Yes	5% of the value of the interim payment unless stated in the Articles (7.4.5)	No express provisions	No express provisions	Tolent is entitled to deduct or set-off against any money (including retention) due to the Sub-Contractor any sums the Sub-Contractor is or may be liable to pay to Tolent under the Sub-Contract or any other agreement (8.1)	Released 60 days after issue of Certificate of Practical Completion under the Principal Contract (15.2)	Released 60 days after the issue of the Making Good of Defects Certificate (or equivalent) under the Principal Contract (15.3)
John Sisk & Son Ltd	Yes	To be agreed between the parties (Sub-Contract Particulars 2.2)	No express provisions	No express provisions	If the Contractor considers that the Sub-Contractor is in breach of the Sub-Contract then the Contractor can set-off against any sums due or to become due to the Sub-Contractor (including retentions) any loss or expense incurred or anticipated (15.7(a))	Released following issue of Certificate of Practical Completion under Principal Contract (15.13)	Released following issue of Certificate of Completion of Making Good Defects under Principal Contract (15.13)
Barr Ltd Sub-Contract Order 1999	Yes	Not specified	No express provisions	No express provisions	Contractor may deduct from or set-off against any monies due to the Sub-Contractor (including retention) any sum the Sub-Contractor is liable to pay, whether the Sub-Contractor incurs such liability under the Sub-Contract or in any other manner (18)	The agreement of the amount of the Final Payment is a prerequisite to the release of the Retention Fund (19)	
HBG Construction Conditions of Sub-Contract	Yes	5% unless otherwise stated (Appendix Clause 8)	No express provisions	No express provisions	Contractor entitled to set off against any sums (including the retention) due to the Sub-Contractor any amounts incurred or which the Contractor estimates are likely to be incurred by the Sub-Contractor (8.4)	Within 14 days of receipt of certificate or other notification under Main-Contract which includes the retention or part of it, the amount becomes due the Sub-Contractor the day after and final date for payment is 17 days after that (8.6)	

Annex A

RETENTIONS MATRIX
BESPOKE SUB-CONTRACTS

	<i>Main-Contractor's</i>	<i>Upstream Insolvency</i>	<i>Employer's</i>	<i>Are there alternatives?</i>
Wates Construction Ltd (1998)	If the Contractor's employment determines under the Main-Contract for insolvency then the Sub-Contractor's does as well and the Sub-Contractor will be paid for materials and work to date (14) but Sub-Contractor is an unsecured Creditor and retention monies will be available to other creditors		Sub-Contractor is an unsecured creditor	No
Tolent Construction Ltd (1999)	No express provisions but Sub-Contractor is an unsecured creditor and retention monies will be available to other creditors		Contractor's payment obligations cease and the Sub-Contractor is entitled only to sums or proportions thereof that the Contractor has received itself (7.8)	No
John Sisk & Son Ltd	No express provisions but Sub-Contractor is an unsecured creditor and monies will be available to other creditors		Sub-Contractor's right to receive payment from Contractor is entirely dependant on Contractor receiving payment from Employer under Principal Contract (15.17)	No
Barr Ltd Sub-Contract Order 1999	No express provisions but Sub-Contractor is an unsecured creditor and retention monies will be available to other creditors		No express provisions but Sub-Contractor is an unsecured creditor	No
HBG Construction Conditions of Sub-Contract	If the Contractor's employment determines under the Main-Contract for insolvency the Sub-Contractor's employment determines as well (16.3), the Contractor is only liable to make payment to the Sub-Contractor once payment of the sums is received from the Employer (16.4.4). The Sub-Contractor is an unsecured creditor and retention monies will be available to other creditors		If the Employer becomes insolvent the Contractor is no longer obliged to make payment to the Sub-Contractor unless payment of the sums are received by the Contractor under the Main-Contract (8.5)	No

Annex A

RETENTIONS MATRIX
BESPOKE SUB-CONTRACTS

	<i>Are there retentions?</i>	<i>Amount</i>	<i>Legal Status</i>	<i>Protection for the fund</i>	<i>Can the fund be accessed?</i>	<i>Repayment</i>	
						<i>1st Half</i>	<i>2nd Half</i>
Snape Roberts Limited Standard Form of Agreement (2001)	Yes	5% (Schedule)	No express provisions	No express provisions	Upon issue of a notice not later than seven days from the final date for payment Contractor entitled to deduct from or set-off against any sum due to the Contractor (including retention), the amount of any loss arising from a breach of the Sub-Contract by the Sub-Contractor (13)	Within six months of the issue of the Certificate of Making Good Defects under the Main-Contract the Contractor is to pay the Sub-Contractor the final Sub-Contract sum (14)	
Llewellyn (2001) DOM/1 1980 edition reprinted 1998 with Llewellyn amendments	Yes	5% (Analysis Schedule 31)	No express provisions	No express provisions	Upon issue of withholding notice (five days before the final date for payment) Contractor entitled to withhold payment from sums due under the Sub-Contract (including retention) and retention monies are not excluded from this (DOM/1 21.3.3 & 21.9.3 and Llewellyn Amendments)	Released upon Practical Completion (DOM/1 21.5.2) which is deemed to take place on the date of practical completion in the Main-Contract (Llewellyn's Addition)	Released after Sub-Contract works have been subject of Certificate of Completion of Making Good Defects at the end of the Defects Liability Period under 17.4 of the Main Contract or after certificate issued under 18.1.3 of the Main Contract (DOM/1 21.5.3) ¹
Waterlink (UK) Ltd Sub-Contract Agreement (2000)	Yes	Can be up to the limit set out in the Main-Contract (9(f))	No express provisions	No express provisions	Any amounts due or which may become due under the Sub-Contract (including retention) may be deducted or reduced by the amount of any sum recoverable from or payable by the Sub-Contractor under the Sub-Contract (9(1))	No express provision	
Newco Interiors Ltd	Yes	5% unless otherwise stated in the Order (4.1)	No express provisions	No express provisions	Contractor entitled to set-off against any money (including retention) due to the Sub-Contractor any damages, costs, losses or expenses incurred or which the Contractor <i>bona fide</i> estimates are likely to be incurred in connection with the Sub-Contractor and subject to a valid withholding notice being served (2.3.3)	Paid to the Sub-Contractor on the next interim payment from the time when any retention or part thereof is due to be released to the Contractor under the Main-Contract (4.3)	

1. The main-contract is JCT 98 and this seems to be a misprint, it should be clause 18.1.2 of the Main-Contract whereby if an Employer takes partial possession early the Architect issues an equivalent certificate to the Certificate of Making Good Defects. Under clause 18.1.3 there are no provisions for certification so presumably the 2nd half of the retentions would never be repaid if this provision kicked in because no certificate could be issued under clause 18.1.3.

Annex A

RETENTIONS MATRIX
BESPOKE SUB-CONTRACTS

	<i>Main-Contractor's</i>	<i>Upstream Insolvency</i>	<i>Employer's</i>	<i>Are there alternatives?</i>
Snape Roberts Limited Standard Form of Agreement (2001)	No express provisions but Sub-Contractor is an unsecured Creditor and retention monies will be available to other creditors	No express provisions		No
Llewellyn (2001) DOM/1 1980 edition reprinted 1998 with Llewellyn amendments	If the Contractor's employment determines due to insolvency the Sub-Contractor's employment determines automatically (DOM/1 31) and Contractor to pay Sub-Contractors's account within 28 days without deducting retention (DOM/1 30.3) but Sub-Contractor is an unsecured creditor and retention monies will be available to other creditors	Contractor not liable for any sums outstanding to Sub-Contractor if Employer becomes insolvent (DOM/1 32.1 and Llewellyn Addition)		No
Waterlink (UK) Ltd Sub-Contract Agreement (2000)	If the Contractor's employment determines due to insolvency the Sub-Contractor's employment determines automatically and the Contractor will afford same entitlement to payment to the Sub-Contractor as it receives under the contract (10(a)) but Sub-Contractor is unsecured creditor and retention monies will be available to other creditors	Contractor will not be liable to pay the Sub-Contractor for the Sub-Contract works for which the Contractor has not received payment (9(k))		No
Newco Interiors Ltd	No express provisions but Sub-Contractor is an unsecured creditor and retention monies will be available to other creditors	Contractor's obligation to pay any sum to the Sub-Contractor is conditional upon payment of sums to the Contractor by the Employer and will only be paid in such proportions as the Contractor will also receive for the Main Works (4.8)		No

Annex A

RETENTIONS MATRIX
BESPOKE SUB-CONTRACTS

	<i>Are there retentions?</i>	<i>Amount</i>	<i>Legal Status</i>	<i>Protection for the fund</i>	<i>Can the fund be accessed?</i>	<i>Repayment</i> <i>1st Half</i>	<i>2nd Half</i>
Interior Plc	Yes	To be completed in Condition 2(ii)	No express provisions	No express provisions	Contractor entitled to withhold any sums from amounts otherwise payable under the Sub-Contract (including retention) upon issue of withholding notice no later than 2 days before the final date for payment (2(vi))	Released on Practical Completion of the Main-Contract (2(ii)) Retention is not automatically released—the Sub-Contractor must present an invoice at the end of the relevant period and monies will be released 30 days following approval (2(iii))	Released at the end of a 12 months Defects Liability Period providing a Certificate of Completion of Making Good Defects has been issued and the Sub-Contractor has agreed final account with Contractor (2(ii))
Midas Construction Ltd Domestic Sub-Contract (2000)—DOM/a 1980 edition reprinted 1998 with Midas' amendments	Yes	5% (Midas Document—The Sub-Contract Sum)	No express provisions	No express provisions	Contractor entitled to withhold sums (including the retention) upon issue of withholding notice not later than 2 days after the date on which interim payment becomes due (Midas Appendix 1 21 2.5)	Released after the Main-Contract works reach Practical Completion (Midas Appendix 1–21.5.2 AND dom/1 21.5.2)	After Certificate of Completion of Making Good Defects issued under the Main-Contract (DOM/1 21.5.3) or after certificate under 18.1.3 of the Main Contract (DOM/1 21.5.3) ¹
Mowlem Domestic Sub-Contract (2001) DOM/1 1980 edition reprinted 1998 with Mowlem's amendments	Yes	5% unless otherwise agreed by the parties (DOM/1 Articles Part 7)	No express provisions	No express provisions	Upon issue of withholding notice (5 days before the final date for payment) Contractor entitled to withhold payment from sums due under the Sub-Contract (including retention) (DOM/1 21.3.3 & 21.9.3)	Released on Practical Completion of the Sub-Contract Works (DOM/1 21.5.2 and Mowlem Am 26)	Released when the Final Certificate is issued under the Main-Contract and the Contractor has confirmed receipt of as built drawings, details, specifications, information, manuals etc (Mowlem Am 26)

1. The Main-Contract is JCT 98 and this seems to be a misprint, it should be clause 18.1.2 of the Main-Contract whereby if an Employer takes partial possession early the Architect issues an equivalent certificate to the Certificate of Making Good Defects. Under clause 18.1.3 there are no provisions for certification so presumably the 2nd half of the retentions would never be repaid if this provision kicked in because no certificate could be issued under clause 18.1.3.

Annex A

RETENTIONS MATRIX
BESPOKE SUB-CONTRACTS

	<i>Upstream Insolvency</i>		<i>Are there alternatives?</i>
	<i>Main-Contractor's</i>	<i>Employer's</i>	
Interior Plc	No express provisions but Sub-Contractor is an unsecured creditor and retention monies will be available to other creditors	Contractor will not be obliged to make any further payment to the Sub-Contractor unless and to the extent that the Contractor has received payment in respect of that amount from the Employer (2(xii))	No
Midas Construction Ltd Domestic Sub-Contract (2000)—DOM/1 1980 edition reprinted 1998 with Midas' amendments	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (DOM/1 31) and Contractor to pay Sub-Contractor's account within 28 days without deducting retention (DOM/1 30.3) but Sub-Contractor is an unsecured creditor and retention monies will be available to other creditors	Contractor will not be obliged to make any further payment to the Sub-Contractor unless and to the extent that the Contractor has received payment in respect of that amount from the Employer (Midas Appendix 1–21.11)	No
Mowlem Domestic Sub-Contract (2001) DOM/1 1980 edition reprinted 1998 with Mowlem's amendments	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (DOM/1 31) and Contractor to pay Sub-Contractor's account within 28 days without deducting retention (DOM/1 30.3) but Sub-Contractor is an unsecured creditor and retention monies will be available to other creditors	Contractor will not be obliged to make any further payment to the Sub-Contractor unless Contractor has received payment in respect of that amount from the Employer (Mowlem Am 21.11)	No

Annex A

RETENTIONS MATRIX
BESPOKE SUB-CONTRACTS

	<i>Are there retentions?</i>	<i>Amount</i>	<i>Legal Status</i>	<i>Protection for the fund</i>	<i>Can the fund be accessed?</i>	<i>Repayment</i> <i>1st Half</i>	<i>2nd Half</i>
Jarvis Construction (UK) Ltd (2001) DOM/2 1980 edition reprinted 1998 with Jarvis' amendments	Yes	5% unless otherwise agreed by the parties (DOM/2 Articles Part 8)	No express provisions	No express provisions	Contractor entitled to withhold payment from sums due under the Sub-Contract (including retention) (DOM/2 21/3/3 & 21.9.3) upon issue of valid withholding notice 2 days before the final date for payment (Jarvis Am 21.3.3 & 21.9.3)	On Practical Completion of the Main Works (DOM/2 21/5/2 and Jarvis Am 21/5/2)	Released after Sub-Contract works have been subject of Notice of Completion of Making Good Defects under clause 16.4 of Main-Contract or after deemed Practical Completion of the Main Works pursuant to a statement issued by Employer under 17.1 of Main-Contract (DOM/2 21.5.3) ²
Kier Group (2001) Sub-Contract Agreement	Yes	5% (Schedule 1A 4.1)	Contract has no fiduciary obligation to the Sub-Contractor in relation to the retention (Schedule 1A 4.4)	The Contractor will not hold the retention as Trustee (Schedule 1A 4.4)	Contractor entitled to withhold/deduct sums from the balance due to the Contractor (including retention) on issue of a withholding notice not later than 1 day before the final date for payment (Schedule 1A 3.2.2)	When the "work" reaches Final Completion (Schedule 1A 4.3) ³	One month after the expiry of the Defects Liability Period or one month after the submission of the Contractor's final account, whichever is later (Schedule 1A 4.3 & 5.7). The Defects Liability Period is the same as that under the Main-Contract (13(2))
O'Rourke (2002)	Yes	3% (Appendix)	No express provisions	No express provisions	Contractor entitled to withhold/deduct from any payment due (including retention monies) any sum which the Contractor may claim to be entitled to under the Sub-Contract or for breach of the Sub-Contract upon issue of a withholding notice 3 days before the final date for payment (15(e))	Released on date of issue of Certificate of Practical Completion under the Main-Contract (15(c))	Released on date of issue of Final Certificate under the Main-Contract (15(c))

2. This is also a misprint or a reference to an old version. There is no clause 16.4 in the JCT Standard Form of Building Contract 1998. Therefore no certificate can be issued under this clause. Therefore the second half of the retention may potentially never be repaid.

3. "Work" is not defined in this clause so it is impossible to tell whether it means the Sub-Contract Work or the Main-Contract Work. Therefore the date of release of the 1st half of the retention is uncertain.

Annex A

RETENTIONS MATRIX
BESPOKE SUB-CONTRACTS

	<i>Main-Contractor's</i>	<i>Upstream Insolvency Employer's</i>	<i>Are there alternatives?</i>
Jarvis Construction *UK) Ltd (2001) DOM/2 1980 edition reprinted 1998 with Jarvis' amendments	Sub-Contractor's employment determines if Main-Contractor's determines due to insolvency (DOM/2 31). Contractor to pay Sub-Contractor's account within 28 days without deducting retention (DOM/2 30.3) but Sub-Contractor is unsecured creditor and retention monies will be available to other creditors	Contractor has no obligation to make any payment to Sub-Contractor if payment has not been received from Employer (Jarvis Am 32.1) and if Contractor has paid to Sub-Contractor any sum it does not receive from Employer, Contractor can recover that sum (Jarvis Am 32.2)	No
Kier Group (2001) Sub-Contractor Agreement	No express provisions but Sub-Contractor is unsecured creditor and retention monies will be available to other creditors	Contractor will not be obliged to make any further payment to the Sub-Contractor of any amount due or that may become due unless and to the extent that the Contractor has received payment in respect of that amount from the Employer (Schedule 1A 9)	No
O'Rourke (2002)	No express provisions but Sub-Contractor is unsecured creditor and retention monies will be available to other creditors	Contractor will not be obliged to make any further payment to the Sub-Contractor of any amount due or that may become due unless and to the extent that the Contractor has received payment in respect of that amount from the Employer or such other person (15(g))	No

Annex B

EVIDENCE RECEIVED FROM FIRMS WITHIN THE SPECIALIST ENGINEERING SECTOR⁵¹

1. Most of our retentions are for switchgear and control panels. Our average wait is 18–20 months from delivery. Sometimes on small jobs retention is held. Some 17 months after completion we are still waiting for £75 retention being held following the removal of some cables from the Ipswich Town FC north stand. If the retention is for performance, how is this quantified on a building site which was demolished 16 months ago?

2. Our company, which has a turnover of approximately £1 million per annum is constantly battling to receive retention which often relates to the final profit on a contract. Over the years a number of companies have failed to pay retention for a number of reasons which we detail below:

- (1) Company goes into receivership.
- (2) Main Contractor fails to agree their own final accounts and withhold our retention because of this.
- (3) Architect/Consultants are reluctant to clear final accounts and pave the way for retention to be paid.
- (4) Often we find we are four or five places away from the client—with Main Contractor, Architect, Consultants etc, blocking our paths.

⁵¹ These are extracts from letters received by the Specialist Engineering Contractors Group and its member trade associations. We have not been able to include all the letters received. However, the original letters are available for scrutiny by the Select Committee if required.

3. I am a sole trader employing five electricians and two apprentices at present and am involved in new housing and local authority work (schools etc) on about a 50/50 basis. Turnover is around £250,000. The housing developer (Campbell Homes of Sheffield) does not hold retention on us, even though our average turnover for them is £3,000–£10,000 per month. I have worked for them for some eight years so perhaps they trust me. The local authority work is normally through a main contractor, though some is direct and almost always attracts a retention.

Since the prices of the work is always very competitive, I find that the retention element is roughly my profit so that the payments basically cover our costs, and we are waiting 12 months for our profit. However, my accountant classes all retention as work in progress, and so is added to my sales figures which in turn attracts income tax. It often falls then that I am paying the Government tax on monies which still reside in the Government's bank account!

The biggest benefit to me in abolishing retention would be an improvement in my cash flow, in turn reducing the level of overdraft I need and in consequence the interest I have to pay on same.

My chosen career is that of electrician, it is what I wanted to be and what I enjoy doing. I also want to be good and professional at my job and I take pride in a job well done. I am an ECA member and am approved by NICEIC, and I have a good working relationship with the local authorities' inspectors who are happy to see us on their sites. I completed a £35,000 electrical installation on a new children's home a year ago, and the defects sheet has been prepared. Our defects were NIL. This is what I strive for, not always successfully, but I would attend to any defect in my work regardless of whether a retention was held or not.

4. In 1998 [my company] carried out a steel erection as sub-contractors of Thomas Barnes & Sons PLC for Sella Office Seating of Bury, Lancashire. As is usual with all works carried out by our company, a retention was held back. The sum currently outstanding is £1,654.22.

Since February 2001, we have, unsuccessfully, tried on numerous occasions to obtain payment of this retention.

Yesterday, 19 August 2002, I again contacted Thomas Barnes & Sons PLC in order to ascertain if and when payment would be forthcoming. Mr Tom Barnes, the Managing Director, informed me that Sella Office Seating would not release the retention and was therefore, unable to give any timescale on payment.

I then contacted Mr Smith at Sella Office Seating, I explained our situation to him and, in my opinion, to say he couldn't care less would be an understatement. I asked for the reasons that the retention was being held and he stated:

"There is a problem with the heating system in the building and until it is resolved no retention monies would be released by his company."

I then asked him if the steel structure that we have erected had any faults or problems to which he replied no.

I was then also informed that there was a problem with the tarmac in the car park as it had weeds growing through it. This was another reason why the retention was being held back.

I explained to Mr Smith that we were being punished for other people's alleged mistakes and quite matter of fact he agreed.

Not only has the retention been held for four years but it is also costing time and money trying to recover what is approximately the profit on this particular contract. At a time when costs of raw materials and insurance are rising dramatically (our insurance has risen by over 300 per cent this year), we need to keep control of our cashflow and costs but retentions normally mean that between 2.5 per cent and 5 per cent of our turnover is held by other companies for periods between one and five years, depending upon the main contractor's ability to rectify any problems that the customer may have or the end user's willingness to pay on time.

5. Glasgow City Council, 10 lifts put into service June 1998, full retention (£4,500) still being withheld due to a query on the test sheet for one of the lifts. The tests were witnessed by the client and accepted.

6. Farnham, lifts completed April 1999, no defects notified, retention held in the amount £1,465 pending the issue of the Making Good Certificate.

7. Balfour Beatty Construction, final release of retention due December 2000 £884 still outstanding.

8. Contractor, Birse, practical completion of the lift work December 1996 retention still outstanding £12,414!

9. I can refer to a current client [a county council] who insists on retentions of 10 per cent on all works.

10. The main problem which has happened to us on several occasions is where the main contractor goes into liquidation.

The Client holds the retention monies as these have also been withheld from the main contractor; the sub-contractor who is still solvent, is owed the retention but is unable to obtain it; and the winner in all of this is the Client, who doesn't have to pay the main contractor because the main contractor will not complete the contract, and who doesn't have any direct contractual arrangement with the sub-contractor, and therefore doesn't have to pay him.

The usual amount of maintenance or warranty work connected with the contract is minuscule compared to the amount of retention monies held.

We also have now had to refuse contracts from a local Housing Association because they request a 15 per cent retention falling to 7.5 per cent on final account, to be held for one year. When one looks at the profit margin on some of these contracts, companies would have to wait one year before seeing a profit. With bank and overdraft charges, this is whittled away to zero.

11. We have undertaken several large projects for a main contractor, in theory we should receive 2.5 per cent (half) of the retention monies six months after practical completion, one rarely is that fortunate. Sixteen months after practical completion, our main contractor is advising ourselves that his client has still not released his full retention monies and although one is advised that the system of "Paid when Paid" is not accepted in law, it is still practised and one has to accept such if one is looking for further contracts from this main contractor.

We have to waste a considerable amount of time in pestering the main contractors' financial directors, surveyors, etc until they finally accept that it is our money (retention monies) that is financing their on-going projects. We have managed so far avoiding going to law to recover these monies due, in one instance nine thousand pounds (£9,000.00), yet it is costing us man/hours to keep up this programme of consistent telephone calling, with the person we need to speak to always at meetings etc, etc.

It is the big unscrupulous contractors who regard retention monies as part of their main builders discount and do resent returning such monies to their sub-contractors who they regard as expendable.

12. We find that some building contractors are holding retentions for all types of contracts regardless of the type and size of the contract. We carry out various sizes of contracts ranging from £100-£100,000 and expect that retentions will be held on some of the larger contracts but not on the smaller jobs.

I have attached examples of one building contractor (who I would not like to name at the present time) who is taking five per cent retention from every job that we do. As you can see from the examples the retention amounts to £39.52 in one example and £11.80 in another. As you can appreciate it is simply not cost effective to keep records and chase up such small amounts in 6/12 months time and so we lose out.

I have written one letter to ask them to release the retention on small amounts but have received no reply and this puts us in an awkward situation as we do not want to upset the client. However, small contractors like ourselves are losing a significant amount of income through this kind of practice.

13. In 1988 my old company had to go into receivership due to retentions held, high interest rates and low profitability.

14. Over the years we have had many bad experiences in relation to retentions, some of which are listed below:

1. Retention for £12.00: to chase this payment and send out the invoice after a year causes a cost far in excess of the retention amount.
2. Payment withheld for 2½ years because the builder had not been paid by the client.
3. Payment withheld because the client in dispute with the builder because a number of trees had died which were part of the builder's original contract. We had to wait nearly three years to collect the retention money, as the builder stated we would only be paid when he was paid by the client.

These are just a few of the abuses that take place when the retention period has elapsed. Everyone in the industry is against retentions, even the builder but if the client holds a sum of money from the builder then all sub-contractors have to share the burden as well, which is a totally unacceptable state of affairs.

15. I am the Regional Director of running their North West operation with a turnover of circa £20 million and I have over 30 years' experience with retentions and related matters. Whilst based on personal experience these are my own views and not necessarily the views of [my company].

I do not accept that contractors need an incentive to avoid or eliminate defects, all contractors are commercially led and as such sheer commercial pressure ensures that the wastage of replacing work or correcting it, is under constant review.

What will have a greater impact on quality, is if we can stabilise the labour pool and create an ongoing training and career path, this would also have a positive effect on the productivity of our workforce.

As it stands the construction industry has created, admittedly by default, a "wandering army" of skilled people often just selling their services to the highest bidder and/or longest hours.

The use of retentions which is typically between 3 per cent and 5 per cent starves a business of cash; many businesses do not make this percentage as profit. This cash deprivation affects everything from training, investments in new technology and distracts the management of the business away from their core business. All this assumes payment is made to terms but delay in payment is extensive.

For example, a £1 million contract with retention at one and a half per cent, at practical completed (three per cent reduced by five per cent) would retain £15,000.00 and defects, light bulbs, broken switches etc, say £50.00 to correct, would stop release.

Conversely, if the Client held retention from the main contractor because of a problem with the carpet colour it still would not be released against a perfect installation of the M&E services!

In addition, as each of the sub-contractors has no contractual link with the client, we can never find out if he has released retention or otherwise.

The time spent at this stage in the contract, when you should really be planning and engineering new works is time consuming and wasteful and if the main contractor goes out of business our entitlement, because it is not “ring fenced” in a separate account, is lost.

1. We have no evidence for retentions achieving their stated aims. As an established contractor of over 50 years, we seek to maintain both our standards and customers by producing quality workmanship. Retentions have no impact whatsoever on this.

We believe that the following would have an impact on defects; less reliance on “contractual” approach, better planning/communication with contractors, more allowance for contractors’ priorities/less aggressive stance.

Retentions are held for all contractors even if only one contractor has outstanding defects. Pay each contractor when their trade is complete.

Removal of retentions would mean less time spent chasing money, improved client relationship, improved cash-flow for contractor.

Our major housing client has done away with retentions [although] they receive the same service as other clients.

Retentions have a significant impact on SMEs. Time is spent negotiating retentions at start of contract, trying to reduce from, say, five per cent to three per cent. Retentions impact greatly on cash flow. In an industry where net profit is of the order one per cent to two per cent puts real pressure on SMEs. (NB Retentions are never paid without considerable chasing and 18 months is average). There is no security of payment. If a company goes bust, we lose the retention (profit) on that job. There are always delays, there is always substantial chasing. We pay an agency commission 10 per cent of retention for this service. Delay is because builders want to hold on to their money and will use any excuse.

Examples of delay

- Clients use release of retentions to negotiate not to pay/write off unpaid invoices—bartering tool.
- Period of maintenance for full and final release of retention is not clear—on housing ie site completion or date plot is occupied.

17. We are a small company turning over something in the order of £1 million per annum About 75 per cent of this is mechanical services contracting or sub-contracting for Local Authorities.

Outstanding retention value runs at about £35,000 at any one time—this is 4.67 per cent of turnover. Some of this is on contracts that are ongoing and some is on jobs that have been finished for some time. It is most unusual for the retention to be cleared immediately after the 12 months period and more likely that a great deal of chasing and threatening is required to achieve settlement at about 18 months after.

This for us represents profits which we are not sure that we will get. A main contractor can easily go out of business and leave retentions unpaid. It very often contributes to a cash flow problem and restricts other important activities such as training.

18. On average my company has at any given time £50–£60,000 of retentions outstanding. This would obviously aid cash flow for companies using overdraft facilities.

19. For the record, in thirty years of trading, we have never yet had any deduction set against a retention by any client, in any circumstances. This is, as always, a sum of money which is owed to us and for which a delay in settlement, usually of twelve months, has to be allowed for.

Last year, my company had accumulated a retention account in the region of £75,000, which we have to cover by means of bank facility and there is a continuous and time-consuming accounting function required to record and, ultimately, recover these sums.

20. You may recall that I have written to you before expressing my concern about the restricting effect retention money has on our business. To give you an example: Our latest monthly management figures show retention to the value of £257,000 on outstanding cash of £2,859,000 ie 9 per cent. Without this retention money outstanding, we could finance extra business to the value of £1,500,000 based on turning our money over six times per year.

21. We do not carry out public sector contracts but in the private sector our contracts range up to the value of £750,000. Retentions should be released after twelve months and final certification. Unfortunately, this seldom happens. A minimum of two years now seems to be the norm and in fact at the present time we are still chasing one retention (approx. £5,000) which has been outstanding for four years.

22. A colleague and myself spend the best part of a day compiling three manuals detailing all electrical work, technical drawings, booklets related to fitted electrical parts and listing details of the manufacturers/

suppliers related to the building of a large complex, by a highly respected developer. The manuals were delivered to the site agent at completion/handover stage. They were then lost. We were then told that we had to compile another set of manuals or our retention would not be released. This took considerably longer than the originals, as many of the related papers/booklets had to be re-obtained from the manufacturers. The manuals were then found by the builders at a later date.

We generally have to chase for payment, almost beg, for retentions due to us and once we had to take legal action and actually go to court in order for us to be paid a retention that was due to us.

May we add that, in our experience builders use any excuse in order not to release a retention. They very often use this as a way to blackmail sub-contractors into doing additional work that was not in the original contract and we see this as a very out-of-date practice that is open to abuse, which can cause the collapse of a small company.

23. From our own experiences we are becoming increasingly frustrated as we are finding main contractors, irrespective of the works being public sector or private, withholding retentions almost always beyond the 12 months defects period. In certain cases the money is never recovered or withheld for periods anything up to 2–3 years.

On completion of contracts and in almost every case we always achieve a near zero defects list. The vast majority of defects in every case are builders' work defects (and there are always hundreds). Nevertheless we have to suffer prolonged retentions because of defects not related to our works.

The response from main contractors is always that they cannot release our retentions until "they" receive a certificate of making good defects.

When you consider the amount of contracts we complete each year to a turnover of approximately 1.5 to 2.0 million pounds, 2.5 per cent retention withheld both during and beyond the 12 months period equates to anything between 37k–50k of our money being withheld by either clients or main contractors at any one time because of other people's defects.

The biggest issue though is the abuse of the release of retentions.

24. Whilst our retentions may be due for release and any defects are cleared, we do not receive payment until all of the defects of every contractor and sub-contractor are completed.

A number of main contractors and even clients, will not release retentions but will utilise this to benefit their cash flow on the basis that we will not pursue this through legal channels.

We have cases where this can drag on for three years or more.

This has a major effect on our cash flow, and can build up to a point whereby the retention outstanding can be between 5 to 10 per cent of our annual turnover, which is an enormous amount in a highly competitive industry of low profits in the 1–2 per cent range.

A number of small sub-contractors cannot survive on this basis and we in fact have to release payment to them without having received it ourselves.

The M&E industry tends to be a major utiliser of directly employed people and this entails the constant requirement to invest in apprentice recruitment and training of people.

The ability to make this investment is severely restricted by the lack of cash flow and this has a negative effect on recruitment, and the future of UK Ltd.

25. The effect of retentions on the business I manage is enormous. We have to fund on average £650,000 per year plus a further £50,000 of overdue retentions due to clients' delay in paying. This costs us over £50,000 to fund. Increasing pressure from banks means we are unable to expand our business thereby stifling local employment opportunities and growth.

We spend hundreds of additional staff hours per year plus legal costs chasing payment of the outstanding sums. We are at risk every time a client or main contractor goes into receivership, we lose the retention money in every case, £21,578 this year to date.

If retentions were outlawed we wouldn't need to borrow money to fund our business, we could invest the cash in the business, we could train more apprentices and definitely improve our profitability.

The whole construction industry would receive a massive injection of cash that has been denied it for many decades. This would provide the money needed to improve conditions of employment, increase training and apprentice recruitment. There would be more money available to support health and safety training and research and development.

It is morally wrong and financially damaging to expect contractors and sub-contractors to fund five per cent of clients' projects for a two year period on average.

At any time our total retention monies equate to six per cent of company turnover. In an industry where net profit before tax averages about two per cent of turnover, then it's easy to see why so many sub-contractors go into receivership at high cost to the tax payer and other creditors.

Current retentions with Central Government: £452.8k + overdue £45.8k

Current retentions with Local Authorities/NHS: £61k + overdue £9.4k.

Good companies such as ours don't need to be encouraged in this way to leave our clients with defect free projects.

27 We herewith enclose details of overdue or late retention payments over the last two years:

	<i>Retention due date</i>	<i>Actual paid date</i>
Bright and Hove City Council	30.08.00	31.10.00
Brighton and Hove City Council	27.03.02	not paid
West Sussex County Council	30.11.00	27.03.01
West Sussex County Council	30.11.01	08.03.02
West Sussex County Council	19.01.02	27.03.02
West Sussex County Council	17.08.02	not paid

28 Some building contractors in our area think of sub-contractor's retention money as being their cut or profit on our work. This situation is totally unfair.

29 For our medium-sized company, although we energetically seek to recover retention monies, we had, during the last 12 months an average total retention account of £171k. How many extra men, computers, vehicles and other assets to increase our business could we have acquired if we did not have to invest this money in the Construction Industry?

In practice, everything is done to frustrate the receipt of retention monies. It is highly unlikely that we would receive the first receipt of retention monies at practical completion. The reasons/excuses for this delay would include the following:

- (a) Snagging is not complete (accompanied by a proliferation of minor snag lists from the various parties, often comprising previously rectified defects, inventions and post-handover damage by others).
- (b) Alleged problems with items of plan, often due to a lack of maintenance by the client (who often believes that if you buy a car under warranty it never needs servicing).
- (c) A favourite contractor ruse is "let us agree the final account and pay it all together". For a sub-contractor with a difficult cash flow this results in the sub-contractor being blackmailed with his own retention money into agreeing an unfavourable final account.

Once our company has clambered over the various hurdles above, we frequently then find that the QS/Engineer of the main contractor who had had responsibility for authorising payments for a project has moved on to another site and no longer has any interest in the previous project and proves very illusive, impossible to contact by telephone and fails to respond to correspondence. All this may be human fallibility or part of a main contractor corporate endeavour to hang onto what profit is left on a project and not pay it to the beastly sub-contractors.

For the sub-contractor, all of the above results in a huge amount of time and cost. The sub-contractor is in the invidious position where high legal costs make it bad business to resort to legal action, which in any event would sour relations where the sub-contractor is seeking another opportunity to have future difficulties to recover new retentions.

30. *Whilst we are a relatively small company (current turnover £4.5 million per annum) we currently have a list of 21 contracts which are over 12 months since practical completion but on which we have not received release of retention. This situation is quite normal.*

You will appreciate that it is a frustrating situation since it takes considerable resource to chase these retentions continuously over many months.

31. *We deal mainly with the large Building Contractors and increasingly we find that where the main contract is phased, even though our sub-contract is complete, tried and tested, the first half of the retention is not released until the final phase of the main contract is complete. It is then at least a further 12 months before final retention is granted and never without weeks if not months of constant chasing. In some cases it has been two to three years before retention has been released on an installation completed by us. Surveyors/contracts managers move on, leaving aged contracts in mid air without anyone knowing the history. The main contractors are, of course, hopeful that sub-contractors will tire of repeatedly tracking down final retentions. As you will be aware, the collection of retention is extremely time consuming and frustrating.*

32. *There is a financial cost to [us] of retention monies being deducted from the value of our work. This is assessed at £100,000 per annum [representing the interest lost on the monies].*

This figure is based upon a 4 per cent interest rate which is historically low. A 1 per cent increase in rates would see this interest cost increase by 25 per cent.

A major problem with the current system is the ability of the client to hold onto **all** retention monies until all of the defects have been cleared. This has the iniquitous effect that our retention monies are often held up because of problems that the main contractor has with another unconnected element of the works (eg cladding).

33. *A developer/contractor recently issued a directive stating that with immediate effect no sub-contractor would be allowed into occupied dwellings to carry out remedial work during the defects liability period. The*

developer/contractor stated that he would remedy any defects notified using maintenance contractors and the cost together with a management charge of 25 per cent would be deducted from retention monies held.

The abuse of retention can act as a restriction to the growth and development of small to medium-sized businesses because in many instances profits generated are tied up in retention. As turnover increases the amount of profit tied up increases proportionately, together with the concern as to whether the money will actually be paid. Furthermore the company may have paid tax on profits not yet received in hard cash.

34. *Our retention account is usually between £80,000 and £100,000 per year, and this equates to far in excess of the amount of profit that the company makes.*

If our retention account was zero, then our bank borrowing would be zero, and our costs borrowing would be zero.

35. *Around £1.6 million is currently due on retentions, both on ongoing contracts and completed contracts where end of defects [liability period] has not been reached. This is not much changed from situation one year ago. This figure represents 45 per cent of total contracting debt due and 28 per cent of total debt (contracting and non-contracting) due to the Group. In terms of our current debtor days, it represents 25 debtor days, a significant figure.*

This £1.6 million consists of 109 contracts; 41 in progress and 68 completed. Three quarters of all contracts have a five per cent, as opposed to three per cent, retention level and no single contract has a “capped” upper limit of retention.

The amount of executive time from surveying to finance to our Main Board which is taken up each month monitoring levels, pushing for release of old retentions, pushing for release of one half retentions upon practical completion is immense and I suspect will run in excess of tens of thousands of pounds of time better spent in doing more productive work.

We generally do not ourselves have many sub-contractors, only raw material suppliers and components/equipment suppliers. Thus retentions held off us are not passed “down the line”. The working capital deficit of a specialist services sub-contractor can be considerably more than a main contractor, particularly in a growth position, where only 95 per cent of increased sales are going to be currently paid.

A company’s cash flow and cash position is the most crucial element within construction. I would hope that, should the day ever come when retentions are outlawed, the additional amount of cash flowing through the system would increase heavily both the productivity and performance of all specialist service sub-contractors.

36. *An example relates to approx. £6,250 retention on an approx. £250,000 contract. Again the Client is a large, very well regarded organisation with which we have had a 20 year relationship. In this instance the main contractor went into liquidation shortly after practical completion was granted. Prior to this all our electrical works had been signed off by the M&E consultant as satisfactory and complete. Similarly our final account had been agreed by the client’s QS.*

Despite this, we and other sub-contractors have not been able to obtain release of this retention directly from the client. Nor will they agree to “ring-fence” the monies.

The client has been able to conveniently argue that they cannot pay directly as any monies should be paid to the main contractor’s liquidator who has a general claim against the client for all monies outstanding under the contract and which would go into a general pool for the benefit of all creditors.

In practice, the client is holding (and will probably never release) a very substantial sum of money, of which the retention is only part, against alleged “defects” in the main contractor’s works (the main contractor’s final account was never agreed). Supposedly these sums are held either until the liquidator’s agent puts right the defects or the client employs another contractor.

You must form your own opinion as to what degree and scale the defects are genuine. However, some two years later, no remedial builder’s works have been carried out. Similarly, in practice, liquidators seldom have the resources, expertise or time to correct defects or the stomach to enter into litigation in these situations where the client is being “difficult”.

In effect the client has had an adequate and serviceable job done (if not to a perfect standard), rather more cheaply than he budgeted for. At the same time, under present contractual arrangements, the client has the perfect excuse for declining to release our retentions.

37.(a) *University—specialist sub-contract works, retention due January 2002, remains unpaid.*

(b) *Private golf club—specialist sub-contract work, retention due December 2001, remains unpaid.*

(c) *Registered charity—specialist sub-contract works, retention due March 2001, remains unpaid.*

Above are just several examples of instances where cash retentions are being held, despite all the works (including defects within liability period) being certified completed.

38. We undertook as a sub-contractor, with a local suspended ceiling contractor, to replace suspended ceilings and light fittings (for a local authority). Our contract value was in the region of £20,000 + VAT. The works were carried out under a standard contract with retention of 2.5 per cent, lasting 12 months from completion which was in April 2001. Amount outstanding £625.47 including VAT. There have been no

defects and we have been chasing the main contractor for retention. He says he is waiting for its release from [the borough]. We have chased [the borough] but to date we have not received the money. Time and effort in chasing the debt has probably cost about half the outstanding money so far. As we undertake regular works for this borough and for the relatively small contract value why have retentions?

39. Retention is currently held on approximately 40 contracts going back for about five years and to a value of £82,190.

Four typical examples as detailed below:

- 1 Mall shopping centre (retention £11,549) work carried out during 1998.
- 2 Oaks Centre Dungannon (retention £4,460) work carried out during 1998.
- 3 Cookstown DVTA (retention £4,000) work carried out during 1999.
- 4 Lumen Christi College (retention £4,686) work carried out during 2000.

Reasons given for not issuing Final Certificates are all related to other trades and sub-contractors.

Annex C

EXPERIENCES OF CLIENTS WHO HAVE ABOLISHED RETENTIONS

ELIMINATING RETENTIONS DOES NOT SEEM TO HAVE A NEGATIVE IMPACT ON DEFECTS

THE GOSPORT BOROUGH COUNCIL PARTNERING TRIAL⁵²:

Gosport Borough Council was a Best Value Pilot Authority and in 1998 completed a review of its repairs and maintenance services.

Like many other organisations, Gosport was experiencing problems with traditional forms of contract procurement. Service to tenants was poor, each contract became more and more adversarial and there were difficulties in providing the right quality at the right price.

The timing of the Best Value review coincided with the publication of the Construction Taskforce study “Rethinking Construction”. As many of the principles in this study appeared to address the issues raised by the review, it was decided to undertake a partnering trial within the Borough for planned maintenance and improvements works.

A £300,000 trial project encompassed a programme of external improvements to a series of homes, including replacement windows and doors, renewal of guttering, fascias and soffits, chimney and brickwork repairs, upgrading insulation and external decoration. All works were carried out with the tenants in residence and therefore consultation was of paramount importance.

In order to fully test whether any clear benefits would come from using a “partnering” approach, a second traditional contract (with retentions), of the same size, value and work type was set up to run alongside the partnering trial. The “partnering” contract did not have retentions; the payment terms were much improved on the traditional contract. By setting some clear performance targets, detailed comparisons could be made as to the benefits that could be achieved. Gosport Borough Council aimed to achieve a target maximum of three defects per dwelling.

	<i>Incidence of Defects</i>	
	<i>Partnering Contract</i>	<i>Traditional Contract</i>
Target maximum of 3 defects per dwelling	Total of 13 defects reported for 65 dwellings. Average 0.2 defects per dwelling.	Total of 107 defects reported for 56 dwellings. Average 1.91 defects per dwelling.

⁵² Extracted from the Local Government Task Force—Working Group Report April 2001: Integrating Rethinking Construction with Best Value.

Annex C

Phone interview conducted on 26 September 2002 with Rod Cossou, Business Development Manager at Western Challenge Housing Association:1. *What type of projects do you tend to undertake?*

They are all new build.

2. *What type of contracts do you tend to use?*

They are all partnering contracts. We have our own bespoke contract based on PPC 2000.

3. *Have you stopped using retentions on all your contracts?*

Yes because our Main Contractors were not charging retentions to their Sub-Contractors and we wanted to replicate that equally.

4. *When did you stop using retentions?*

18 months ago.

5. *What mechanisms are you using instead of retentions?*

We sometimes use a retention bond and for the first time recently we have had three-year Defects Liability Periods.

6. *Have the number of defects varied noticeably since eliminating retentions?*

Well, the partnering process has tended to produce a better quality product. We have now achieved nought defects at handover. We certainly never achieved that before with traditional methods of procurement.

7. *Have you had problems getting people to return to remedy their defects since eliminating retentions?*

No, because the partnering culture is based on long-term relationships and contractors want to keep you happy. Before when we used to employ people to carry out “one-off jobs” we had a lot more problems. You have to realise that it’s the Sub-Contractors who do the majority of the work so you need to bring them on board and incentivise that. They used to price the product and factor the retention into that price. This meant they knew they had their price before the retention was released so there was no incentive for them to come back and remedy the defects.

8. *Has the speed of the construction process varied?*

Absolutely, we are producing the product much more quickly. We’re also a lot keener on things like Health and Safety whereas we didn’t really pay much attention to that before.

9. *Has the quality of the work varied?*

Well we have learnt that quality varies between people. However there is an improved product now because we’re taking an holistic view whereas before we were tending to look just at the cost. Best value is not just about price but about the overall product. Tenants certainly seem to be getting a higher degree of quality. Essentially we’re getting a much better product.

10. *General comments on eliminating retentions—has it been beneficial and how?*

Eliminating retention helps to build teams. It’s all about the Sub-Contractors and by eliminating retentions you can show them that you’re not going to hold them back. If they are building less defective products for us now we’ve eliminated retentions then why do we need to use retentions in the first place? Anyway if you’re in a long-term supply chain partnership you don’t need retentions.

The Sub-Contractor is the small guy and he’s the one who needs the money. Freeing up this cash flow increases the productivity of the contractor. You don’t want to mess up a small contractor’s cash flow. Contractors have millions tied up in retentions every year and it just seems unnecessary. A small Sub-Contractor will align with you more if there is no retention and they really need the money.

Phone interview conducted on 26 September 2002 with Paul Hill, Deputy Director of Repairs and Renewal at Oldham Metropolitan Borough Council:

1. *What type of projects do you tend to undertake?*

External refurbishment and planned maintenance work on large scale projects. This will be changing over the next four years and we will be undertaking whole house refurbishment.

2. *What type of contracts do you tend to use?*

Our partnership contract is the PPC 2000.

3. *Have you stopped using retentions on all your contracts?*

Not all, we still retain a few traditional contracts as a benchmark.

4. *When did you stop using retentions?*

About 18 months ago on our partnering work.

5. *What mechanisms are you using instead of retentions?*

Incentives. We have a 50/50 split between ourselves and the contractor. If over the course of the project we have saved money on time and cost etc we split that 50/50 with the contractor. This really brings in all 10 KPIs.

6. *Have the number of defects varied noticeably since eliminating retentions?*

Yes they have dramatically gone down. There is a huge difference between our partnering contracts and the traditional contracts we have retained. This is centred around efficiency, eg all the planning work is done up front so there are no variations. An important part of this is that both ourselves and the contractor are working to minimise defects as much as possible.

7. *Have you had problems getting people to return to remedy their defects since eliminating retentions?*

No, it's easier. On traditional contracts it is always a problem getting contractors to return but with our partnering contracts the contractor actually wants to do it because we are both working towards the same goal. In fact our contractor has installed an in-site agent to deal with this so the snagging process is now obsolete.

8. *Has the speed of the construction process varied?*

Yes, it has got quicker.

9. *Has the quality of the work varied?*

The quality has increased on the partnering work.

10. *General comments on eliminating retentions—has it been beneficial and how?*

It has definitely proved beneficial for us. You need to look at risk and incentivisation. These factors are linked in with eliminating retentions and improving quality.

Phone interview conducted on 23 September 2001 with Max Baxter, Property Investment Manager of West Wiltshire Housing Society:

1. *What type of projects do you tend to undertake?*

New build and refurbishment work. At present refurbishment is the largest part of our work accounting for £4–£5 million of our annual turnover whereas the new build accounts for £2.5–£3 million per year.

2. *What type of contracts do you tend to use?*

Partnering. For the new build we use guaranteed maximum price contracts. For refurbishment we have a pure open relationship with the contractors based on the NEC Contract.

3. *Have you stopped using retentions on all your contracts?*

Yes.

4. *When did you stop using retentions?*

For the refurbishment 18 months ago and for the new build one year ago.

5. *What mechanisms are you using instead of retentions?*

We use an incentive rather than a retention, we pay a flat fee profit percentage and top it up against performance indicators, one of which is defects liability management. We tend to fence off an additional one per cent of the contract sum which is on top of the contract price so it is not a retention. During the defects liability period we monitor how many defects there are and how well the contractor deals with them before releasing the additional one per cent.

6. *Have the number of defects varied noticeably since eliminating retentions?*

The defects in refurbishment are now almost non-existent. For example in one contract nearly 1,000 doors were replaced and we have only had one recall in the past year. Before eliminating retentions we would expect the number of defects to be much higher.

7. *Have you had problems getting people to return to remedy their defects since eliminating retentions?*

No problems at all. Most contractors tend to write off the retentions so under traditional contracts that include retentions it is more difficult getting them to return to remedy their defects.

8. *Has the speed of the construction process varied?*

No massive difference.

9. *Has the quality of the work varied?*

The quality of the work has gone up massively. The real difference in eliminating retentions is in the quality and the quality has risen.

10. *General comments on eliminating retentions—has it been beneficial and how?*

The main KPI as far as we're concerned is defects. Eliminating retentions has reduced defects and had a positive impact on client satisfaction. We believe that partnering in general shows good faith and commitment on the part of the client.

Annex C

Questionnaire completed on 16 September 2002 by Graham Cook, Head of Property Services at South Somerset Homes:

Please note that the following comments only apply to our partnering arrangements.

1. *What type of projects do you tend to undertake?*

We only dispense with the use of retention on our partnering arrangements. This currently only applies to Planned Maintenance works to domestic dwellings. However, we have used this approach on a new build pilot project and we have recently introduced the same principal on a five-year horticultural maintenance partnering arrangement. Partnering works currently account for about 30 per cent of our annual works programme by spend.

2. *What type of contracts do you tend to use?*

We use the New Engineering Contract on all of our partnering schemes.

3. *Have you stopped using retention on all your contracts?*

No. We still apply retention on all traditionally procured works.

4. *When did you stop using retention?*

We stopped using retention on partnering projects in September 2000.

5. *What mechanisms are you using instead of retention?*

We link the use of retention to quality. If quality achieves a pre-agreed threshold then no retention is held. If quality consistently fails then retention can be introduced on a sliding scale but the maximum retention that could be held will not exceed that expected to be found in a traditionally procured arrangement.

6. *Have the number of defects varied noticeably since eliminating retention?*

We tend to get fewer defects on partnering arrangements.

7. *Have you had problems getting people to return to remedy their defects since eliminating retention?*

No. All partnering arrangements have to date managed defects successfully.

8. *Has the speed of the construction process varied?*

All partnering projects have to date finished on or before the agreed completion dates. We have not had to issue any extension of time on any partnership arrangement. How much of this is due to the effect of not holding retention is difficult to measure but I am convinced that this tool has had an impact on early completion.

9. *Has the quality of work varied?*

Virtually all of our partnering contracts have had 100 per cent compliance with agreed quality benchmarks. It is not uncommon to achieve 50 per cent + zero defects on properties at their hand-over and 100 per cent zero defects on individual properties at practical completion of the project.

10. *General comments on eliminating retention—has it been beneficial and how?*

The elimination of retention acts as an incentive to contractors, not because they are paid more for delivery of a quality standard but rather that they are paid what the job is worth earlier in the construction process. Contractors are then free to re-employ this capital on hopefully other profitable operations. It is also important for us as an organisation that the elimination of retention is passed on down the supply chain. We therefore expect our principal partners to offer the same terms and conditions on the elimination of retention to the key specialist contractors and suppliers as it is not uncommon in planned maintenance works to have 90 per cent of the project delivered by specialist sub-contractors.

APPENDIX 5

Supplementary memorandum by the Construction Confederation

Thank you for allowing the Construction Confederation the opportunity to give written and oral evidence into the Trade and Industry Select Committee Inquiry into retention. Whilst giving oral evidence at Portcullis House on Thursday, 18 October 2002, you asked that we write with further details about Constructionline and in particular its lack of co-ordinated use throughout central government and local authorities.

Constructionline, as you may be aware, is said to be the UK's largest register of pre-qualified construction services. It was set up with the original objective of supplying the construction industry and its clients with a single national pre-qualification register scheme.

Constructionline is owned by the Department of Trade and Industry and is a contributor to the Rethinking Construction Initiative. Over 10,000 contractors and consultants are registered with Constructionline and all have gone through the process of meeting the pre-qualification requirements supported by the DTI. The contractors and consultants registered cover the full spectrum of construction activities from architecture to demolition and range in size from small specialists to the largest main contractors.

As advised during the oral evidence session last Thursday, Constructionline does have a relatively large client base (its website which can be found at www.constructionline.co.uk), and suggests that it has 13,000+ clients. However, although a number of these clients include central government departments and local authorities, there are equally a large number of central government departments and local authorities which do not actually make use of Constructionline and instead either have their own independent lists of contractors or use one of a number of registers held and maintained by private organisations.

Since appearing before you, we have been in contact with Capita (who run Constructionline on behalf of the DTI), and have obtained from them a list of the central government departments that have not signed up to Constructionline. A copy of this extensive list is attached*. Interestingly, amongst the many departments on this list is the Department of Trade and Industry itself. This list also includes NHS Estates, Defence Estates and the Environment Agency, who you will recall were mentioned by us when giving oral evidence.

As you will appreciate, where different central government departments and local authorities utilise different lists, any contractors within the industry wishing to go on these lists have to go through numerous qualification schemes including completing various application forms and providing extensive background information to different central government departments, local authorities and other organisations.

*Not printed.

Having one central register would benefit both the construction industry and central government and local authority departments by significantly reducing the administration that would otherwise be required in applying for and maintaining separate lists. For clients the benefit of Constructionline is that it saves money by reducing the administrative burden of maintaining their own lists and would help free up valuable resources and streamline their procurement process allowing them to deliver more efficient and effective services. This will assist in achieving best value.

EFFECTS OF MULTIPLE QUALIFICATION BODIES

The concept of a single qualification system for construction as a stated aim in the Latham Report was put forward so that duplicated effort undertaken by contractors qualifying with numerous clients could be eliminated. The formation of Constructionline was a result of that initiative. However, since that time there has been the establishment of other registers as outlined below and contractors would need to qualify for a multiplicity of registers to cover work in all sectors and with all clients. This results in a large duplication of effort by contractors in addition to the fees required for registration and annual fees to continue to be included on these databases.

CONSTRUCTION REGISTERS

Apart from Constructionline there are five companies that hold and maintain registers of construction companies to enable clients of the construction industry to procure works. They are Achilles, The Select List, National Britannia, Exor Management Ltd and Business Information Publications Ltd. Achilles has four databases targeting different client sectors which are the Utilities Vendors Database, Link-up which is aimed at the railway sector, CATALiST (sic) which has two registers, one concerning the higher education sector, the other is aimed at the police sector. Exor Management Ltd runs the Sinclair Database which in fact is two databases, but inclusion of one means automatic inclusion on the other. National Britannia runs "Supplyline", Business Information Publications Ltd runs "Delta Select". The Select List runs its database called The Select List

In all contractors wishing to cover all sectors both nationally and regionally would be required to qualify to be included on eight registers, all of which require extensive information to qualify for inclusion, an annual fee is required in most cases and often a registration fee is payable, chargeable upon registration. Further details of each register can be provided if required.

CONCLUSION

As you will appreciate, there are many benefits to be obtained both by central and local government in supporting and utilising facilities such as Constructionline. The financial and administrative savings, would be significant but its use will only be of value if all government and local authorities are compelled to utilise its services. Any lesser obligation would allow the continuation of the existing unsatisfactory, costly and highly duplicative position.

The Construction Confederation invites you to propose that the release of any money by the Treasury to any government department or local authority be subjected to their agreeing that they will only use contractors registered with Constructionline and that they will not require contractors to be on any other register.

John Bradley
Legal Department
Construction Confederation

23 October 2002

Annex A

LIST OF GOVERNMENT DEPARTMENTS NOT SIGNED UP TO CONSTRUCTIONLINE

AS REFERRED TO IN LETTER FROM JOHN BRADLEY OF THE CONSTRUCTION
CONFEDERATION

DATED 23 OCTOBER 2002

APPENDIX 6

Supplementary Memorandum by the Department of Trade and Industry

Thank you for your letter of 21 October enclosing transcript copies of the evidence given to the Trade and Industry Select Committee on the use of retentions in the construction industry. With this letter are enclosed:

- A paper containing additional information on some of the initiatives discussed in the DTI's evidence. The Select Committee specifically requested some of this. The information covers:

- The Quality Mark
- Constructionline
- Key Performance Indicators
- Construction Insolvencies
- A copy of the paper produced by the Office of Government Commerce which I submitted to the Select Committee in advance of its hearing. As you are probably aware, it became clear on the morning of the hearing that the version of the paper which the OGC had sent to me included a formatting error. Though the final correct version did reach us during the hearing, I include it here for the purposes of completeness.
- At our suggestion the OGC has also prepared a short paper on the main groups which it has established to bring together Central Government client organisations.

Paul Smith

Construction Sector Unit—DTI

1 November 2002

PRACTICES OF SOME CENTRAL GOVERNMENT DEPARTMENTS AND AGENCIES IN RESPECT OF RETENTIONS

<i>Department or Agency</i>	<i>Retentions—Practice</i>	<i>Action that will reduce requirement for retentions</i>
Defence Estates	Prime Contracting does not involve retentions (except to the extent of dividing the pain/gain shares). Projects undertaken under GC Works use the standard retention of 5 per cent until practical completion, and 2.5 per cent until the end of the maintenance period. DEFCON2000 projects do not involve “retentions” as such, but have a 5 per cent final milestone, payable at the end of the Defects Liability period.	Defence Estates is looking to build upon initiatives such as Prime Contracting, to find ways of improving its relationships with key suppliers. Building on lessons learned from Prime Contracting, the incentive-pricing ethos may be extended, replacing the need for a retention.
Department of Trade and Industry	Department of Trade and Industry has no standard practice on retentions—there is an option to dispense with retentions on basis of past performance, or reduced contract price for no retention in the contract.	Cases are considered on their merits, based on past performance. Measured term contracts (longer term), do not have retentions—failure to remedy defects can result in termination of contract.
Department of Work and Pensions	Since 1998, most of the Department of Work and Pensions’ estate is owned by its PFI partner (Land Securities Trillium), and therefore the Department has few direct construction contracts. Land Securities Trillium currently does use retentions in construction contracts.	In line with Achieving Excellence principles, Land Securities Trillium is looking to reduce the number of companies with whom they do business, and adopt a partnering approach with them. Retentions will be replaced by an incentive-based approach.
Environment Agency	Construction budget >£100 million/annum. The majority of the work is now procured using a national framework (with seven contractors), based on partnering, target costing and mutual objective achievement, and no requirement for retentions (with the exception of an option for retentions towards the end of the long-term arrangement). The remainder (small works <£100k), use stand-alone contracts with retentions considered on a project-by-project basis. Retentions in these cases are often viewed as a useful tool to help protect Environment Agency’s commercial position.	The National Frameworks have removed the need for retentions, with the exception of contracts let towards the end of the framework period.

<i>Department or Agency</i>	<i>Retentions—Practice</i>	<i>Action that will reduce requirement for retentions</i>
Highways Agency	Highways Agency is moving away from retentions through the use of long-term partnerships and incentivised target costing. New maintenance contracts (with improvement projects < £0.5 million) do not have retentions. The option to use retentions on framework contracts (£0.5–5 million) is available but seldom used. Major projects (£5–200 million) have the option of a retention bond, but this is not ideal and new procurement methods for major projects which involve packaging works together, will significantly reduce the need for retentions or retention bonds.	Highways Agency is changing its methods of procurement and moving to longer term arrangements, with performance monitoring, partnership working and incentivisation. Highways Agency believes that it will be able to eliminate retentions from its contracts before 2007.
Home Office	Several major projects have been undertaken via the PFI route, which does not involve client-held retentions. Others are undertaken via Design, Build and Operate which does involve a retention. Small projects would be undertaken using the GC Works contracts, and do include a retention.	Home Office have undertaken several of their major projects via the PFI route, which involves a long-term contractual relationship with the private sector for the delivery of services. The private sector will be responsible (as compatible with Achieving Excellence) for the design, construction, operation and maintenance of the assets necessary to deliver the required services. No retentions by the public sector are appropriate due to the nature of the relationship.
NHS Estates	Under Procure 21, the intention is to phase out retentions. Procure 21 has four strands—partnering, best client, design quality and benchmarking/cost intelligence. Procure 21 includes an optional retention for use where a supplier fails to perform to zero defects or efficient and effective defect rectification. This supports the objective of phasing out the use of retention.	Procure 21 Partnering Supply Chain (Integrated Team) frameworks will be rolled out across the remainder of the NHS (currently cover North West and West Midlands). The frameworks will involve carefully selected supply chains for the delivery of design and construction services. Certain areas of concern (delivery of “fitness for purpose”; integrated supply chains; Total Quality Management and “right first time”; responsive and proactive approach to defect resolution; and whole life cost solutions) must be addressed before the requirement for retention can be completely removed.
The Court Service	PFI is used for major projects, and no client-held retention is applicable. Retentions are not used for professional services commissions, or supply contracts. Minor works contracts use GC Works and the retention provision therein, to protect the Employer in respect of defect rectification and to help prevent non-completion. Retention bonds (as allowed for in GC Works) have not been used—they are untested, and could provide a further area for dispute.	PFI used for major projects. If the construction industry were able to offer zero defects, retentions policy could be reviewed.

THE QUALITY MARK FOR HOUSEHOLD REPAIR MAINTENANCE AND IMPROVEMENT

The development of Quality Mark honours a manifesto commitment given by the Government in 1997. The scheme aims to drive out the “cowboy” builders operating in the domestic repair, maintenance and

improvement sector, who currently generate adverse publicity for the industry through their poor performance. Consumer complaints to the Office of Fair Trading about building firms reached 106,000 in 2001, a rate which is increasing steadily and exceeds all other sectors'. Quite apart from providing a significant consumer protection measure, by raising industry standards of technical competence and customer service through periodic independent (UKAS-accredited) assessment, Quality Mark is a means of improving the industry's reputation, its ability to attract and retain good quality staff and its skill levels. Further, it has been suggested that £4 billion a year of additional work would be commissioned if consumers' fears of botched work could be allayed. Quality Mark has a role in consumer education, through guidance on what to look for when commissioning work and how to deal fairly with contractors.

The scheme is designed to suit the needs of firms ranging from sole traders to those with a turnover of £ millions. After completing a simple application form, firms are independently assessed, on site, against industry standards of technical competence, skilled staff ratio (1:2 qualified:unqualified), against basic management practice; and compliance with statutory and good practice health and safety standards and environmental practice, a code of practice governing customer relations, financial probity, and with statutory requirements for employer's liability insurance. They must provide a 6-year warranty of all work against insolvency and defective workmanship and have adequate public liability insurance. Periodic checks ensure standards are maintained. On-site audit takes between a half and one day, a well-prepared firm may achieve the Mark in 4–6 weeks. Most reputable companies meet the technical and skills requirements of Quality Mark. If required, help is available in the form of advice or training from the Construction Industry Training Board, trade bodies, Business Links and others. Once sufficient firms are registered in a locality the scheme is publicised to consumers. They access firms through the call centre or web site.

Registration fees relate to domestic work turnover, eg from £500 for annual domestic turnover up to £100,000, £920 for annual domestic turnover up to £1 million. DTI is currently subsidising registration costs, to achieve critical registered mass. Warranty cost is based on domestic turnover and has fallen over the last year to £5 to £7.50 per £1000 of work. Some insurance companies are considering offering a package of employer's liability and public liability insurance plus Quality Mark cover.

Following the successful evaluation of two pilots (in Birmingham and Somerset), the Minister announced in March 2002 that the scheme is being rolled out nationwide over a three or four year period. A group comprising all the key industry, consumer and operational stakeholders has been set up to shadow DTI's management of the scheme, with the intention of assuming ownership once the operation breaks even. Management consultants WS Atkins have been appointed by competitive tender to develop and agree a robust business plan by the end of the year. The group is developing a continuing roll-out schedule.

The scheme appeals strongly to consumers with relatively low levels advertising generating interest. There have been over 30,000 calls to the call centre to date, and 50,000 website hits. Take-up with the contractors has been slower given healthy order books and less interest in generating more work or operating more efficiently. The industry is populated by large numbers of "lifestyle" firms, content to work on a level of profitability which funds their desired lifestyle and slow to appreciate the benefits of strengthening or broadening their business. Nevertheless it is clear that voluntary registration remains the appropriate basis for the scheme, recognising the impracticality of policing activity which largely occurs behind closed doors, and allowing quicker implementation of operational or policy change. The scheme is therefore targeted on achieving a critical mass of reputable firms with the support of trade associations, consumer groups and influencers such as local authorities and trading standards officers.

Consumer pressure is expected to drive take-up increasingly as the scheme rolls out. In addition, case studies are being identified from Quality Marked firms already reporting significant improvement to the way they manage their business, a broader range of clients, better value jobs and consequent improvements to their bottom line. Quality Mark is strongly supported by the more reputable industry trade bodies, to the extent that four are implementing board decisions to introduce Quality Mark standards into membership requirements. Meanwhile, 250 firms have earned the Mark, 356 are under assessment. Trade launches are due in Leeds (4 November), Nottingham (25 November), Derby (28 November).

CONSTRUCTIONLINE

Constructionline was developed in response to Sir Michael Latham's recommendation ("Constructing the Team" 1994) for a single national database of construction firms vetted for their general capacity and capability to carry out their work range. Vetting standards would be those generally applied by the majority of public sector clients. Public clients could access the register instead of carrying out their own prequalification process at the start of works procurement. This would drive out the expensive waste of repeated form filling and assessment for firms and clients. Constructionline was launched in 1998. It is owned by government and operated under a public private partnership with Capita. Clients access data free. Firms pay to be registered, close to cost, according to their annual turnover:

<i>Contractors Turnover</i>	<i>Consultants Staff</i>	<i>Price</i>
£0—£250k	1–5	£70
£250k—£1m	6–10	£195
£1m—£2m	11–15	£345
£2m—£5m	16–20	£395
£5m—£20m	21–50	£595
£20m—£50m	51–100	£875
£50m +	101 +	£1,275

The principle is strongly supported by the industry. However unrealistic industry expectations during the early re-engineering of service and administration led to widespread industry and client criticism. Considerable remedial work over the last 18 months has increasingly recovered support. Administration has improved to the extent of Constructionline's Basingstoke office achieving accreditation to ISO9001/2000 without non-conformities. Over the coming months the remaining Constructionline operation bases will apply for accreditation. The sales team are now focusing on customer relationship management to enable existing clients to use the system fully, tailor their own enquiries to remove data already collected by Constructionline.

Improvement is reflected in rising client and firms' registration. In the year ended September 2002, numbers of firms registered had risen by 8.7 per cent to 10,996 (11,133 at 10 October 2002). More than half are small or medium sized enterprises. In the same period registered clients rose by 19.7 per cent to 1,525. More than half of registered firms renew registration at the end of September and the achievement this October of 74 per cent of invoices being paid after one reminder, compared to 56.2 per cent at 31 October 2001 after two reminders shows the benefits being delivered as a result of improved performance.

However the slow start allowed other registers to gain market presence and these are a strong irritant to firms who are faced with paying several registration fees annually to retain or expand their client base. To the industry's frustration, Constructionline cannot have a monopoly position. It must rely on the merits of its services to attract clients and align with or absorb competitors where that makes business sense. It is only now achieving sufficient market strength for meaningful negotiation with competitors. The range of data collected by Constructionline is also seen as a hindrance. The data collected reflects the traditional procurement culture and current cross-government understanding of the data that can be requested during pre-qualification under the legal and regulatory framework applying to procurement. If the register is to remain relevant to clients and the industry, database capacity, delivery and data range must be updated to reflect and promulgate Rethinking Construction initiatives and industry development. DTI and Capita are currently scoping potential re-engineering. Constructionline will involve the full range of users in re-engineering the service.—Meanwhile both central and local government could save substantive public funds and industry cost now, just by making the *current* service an integral part of their construction procurement process.

Capita was recently asked by Construction Confederation for a list of central government departments who are not registered, so that the Confederation might write to ask them to take-up Constructionline. This has since been copied to the Select Committee. As Capita explained to the Confederation, this list was sourced from a commercial database and has no construction focus. The list includes many bodies without construction procurement need and includes numerous sites for individual departments. For example, some DTI sites are listed even though DTI is registered with Constructionline (Constructionline only holds the address of DTI's procurement section). The list does not, therefore provide a suitable basis for assessing the extent of usage of Constructionline by central government clients. The list attached with this paper shows existing Constructionline clients who are not local government or commercial client bodies.

Constructionline client list at 1 October 2002 (less local government and some charities etc)

<i>Coni Ref no</i>	<i>Client name</i>
41	CUSTOMS AND EXCISE LONDON
5749	D E F R A (5)
7	D E F R A(1)
2063	D E F R A (2)
94	DSA, NOTTINGHAM
1987	DTI
2053	DTI (2)
28	EMPLOYMENT SERVICES, SHEFFIELD
305	ENGLISH HERITAGE
269	FOREIGN AND COMMONWEALTH OFFICE
2	HEALTH & SAFETY EXECUTIVE
92	HEALTH AND SAFETY LABORATORY
1960	Highways Agency(Birmingham)

<i>Coni Ref no</i>	<i>Client name</i>
1959	Highways Agency (Leeds)
1962	Highways Agency (Bedford)
1705	HIGHWAYS AGENCY (Bristol)
1961	Highways Agency (Dorking)
1678	HIGHWAYS AGENCY (London)
50	HM PRISON SERVICE, HAVERIGG
1	HM PRISON SERVICE, LONDON
148	HOME OFFICE BUILDS & ESTATES
1635	MARITIME & COASTGUARD AGENCY
90	MOD (Farnborough) previously DERA*
8210	MOD (RAF Brize Norton)
155	MOD BENSON
8	MOD DEFENCE WORKS SERVICES
162	MOD HOUSING EXECUTIVE LONDON
54	MOD PORTSMOUTH*
58	MOD WILTON
9	MOD/DEO (USAF) CAMBRIDGE
8150	North Wales Magistrates Courts
7876	Northumbria Magistrates Courts
403	O G C (BIRMINGHAM)
406	O G C (LEEDS)
75	O G C (LONDON)
407	O G C (MANCHESTER)
6730	O G C Buying Solutions
59	ODPM/DFT (1)
2104	ODPM/DFT (2)
132	SECURITY SERVICES GROUP*
129	THE COURT SERVICE
1632	THE CROWN ESTATE
7388	Vehicle Inspectorate Exe Agency (1)
7389	Vehicle Inspectorate Exe Agency (2)
2050	East Midlands Development Agency
2070	East of England Dev Agency (1)
2071	East of England Dev Agency (2)
1939	North West Development Agency
5481	South West of England Regional Dev Agency (1)
5569	South West of England Regional Dev Agency (2)
5570	South West of England Regional Dev Agency (3)
1933	Yorkshire Forward
7760	London Development Agency
55	BRITISH MUSEUM, LONDON
152	HORNIMAN MUSEUM
267	R A F MUSEUM
1790	SCIENCE MUSEUM
137	THE BRITISH LIBRARY
6243	Sport England
7738	Coal Authority
2040	Equal Opportunities Commission
1929	Forensic Service Services
1979	Greater Merseyside Enterprise
39	HISTORIC ROYAL PALACES AGENCY
160	HM LAND REGISTRY
6470	Lee Valley Regional Park Authority
7183	Met Office
2106	National Blood Service
6573	Office of Fair Trading
6257	Office of Government Commerce
1670	ORDNANCE SURVEY
47	PARLIAMENTARY WORKS DIREC
6876	Speke Garston Development Co
7194	The Countryside Agency
1867	Royal Parks Agency
1887	Addenbrookes NHS Trust
1830	Airedale NHS Trust

<i>Coni Ref no</i>	<i>Client name</i>
971	Anglia Support Partnership (previously Lifespan Healthcare NHS)
288	AYLESBURY VALE COMMUNITY NHS
7004	Barnet Primary Care NHS Trust
6941	Barnet, Enfield & Haringey Mental Health NHS Trust
1896	Barts and The London NHS Trust (1)
1897	Barts and The London NHS Trust (2)
821	Basildon & Thurrock General Hospitals NHS Trust
834	BLACKBURN HYNDBURN & RIBBLE VALLEY HEALTH
826	Bedford Hospitals NHS
7650	Bradford District Care Trust
237	BRADFORD HOSPITALS NHS TRUST (1)
844	BRADFORD HOSPITALS NHS TRUST(2)
70	BRIGHTON HEALTH CARE NHS TRUST
845	Bromley Hospitals NHS Trust
1844	Brunelcare
7517	Calderdale & Huddersfield NHS Trust (1)
7518	Calderdale & Huddersfield NHS Trust (2)
851	Camden & Islington Community Health Services NHS
11	CAPITEC (LEEDS)
1815	Capitec (Tunbridge Wells)
182	CAPITEC BATH
357	CAPITEC ESTATES
131	Capitec Gloucestershire*
122	CAPITEC PLYMOUTH
855	Central Manchester Healthcare NHS Trust
7048	Central & North West London Mental Health Trust
8193	Central England Audit Consultancy
868	CITY HOSPITALS SUNDERLAND NHS*
7440	Community Health Sheffield NHS Trust
166	Community Health South London NHS TR*
1353	COMMUNITY HEALTHCARE BOLTON NHS
67	COUNTY DURHAM & DARLINGTON PRIORITY
2019	Derby City General Hospital
230	East & North Hertfordshire NHS Trust (1)
900	East & North Hertfordshire NHS Trust (2)
126	EAST GLOUCESTERSHIRE NHS TRUST
7842	East Kent Community NHS Trust
408	EAST KENT HOSPITALS NHS TRUST*
125	EAST SOMERSET NHS TRUST*
76	Eastbourne & County Healthcare
917	Frimley Park Hospital NHS Trust
187	GATESHEAD HOSPITALS NHS TRUST*
158	George Elliot Hospital NHS Trust
1774	GLOUCESTERSHIRE ROYAL
924	Great Ormand Street Hospital
930	Hammersmith Hospitals NHS Trust
934	HARROWGATE HEALTH CARE
207	HASTINGS & ROTHER NHS TRUST
7644	High Peak and Dales Primary Care Trust
943	Hillingdon Hospital NHS Trust
7522	Hinchingbrooke Healthcare NHS Trust
945	Homerton Hospitals NHS Trust
950	Hull & East Riding Community Health NHS Trust
7497	Huntingdonshire Primary Care Trust
161	KENT & SUSSEX WEALD NHS TRUST
7433	Leeds Community & Mental Health Teaching NHS Trust
396	LEWISHAM HOSPITAL
279	MEDWAY NHS TRUST
6937	Mid Essex Hospitals Services NHS Trust
376	MILTON KEYNES GEN NHS TRUST
35	NEWCASTLE CITY HEALTH NHS TRUST
181	Newcastle Upon Tyne Hospitals
7434	Newcastle Upon Tyne Hospitals
1000	Newham Healthcare NHS Trust

<i>Coni Ref no</i>	<i>Client name</i>
1007	North Hampshire Hospital NHS Trust
7094	North Herts & Stevenage Primary Care Trust
156	North Tees & Hartlepool NHS TRUST*
66	NORTH WEST CONSORTIUM
1020	NORTHAMPTON COMMUNITY NHS
1021	Northampton General Hospitals NHS Trust
7276	Northern Lincolnshire & Goole Hospitals NHS Trust (1)
7277	Northern Lincolnshire & Goole Hospitals NHS Trust (2)
1026	Northgate & Prudhoe NHS Trust
4	NORTHUMBRIA HEALTHCARE NHS TRUST (1)
51	Northumbria Healthcare NHS Trust (2)*
1032	Nottingham City Hospital
380	OXFORD RADCLIFFE HOSP NHS
1048	Pinderfields & Pontefract Hospitals
168	PLYMOUTH HOSPITALS NHS TRUST
7215	Poole Hospital NHS Trust
809	PORSTMOUTH HOSPITAL NHS T (2)
208	PORTSMOUTH HEALTHCARE NHS
209	PORTSMOUTH HOSPITALS NHS T (1)
1054	Queen Marys Sidcup NHS Trust
119	QUEEN VICTORIA HOSPITAL
1070	Royal Brompton & Harefield NHS Trust
1071	Royal Devon & Exeter NHS Trust
6950	Royal Liverpool University Hospital Trust
1078	Royal National Orthopaedic Hospitals NHS Trust
1080	Royal Orthopaedic Hospital NHS Trust
6888	Royal Surrey County Hospital NHS Trust
276	ROYAL WEST SUSSEX NHS TRUST
7013	Salford Primary Care Trust
171	SALISBURY HEALTHCARE NHS TRUST
1089	Sandwell Healthcare NHS Trust
1090	Scarborough & North East Yorkshire NHS
154	SEVERN NHS TRUST
1093	Sheffield Children's Hospital NHS Trust
2138	Sherwood Forest Hospitals NHS Trust
201	SHROPSHIRE COMM & MENTAL H (1)
1664	SHROPSHIRE COMM & MEN H (2)
1667	SHROPSHIRE COMM & MENT (4)*
1665	SHROPSHIRE COMM & MENT T (3)*
2097	Somerset Community Housing Trust (2)
7631	Somerset Care
172	SOUTH DOWNS HEALTH NHS TRUST
89	SOUTH DURHAM HEALTHCARE NHS
6675	Essex Mental & Community Care NHS Trust
6942	South Essex Mental Health & Community Care NHS Trust (2)
173	SOUTH KENT HOSPITALS NHS TRUST
2048	South London & Maudsley NHS
226	South of Tyne and Wearside Mental Health NHS Trust (previously Prior)
1106	South Tyneside Healthcare NHS Trust
5448	South Warwickshire General Hospitals NHS Trust
5709	South West London Community NHS Trust (1)
5710	South West London Community NHS Trust (2)
323	SOUTHAMPTON COMMUNITY HEALTH SER
210	Southampton University Hospitals
1973	Southend Hospitals NHS Trust
6907	Southern Derbyshire Community & Mental Health Services NHS Trust
7043	St Mary NHS Trust
287	STOKE MANDEVILLE- HOSPITAL NHS
7494	Surrey Oaklands NHS Trust
139	TEES & NORTH EAST YORKSHIRE NHS TRUST
3615	The Enham Trust
52	THE PRINCESS ROYAL HOSPITAL
53	THE ROYAL FREE HAMPSTEAD TRUST
7336	United Bristol Healthcare NHS Trust

<i>Coni Ref no</i>	<i>Client name</i>
280	WEST CUMBRIA HEALTH CARE NHS T*
274	West Dorset General Hospital NHS
275	West Kent NHS (formerly Invicta Community Care NHS Trust)
261	West Sussex Social Health Care (1)
239	West Sussex Social Health Care (2)
1176	Whittington Hospital NHS Trust
1180	WINCHESTER & EASTLEIGH
120	WORTHING & SOUTHLANDS HOSP
1187	York Health Services Trust (1)
3827	York Health Services Trust (2)
8068	Department for Regional Development—Roads Service (1)
8069	Department for Regional Development—Roads Service (2)
7817	Dept of Finance and Personnel
85	MOD (Scofni) (Previously over counter client)
8096	Rivers Agency
7841	South Eastern Education Library Board
8108	Health Estates Agency
7523	Public Record Office
6024	L H C Building Components and Services
2075	Leeds Construction & Training Agency
6931	Turning Point (1)
6943	Turning Point (2)
69	AVON AND SOMERSET CONSTABULARY 1286 Cheshire Constabulary
118	DEVON & CORNWALL CONSTABULARY
61	GREATER MANCHESTER POL
159	HAMPSHIRE CONSTABULARY
402	HUMBERSIDE POL
200	Kent County Constabulary
1302	Lancashire Constabulary
121	METROPOLITAN POL SERVICE
165	NORTHAMPTONSHIRE POL*
179	WEST MERCIA CONSTABULARY
307	WEST MIDLANDS POL AUTHORITY
1767	WEST MIDLANDS POLICE
180	WEST YORKSHIRE POL
1284	Cambridgeshire Constabulary
303	Essex Police
7301	National Crime Squad (1)
7302	National Crime Squad (2)
7303	National Crime Squad (3)
7814	Nottinghamshire Police
1312	South Yorkshire Police
196	Thames Valley Police
1318	Warwickshire Police
6256	Historic Scotland
2143	National Archives of Scotland
405	O G C (EDINBURGH)
2429	Scottish Agricultural Science Agency
1252	Scottish Ambulance Service Board
4280	Scottish Court Service
5627	Scottish Education Authority
5628	Scottish Education Authority (2)
5446	Scottish Executive (2)
2430	Scottish Executive Development Dept
2431	Scottish Executive Fisheries Research Services
49	SCOTTISH EXECUTIVE, EDINBURGH
3207	Scottish Natural Heritage (2)
133	SCOTTISH PRISON SERVICE
7992	Scottish Public Pensions Agency
1759	LANARKSHIRE DEVELOPMENT AGENCY*
1714	MORAY BADENOCH & STRATHSPEY EN*
2122	Scottish Enterprise Fife
142	Scottish Enterprise Glasgow
2076	Scottish Enterprise Tayside

<i>Coni Ref no</i>	<i>Client name</i>
264	National Galleries of Scotland
3275	National Library of Scotland
65	NORTHERN LIGHTHOUSE BOARD
8141	Scottish Children's Reporter Administration
3206	Scottish Natural Heritage
7099	Argyll & Clyde Acute Hospitals NHS (1)
7100	Argyll & Clyde Acute Hospitals NHS (2)
7101	Argyll & Clyde Acute Hospitals NHS (3)
7102	Argyll & Clyde Acute Hospitals NHS (4)
1253	Ayrshire & Arran Acute Hospitals NHS
7313	Dumfries & Galloway Primary Care NHS Trust (1)
7314	Dumfries & Galloway Primary Care NHS Trust (2)
1229	Falkirk & District Royal Infirmary
2142	Fife Primary Care NHS Trust
2130	Forth Valley Primary Care NHS Trust
1233	Grampian Primary Care NHS Trust
1234	Greater Glasgow Primary Care NHS
5417	Highland Acute Hospitals NHS Trust
3902	Highland Primary Care NHS Trust (1)
3903	Highland Primary Care NHS Trust (2)
3904	Highland Primary Care NHS Trust (3)
3905	Highland Primary Care NHS Trust (4)
4567	Lanarkshire Acute Hospitals NHS Trust
1240	Lanarkshire Primary Care NHS Trust
5664	Lanarkshire Primary Care NHS Trust
7310	Lanarkshire Primary Care NHS Trust (3)
2111	Lomond & Argyll Primary Care NHS Trust (2)
2110	Lomond & Argyll Primary Care NHS Trust(1)
7106	Lothian Primary Care NHS Trust
2152	Lothian University Hospitals NHS Trust (1)
1249	Renfrewshire & Inverclyde Primary Care Trust (1)
5377	Renfrewshire & Inverclyde Primary Care Trust (2)
395	STIRLING ROYAL INFIRMARY
2139	Tayside Primary Care NHS Trust
7018	Tayside University Hospitals
5549	The State Hospital
5445	Western Isles Health Board
1260	Yorkhill NHS Trust
1688	Clackmannan College of Further Education
8220	Dumfries & Galloway College
1696	Elmwood College
359	GLASGOW CALEDONIAN UNIVERSITY
1690	Glasgow College of Building & Printing
1691	Glasgow College of Nautical Studies
5795	Glenrothes College
184	HERIOT WATT UNIVERSITY*
5912	James Watt College
7081	Jewel & Esk Valley College
3204	John Wheatley College
6684	Langside College
2419	Lauder College
5733	Moray College
503	NAPIER UNIVERSITY EDINBURGH
1693	Perth College
143	ST ANDREWS UNIVERSITY
5840	Stow College
2425	Strathclyde University
134	UNIVERSITY OF DUNDEE
228	University of Edinburgh
221	UNIVERSITY OF GLASGOW
507	University of Stirling
1915	Scottish Water (1)
1646	Scottish Water (2)
6565	Scottish Homes (1)

<i>Coni Ref no</i>	<i>Client name</i>
6566	Scottish Homes (2)
6940	Angus College
1704	Barking College
5425	Barnsley College
1753	BATH SPA UNIVERSITY COLLEGE
5428	Birkbeck College—University of London
6207	Birmingham Diocesan Schools Commission
7244	Christ's—Hospital School
1994	Churchill College
1984	City & Islington
2057	Edgehill College
6527	Filton College
5854	Hertford Regional College
1674	IMPERIAL COLLEGE OF SCIENCE LONDON
6977	Imperial College of Science (2)
68	MANCHESTER UNIVERSITY
7657	Manor Park Community School
7824	Michael Teppit School
581	Middlesex University
391	NEWCASTLE COLLEGE*
463	NOTTINGHAM TRENT UNIVERSITY
7133	Oxford College of Further Education
5964	Pilning Primary School
1814	Queen Mary & Westfield College
286	Royal Holloway, University of London
6123	South Birmingham College
5690	St Helens College
7003	St John Payne Catholic School
2426	UMIST
416	UNIVERSITY OF BATH
1770	UNIVERSITY OF DURHAM
397	UNIVERSITY COLLEGE LONDON
214	UNIVERSITY OF BIRMINGHAM
145	UNIVERSITY OF BRISTOL*
7228	University of Cambridge
433	UNIVERSITY OF EAST LONDON
434	University of Essex
42	UNIVERSITY OF HULL
2068	University of Kent
157	UNIVERSITY OF LEEDS
449	University of Liverpool
451	UNIVERSITY OF LONDON
459	University of Newcastle upon Tyne
460	University of North London
135	UNIVERSITY OF NORTHUMBRIA
468	University of Portsmouth
243	UNIVERSITY OF SHEFFIELD
475	University of Southampton
392	UNIVERSITY OF SUNDERLAND
363	UNIVERSITY OF SURREY
5528	University of Sussex
114	UNIVERSITY OF TEESSIDE
2069	University of West England
485	UNIVERSITY OF WESTMINSTER
486	University of Wolverhampton
205	UNIVERSITY OF YORK
1859	Wakefield College
483	WARWICK UNIVERSITY
1860	Working Mens College
1904	Cardiff University Estates Division
231	DVLA
7925	Welsh Development Initiative Team
56	WELSH HIST MONUMENTS CARDIFF
7743	Welsh Dev Agency

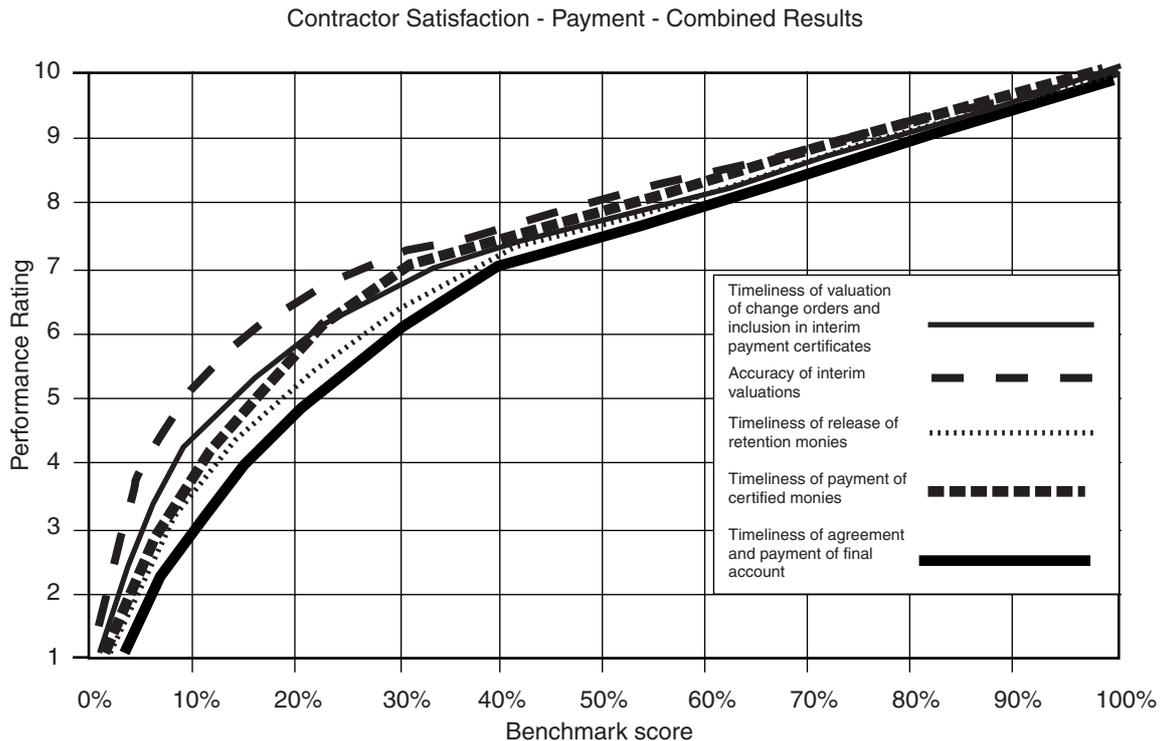
<i>Coni Ref no</i>	<i>Client name</i>
7047	Countryside Council for Wales
553	North East Wales Institute
6377	Office National Statistics
6076	Bro Morgannwg NHS Trust
2091	Cardiff & Vale NHS Trust
1874	Carmanthshire NHS Trust
1191	Ceredigion & Mid Wales NHS Trust
6015	Conwy & Denbighshire NHS Trust (1)
6016	Conwy & Denbighshire NHS Trust (2)
7843	Gwent Healthcare NHS Trust (1)
7843	Gwent Healthcare NHS Trust (2)
7845	Gwent Healthcare NHS Trust (3)
2098	North East Wales NHS(1)
2099	North East Wales NHS(2)
1206	North Glamorgan NHS Trust
7799	North West Wales NHS Trust (1)
7800	North West Wales NHS Trust (2)
1831	Pembrokeshire & Derwen NHS (1)
1208	Powys Health Care
1209	Rhondda NHS Trust
2033	Swansea NHS Trust (1)
2034	Swansea NHS Trust (2)
164	North Wales Police
2120	Coleg Gwent
7798	Coleg Llandrillo
7179	Deeside College
7371	University of Wales, Bangor
60	UNIVERSITY OF GLAMORGAN
144	UNIVERSITY OF WALES
557	University of Wales Institute Cardiff
489	University of Wales Aberystwth

KEY PERFORMANCE INDICATOR DATA ON PAYMENT AND DEFECTS IN CONSTRUCTION

The Select Committee asked about the use of Key Performance Indicators in construction as a means of measuring the performance of the industry and prompting improvement.

PAYMENT KPIs

There are a number of indicators which allow contractors and subcontractors to measure the performance of main contractors or clients on prompt payment. These are shown on the chart below. Each line on the chart allows the contractor or subcontractor to identify where the performance fits within the overall performance of the industry. The contractor assesses performance simply on the basis of a scale from one to 10 measuring his or her satisfaction. A contractor who receives a satisfaction rating of five for accuracy of interim valuations will therefore be in the tenth percentile of performance in the industry.



A higher graph line on the indicator would therefore indicate that generally satisfaction in the industry is higher in relation to prompt payments of the type indicated. Retentions appear to be a source of less satisfaction, as the graph is the lowest covering a particular payment type apart from the indicator for the settlement of final account.

The real benefit of KPI's is their contribution to project management and performance. Low levels of satisfaction with one particular contractor's payment practices may lead a client to consider whether they should be invited to tender for work in contracting teams in the future.

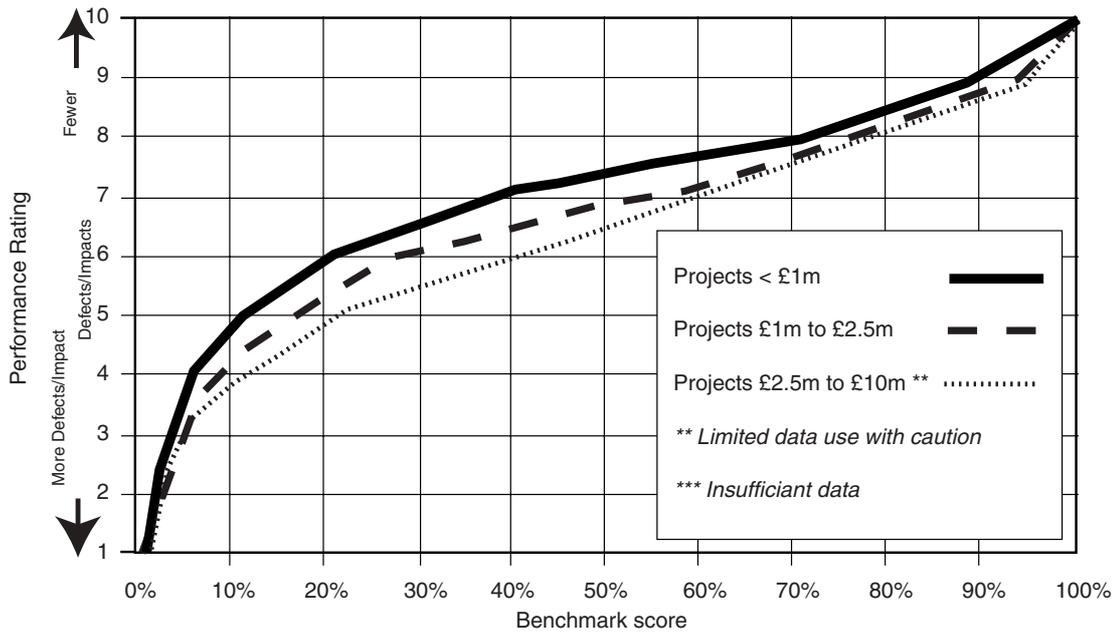
DEFECTS KPIS

KPI's measuring the performance of contractors on the elimination of defects have been developed and made available over a number of years since the original publication of *Rethinking Construction* in 1998. Defects KPI's have proved extremely useful to contractors and clients as a means of assessing the defects performance of their projects. Monitoring of projects using a whole suite of KPIs for cost, time predictability, defects and payment allows a contractor to identify where the firms performance is in particular need of improvement.

Disaggregation of the defects data allows a number of useful conclusions to be drawn. These are that:

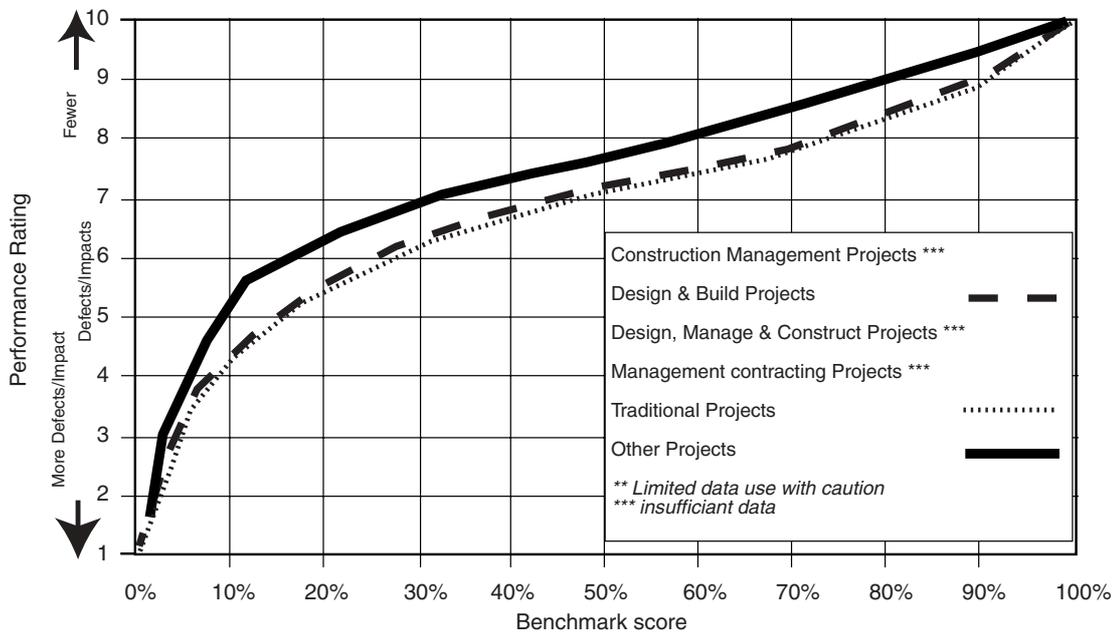
- *Assessment of project performance categorised by their total financial value* suggests the impact of defects is generally greater on higher valued projects. Data is limited for projects over £2.5 million but the general trend is still clear.

Defects - Impact - All Construction - Analysis - By Value

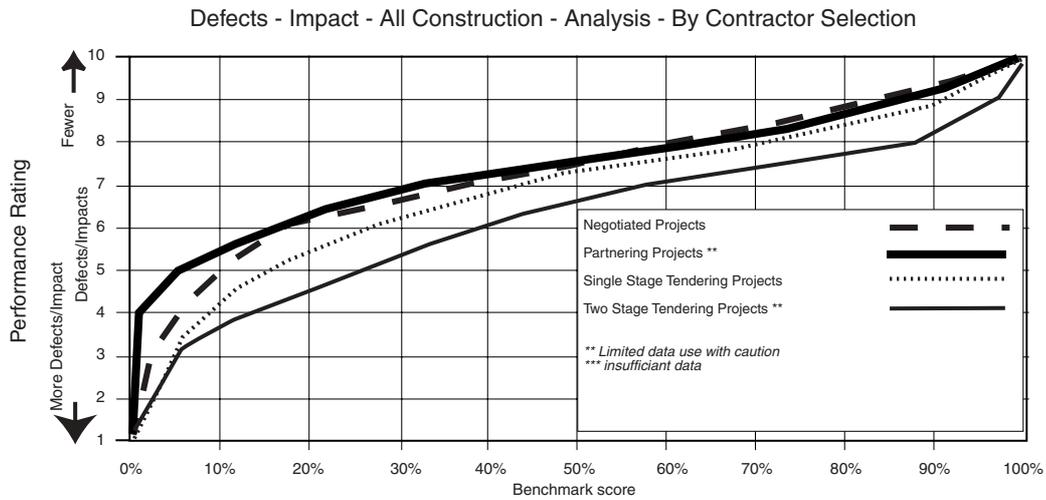


— Assessment of project performance categorised by to procurement type (see top of following page) is relatively inconclusive given that the impact of defects is reduced most effectively by projects not easily categorised. All the procurement types that were specifically assessed are used for one-off project procurements. Projects falling into the category of “other” include longer-term procurements as these vary in type quite extensively. Given the size of the sample falling into the “other” category, it is appropriate to conclude that longer-term procurement relationships reduce defects.

Defects - Impact - All Construction - Analysis - By Procurement Type



- *Assessment of projects by the method of selection of contractors* (below) indicates that the impact of defects is highest on (less integrated) two-stage tendering projects. Partnering projects (which are more integrated) have reduced the impact of retentions.



INSOLVENCIES AND BANKRUPTCIES OF CONSTRUCTION FIRMS¹

England and Wales

Year	Bankruptcies Construction Self-Employed		Company Insolvencies ³ Construction Companies	
	Number	Percentage of Total ²	Number	Percentage of Total
1991	3,812	16.8	3,373	15.5
1992	4,692	14.6	3,830	15.7
1993	4,361	14.1	3,189	15.4
1994	3,362	13.1	2,401	14.4
1995	2,783	12.7	1,844	12.7
1996	2,713	12.4	1,610	12.0
1997	2,182	11.0	1,419	11.3
1998	1,919	9.8	1,325	10.0
1999	1,911	8.8	1,529	10.7
2000	1,741	8.1	1,474	10.3
2001	1,783	7.6	1,509	10.1

Notes:

¹ Based on the definition of the construction industry as given in the Revised 1992 Standard Industrial Classification.

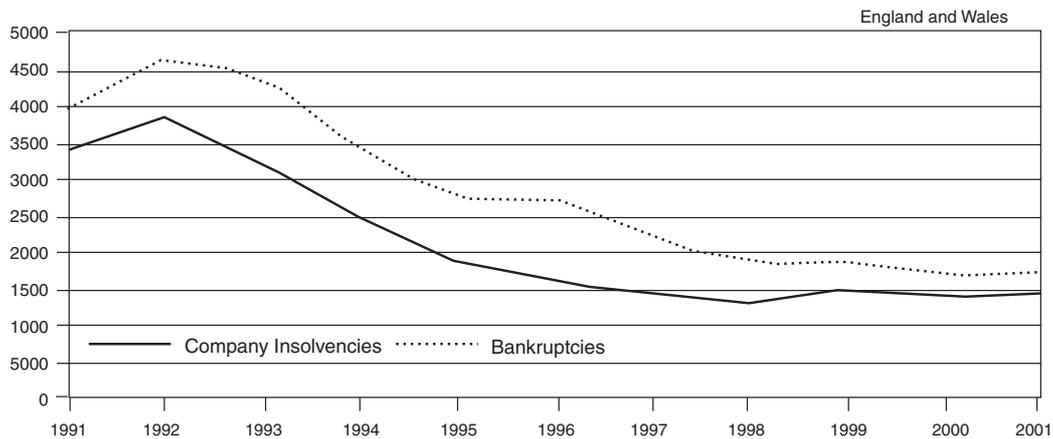
² Includes employees, unemployed, directors of companies as well as individuals whose occupation is unknown.

³ Including partnerships.

Source of Data: Construction Market Intelligence, Department of Trade and Industry.

Contact: Abby Sneade 020 7215 1930.

Figure 3.1 Insolvencies and Bankruptcies of construction firms



Source of Data: Table 3.2

CENTRAL GOVERNMENT TASK FORCE (CGTF)

Background

The Central Government Task Force comprises senior representatives, many at Chief Executive level, from Government Departments, Agencies, and Non-Departmental Public Bodies, with control over the most significant construction expenditure. It meets about three times a year on average, and is chaired by the Chief Executive of the Office of Government Commerce (OGC).

The Taskforce has played a significant role in achieving the targets set for the first three years of the Government's improvement strategy, *Achieving Excellence in Construction* and its supporting Action Plan. It will play an equally important part in delivering the *Achieving Excellence* future strategy.

The Taskforce reports to the Chief Secretary to the Treasury and the Movement for Innovation Steering Group, chaired by the Minister for Construction, and through that Steering Group to the Deputy Prime Minister.

Terms of Reference:

- commit to and be accountable for implementing improvement targets within their own organisations and through this commitment, aim to influence other Government and Government-funded organisations;
- review progress being made by the Taskforce members in their own organisations;
- monitor progress being made by Government as a whole via reports from the OGC Property and Construction Panel;
- identify further initiatives required to develop Government's performance as a construction client.

Membership

Defence Estates
 Department of Culture, Media and Sports
 Department for Education and Skills
 Department of Trade & Industry
 Highways Agency
 HM Prison Service
 NHS Estates
 Office of Government Commerce
 Office of the Deputy Prime Minister

PROPERTY AND CONSTRUCTION PANEL (P&C PANEL)

Background

The P&C Panel reports through the OGC Chief Executive's Advisory Group (CEAG) to the OGC Supervisory Board. This high level buy-in ensures that the decisions taken by the Panel and any associated groups or fora have authority both across government and within participating departments. The Panel provides leadership and takes responsibility for matters of general interest to the central civil government property and construction community, including *Achieving Excellence*.

Terms of Reference:

- To take responsibility for considering cross-government issues that affect property and construction procurement including asset management and, as necessary, notifying the Chief Executive's Advisory Group (CEAG) and advising the Supervisory Board and OGC as well as liaising with the Sustainability Development Group.
- To identify, develop and agree best practice in, and operational guidance for, property and construction procurement.
- To advise OGC about significant developments affecting departments' property and construction procurement, and about the critical areas in which departments require support through advice, guidance, training and frameworks.

Membership:

Defence Estates
Department of Culture, Media and Sport
Department For Education and Skills
Department of Trade & Industry (Construction Directorate)
Department of Work and Pensions
Foreign & Commonwealth Office
HM Prison Service
Highways Agency
Home Office
NHS Estates
Office of Government Commerce
Office of the Deputy Prime Minister
The Court Service

APPENDIX 7**Supplementary Memorandum by the SEC Group**

At the end of the above hearing you kindly gave those in attendance the opportunity to respond to any points raised during the evidence that required clarification, and the substance of this letter deals with a few such points. However, we should like to re-state what it is that we are asking the Select Committee to do. We believe that the Select Committee has an opportunity in its Report to change the industry for the better.

The Specialist Engineering Contractors' Group is not seeking major legislative change, but is asking the Select Committee to do the following:

- A recommendation to the Department of Trade and Industry (DTI) that retentions be phased out by 2007 (or earlier) on all public sector works;
- A recommendation to DTI that in the interim, that measures to protect contractors against abuse and insolvency is taken.

We have developed these issues in the attachment to this letter.

Professor RUDI KLEIN
SEC Group
Chief Executive

29 October 2002

What are we asking the select committee to do?

We invite the Committee to recommend to the Department of Trade and Industry (DTI) that retentions be phased out by the end of 2007 (or earlier) on all public sector works contracts at all levels of contracting including those construction contracts which are wholly or partly funded by the public sector. *We believe that a target is essential. Retentions will not "wither" away; unfortunately, bad practice has more of an enduring quality than good practice. As Mr Derrick East said in evidence: "Retention is bad practice, it needs to be out of the way in order for good practice to flourish."*

The DTI will, no doubt, have to engage with the Office of Government Commerce and the Central Government Construction Taskforce to ensure that the 180 spending departments and agencies are informed. Some of the largest spending departments are, of course, already on track to phasing out retentions by this target. However, it is important that the DTI tracks progress towards phasing out retentions to ensure that the target is met.

The DTI will also need to engage with the Office of the Deputy Prime Minister (ODPM) in order to persuade the ODPM that local authorities should be requested to meet this target.

"it is important that the public sector demonstrates that it is a best practice client. . ."

(para. 4.10 Accelerating Change)

POSSIBLE INTERIM MEASURES

The commitment to the phasing out of retentions is paramount. However, in the interim, we suggest three areas where measures can now be taken.

1. *Insolvency Protection*

Firstly, according to the H&V News survey (submitted to the Select Committee) 25 per cent of the respondents (mainly building services firms) lost over £50k over the last ten years because of insolvencies higher up the payment chain. If this figure were to be projected across the industry the losses from insolvency would run into millions of pounds. Whilst the Committee is aware that the Strategic Forum for Construction will be commencing a study to consider changes in insolvency law and practice we invite the Select Committee to consider an immediate measure.

Public sector contracts for construction works should require that the client lodge all retention monies in a separate ring-fenced account for the protection and benefit of sub-contractors. This will ensure that, in the event of insolvency of the first line contractor, the retention monies can be paid directly to sub-contractors.

2. *Retentions to be released on the satisfactory completion of work*

Secondly, in the SEC Group submission, we highlighted the major problem that recovery of retentions is never contemporaneous with the completion of satisfactory work. Their recovery is usually dependent upon issue of certain certificates under the main contract; sub-contractors have no control or influence over the issue of these certificates. This affects all sub-contractors and sub-sub-contractors especially the early trades such as piling and steelworks. The steelwork contractor, for example, will have satisfactorily completed his sub-contract for the steel frame at the outset of the project but will have to wait some years before he is able to recover his retentions. Moreover, since retentions are not recovered on the completion of satisfactory work, it is difficult to argue that they constitute an incentive to deliver defect-free work.

It will only require an amendment to the standard (Government) contract form to implement this change. Consequently as a further measure, we invite the Committee to recommend a change in Government contracts (including sub-contracts) that—where cash retentions are required—the retentions are repaid on completion of the contractor's proper discharge of his contractual obligations.

Whilst this change might be welcomed as an immediate, interim step, it should be part of a planned discontinuation of retentions in their entirety. The phasing out of retentions must remain the target.

3. *Qualification of Firms*

Thirdly, we refer to the issue of qualification. Our earlier submission emphasised that construction work should only be carried out by firms that are properly resourced and have the technical ability to carry out the type and volume of work required. The appointment of such firms is the best way to achieve overall quality for clients. The industry has invested in qualification schemes for firms that aim to demonstrate that they can deliver the necessary quality. We invite the Select Committee to recommend that public sector promote and use firms qualified under these schemes.

ISSUES RAISED IN THE COURSE OF EVIDENCE TO THE ORAL HEARING

The following are the issues raised in the course of evidence that we believe require some further clarification.

One-off and occasional clients

We agree with the response of the Confederation of Construction Clients in oral evidence to the Committee that clients are unlikely to get a better quality service because of retentions. The Confederation acknowledges that the system is imperfect. One can argue over the degree of imperfection, but the critical issue is the cost of retentions—both the cost to individual firms (especially small firms who bear the burden of financing retentions) and the macro-economic cost to the industry and its clients.

The Confederation, however, made the point that clients need redress. There is always redress if work is not performed in accordance with the contract. Apart from the usual claim for damages for breach of contract, the payer will also have other “incentives” at his disposal. Payments are always made in arrears and, generally, by the end of the contract there are large sums of money outstanding because of “variations” and “extras”. The problems are exacerbated at the level of sub-contracts. The length of payment cycles is increasing. Jarvis Construction plc⁵⁴, for example, has a clause in its sub-contracts that payment cycles will be of three months duration!

⁵⁴One of the top 20 national contractors.

One-off and occasional clients do require help but there are now in place a number of actions designed to help this type of client including the proposal in Accelerating Change for an independent client advisor. Again, the use of qualified contractors will also help. But, as we stated in our report, the major cause of defects is a lack of information and/or inadequate information. This is primarily addressed by the industry continuing to develop teamworking and partnering arrangements advocated in the Accelerating Change report.

INSOLVENCY OF CONTRACTORS

A point made in evidence by the Confederation of Construction Clients was that clients had to be protected from the insolvency of contractors and sub-contractors. The statistics given by the DTI representatives were that 1,509 insolvencies occurred last year in the construction industry. There are a total of 168,000 VAT registered firms in the industry and therefore this represents less than 1 per cent of firms becoming insolvent.

The bulk of the firms that become insolvent are SMEs often carrying out work as sub-contractors. Many of these insolvencies are due to problems of late payment and payment abuse. This leads to another issue. The system of retentions does not embrace any mutuality; there is no similar form of security available to firms carrying out work when faced with the insolvency of a payee. A point made by Mr Derrick East in his evidence was that firms in the construction industry are obliged to repose a massive degree of trust in payers higher up the payment chain that, *eventually*, they will pay for the work.

There is one further point concerning insolvency that is worth making. During the course of evidence, reference was made to the position of retention in the case of client insolvency. It was pointed out that public sector clients do not become insolvent. However, this does not protect the subcontractor who is one or more levels down: intervening contractors do on occasion become insolvent, and subcontractors become unsecured creditors.

THE POSITION OF CONSULTANTS

The confederation of Construction Clients in evidence stated that consultants provide professional indemnity insurance, the implication being that this was an alternative to retentions. PI insurance is personal to the policyholder—the consultant. It does not involve the provision of cash to the payer. The insurer will only make a payment under such policy when there is a judgment of a court an arbitrator's award or, possibly, an adjudicator's decision to the effect that the consultant has been guilty of negligence in the discharge of his/her responsibilities. The client will have to prove in these proceedings that the consultant has been negligent. Contractors, especially sub-contractors, are often denied their retentions when they are not at fault. (Mr Trevor Hursthouse gave an example in his evidence.)

Furthermore, specialist contractors—especially those carrying out design work—will provide PI insurance in any event. This requirement is insisted upon in warranties demanded by funders, developers and prospective tenants/occupiers/purchasers. These warranties normally require that the specialist contractor maintain a PI policy for at least 12 years from completion of the project.

Manufacturers are also heavily involved in construction work but they do not provide retentions.

Part II of the Housing Grants, Construction and Regeneration Act 1996 and the Late Payment of Commercial Debts (interest) Act 1998

In the evidence provided by the DTI representatives it was suggested that the existence of the above legislation was helping to ameliorate the problems with retentions. Unfortunately, this is a “red herring” since neither of these pieces of legislation outlaw retentions but, more importantly, do not address the length of payment cycles nor the problems associated with non-recovery of retentions through insolvencies upstream.

To what extent do firms reflect the cost of retentions in their pricing?

During the oral evidence the answer to this question was not clearly established. Firms appear to deal with this issue in different ways depending upon their position in the marketplace and the state of the market; some firms will seek to include an amount in their prices for retentions. However, this can only be an estimate since there is no certainty of the date on which retentions will be recovered particularly if the company concerned is a sub-contractor. In practice, the majority of firms are not able to accommodate the real cost of retentions in their pricing because of rounds of price negotiation aimed at achieving the lowest price. There is also the difficulty of building into the price many other requirements (covering the same “ground” as retentions) such as warranties, performance bonds, parent company guarantees and lengthy payment cycles.

The fundamental issue is whether firms in the industry—especially SMEs—should be required to price what is, in effect, a banking service. However, this is a banking service with a difference since it involves lending £3.325bn at any one time at nil percent interest without any guarantee that this sum of money will ever be returned. We are not aware of any other industry, which hands over such a vast amount of money with no questions asked!

The domestic market

If the Select Committee recommends the phasing out of retentions in the public sector this will not affect the domestic market, that is, works carried out at the request of individual householders. We fully support the Government's Quality Mark Scheme, which will enable householders to identify good quality firms that will warrant their work.

The problems associated with retentions

During the oral hearing there was little opportunity to explore the extent of retention abuse but the Select Committee will gauge from the selection of letters in our submission that such abuse is widespread. As a result retentions have generated countless disputes in the industry. In fact the existence of retentions often acts as an incentive to the payer to find problems with the works thus justifying non-payment or delay in paying retentions. This has, of course, helped to fuel adversarialism in the industry and perpetuate poor relationships. These problems alone, in our view, are sufficient reason for the public sector to end the practice.

Retentions represent a massive waste of resources. There is no "hard" evidence that they help to reduce the incidence of defects or encourage contractors to return to remedy defects. In fact there is evidence to the contrary⁵⁵. Defects are inherent in a culture (embedded within client organisations and the industry) that doesn't seem to plan and/or design out defects at the outset or manages out defects as work proceeds. Time and time again specialist contracting firms have been frustrated at their inability to become involved in projects at the outset since such early involvement would enable them to advise clients on materials, components, methodologies and processes which would be better suited to the client's needs.

We acknowledge that there are those firms, which are the "bad apples" in the industry. But, such firms are just as unconcerned about delivering quality as they are about many other matters such as the health, safety and welfare of their employees. The *Accelerating Change* report makes clear that we should aim to have an industry in which both firms and their employees are qualified and competent.

Retentions in other jurisdictions

The Select Committee expressed an interest in receiving information on the extent to which the practice of retentions applies in other countries. We understand that Mr Glen Loftus, an MSc Construction Law student at Kings College London has submitted to the Committee a copy of his dissertation on retentions. His dissertation provides helpful information on the practice of retentions in other countries and also construction-specific insolvency regimes in other countries that provide protection for firms supplying labour and materials.

Whilst the practice of retentions is fairly widespread, there is often a greater freedom for the contractor to offer alternatives to retentions such as bonds, guarantees and even government stocks. Many states in the United States have statutory restrictions on the use of retentions (or retainage) within the public sector. These may seek to limit the amount of retention, set time limits on the withholding of retention or require that retentions are released to subcontractors following release by the client. Interestingly the state of Arkansas has legislation that stipulates that retentions are not to be deducted from those parts of progress payments on public sector contracts that include the cost of materials or equipment stored on site. In Colorado state law stipulates that retentions are not to be withheld on public sector contracts after the work has been 50 per cent completed. This applies to all contracts including sub-contracts. New Mexico has just passed a law that requires that all retentions to be held in a separate *escrow* account. The Federal Government in the United States does not deduct retentions on federal works unless there is good cause:

"Retainage should not be used as a substitute for good contract management, and the contracting officers should not withhold funds without cause. Determinations to retain and the specific amount to be withheld shall be made by the contracting officers on a case-by-case basis."

(Federal Acquisition Regulation 32.103)

In France, the use of retentions in the private sector is governed by statute. The use of retentions is confined to defects claims and the retention monies must be entrusted to a third party agreed by the parties. Furthermore, many of the common law jurisdictions (United States, Canada, Australia and New Zealand) have legislation that offers a measure of insolvency protection. In Europe, France and Germany, for example have legislation that requires all those procuring work (including main contractors procuring work from sub-contractors) provide security (such as bonds, bank guarantees etc) for payment. In France there is legislation requiring clients to make payment direct to sub-contractors in the event of non-payment by main contractors.

⁵⁵ A Government report, "Contracting in Civil Engineering since Banwell" (HMSO 1967) acknowledged that the use of retentions for these purposes was rare. Also we indicated in our report that there have been no calls on the guarantee scheme offered by the Lift & Escalator Industry Association or on the bonding scheme provided by members of the British Constructional Steelwork Association. In evidence, Mr Trevor Hursthouse, said that, in his experience of over 30 years as a director, retentions have not been used to require his firm to remedy defects.

APPENDIX 8**Memorandum by Mainland Contractors**

We note from industry publications, and with vested interest, that an inquiry has been launched by the Select Committee into the construction industry retention system.

Mainland Contractors Limited operate primarily as a subcontractor to Main Contractors and Construction Managers, predominantly undertaking groundworks and civils elements for major industrial and commercial developments.

We are generally contracted under one of the traditional forms of subcontract, that is DOM 1, DOM 2 or CECA blue form.

In line with the terms and conditions of those forms of subcontract, our retention releases are conditional on the Main Contractor receiving his Practical Completion for triggering half release and the issue of the Maintenance Certificate (normally 12 months later) for release of the final moiety.

It is often the case that our works are completed well in advance of those of the main Contractor and yet our retention is withheld. Further, at the expiry of the Maintenance Period, we are proactive in resolving all of those items under our control which might prevent the final certificate being issued. We are, nonetheless, powerless to recover our own final moiety of retention until the Main Contractor and all of his other subcontractors have fulfilled their own obligations in line with the contract. Clients and their representatives rarely seem to timeously issue defects lists or actively seek to draw the contract to a conclusion with the associated final release of retention. We currently have examples where, despite regular correspondence and telephone calls to the Construction Manager, a substantial retention sum remains outstanding some three years after our works were completed.

We are aware of the protection afforded to us by the Construction Act, although test cases appear to be ongoing, but notwithstanding this, our client relations and future work opportunities would be seriously jeopardised if we were to resort to the Act each time a retention was delayed.

We have had a degree of success in implementing retention bonds in the favour of our clients, but their acceptance of this is at their discretion. The cost of the bond is exclusively met by us as a trade off for its acceptance.

Our own subcontractors suffer the same penalties as ourselves since the problem obviously extends down the chain to them.

The issue of retention needs to be addressed as a matter of some urgency. Retention bonds are, in our view, the way forward, giving the client comfort that funds exist to rectify defects in the event of default by the contractor or subcontractor.

It would be relatively easy to incorporate the provision of a bond into the industry standard forms of contract and subcontract, without the need for legislative measures.

We would be pleased to offer further comment in this regard and would ask that you contact the writer for any additional information that you may require.

Mainland Contractors Limited
R G Martins
Construction Director

6 August 2002

APPENDIX 9**Memorandum by NT Security**

We have received the press notice PN 32 2001-02 regarding Retentions in the Construction Industry and would like to state our view on the subject, by responding to each of the questions in the release and then giving some examples.

(a) Retentions do not provide any incentive to eliminate defects. All it does is provide the ultimate client and main contractors a reason to delay payment of large amounts of cash. At the completion of all projects a pre handover snagging is carried out by the architect/consultant and again at handover. This then releases a completion certificate and retention is reduced to 50 per cent. At this stage all retention should be released as the client has snagged a project at least twice by this time. 95 per cent of sub contract companies are in the same position as we are, in that we want to work with the same client again and again, so the standard of workmanship is very high anyway and defects that do come up after 12 months are 99.9 per cent due to damage by the client and or third party problems.

Eg a recent call was from a builder who stated that two CCTV cameras were not recording, according to the client's snagging list. When we checked the log and recording equipment on site, and found no tape was in the VCR. The member of staff who controlled the system and changed the tapes on a daily basis had retired

and no one had bothered to change the tapes and even check if there was one in it. No other problems were found on this site and we have waited 19 months for the release of £2,245.

All projects require insurance cover in Failure to Perform, Efficacy cover, All Risks, and in some cases performance bonds. With all this in place why do they also need to deduct retention?

(b) There are only grounds for holding retention while the project is in progress. At completion each section should be viewed and retention released and not as it is now that every trade must be complete and defect free before anyone gets paid. This could be more cost effective, as time spent visiting site, writing letters requesting the release on cash due, credit control chasing would become a thing of the past.

(c) The only cost benefit for retention is made by the Main Contractor and client. The cash stays in the client's bank until he feels like releasing it and if it is under the full amount the builder passes any reduction to all sub contractors insuring their margin stays the same. We also know for a fact that a fairly large proportion of small sub contract companies do not record the full amount of retention being held, as claims for payment will show the reduction and a separate book needs to be kept listing the value of retention outstanding. A large number of Main Contractors only expect about 50 per cent of retentions to be actually claimed.

(d) Retentions should not be applied, full stop.

(e) Where we work direct with clients and no retention is applied we find that we get on as trading partners far better and there is very little conflict. Conflict regarding retention only ever occurs when a Main Contractor is involved.

(f) There are no obstacles in the way of abolishing retentions. There are also no consequent savings as the cash is due in the first place to the sub contractor as it is part of the tender bid. The savings will be for companies such as ours where we save in wasted time and expense to get what is ours anyway.

(g) We currently have £10,644 outstanding retentions and two of these are nearly three years old. More details are as follows.

As a specialist Security Company, we have to provide a service and maintenance package for all projects to comply with our trade association guidelines.

Retentions are held on the pretence that it is for a 12 month defects period, but in our trade we provide commissioning, staff training, service and support from the date of handover to the client. Therefore 12 month defects period does not come into the equation. We have argued this on numerous occasions with Main Contractors and the reply we receive is always the same. "It is in the contract."

When it comes to claim the retention the excuse is also always the same, "The 12 month defects have not been signed off".

The defects do not get signed off by the client/architect for problems with other trades and therefore nobody gets paid.

We have an example of a major Hotel project at Heathrow which was installed in 1999 and the building has a design fault with the roof and has continuous leakage problems. This builder (John Laing) has not paid us and is using the same excuse and again when we argued that the problems they have are structural and nothing to do with the Security system we were told they can not pay us until they are paid. We contacted the client direct, as we have a close relationship with them after three years of supporting the systems, and we were informed that the builder has severe roof problems. When LAD's are applied for late completion, plus the damages for the leak problems and offset against outstanding cash, there would not be any cash due to the builder.

Therefore £3,000 due to us, we will not get and we end up funding the builder's failures. This applies to all trades that were on this project who all had 5 per cent retention held back. In the end the builder will recover a large proportion of the costs for his failures and the losers are the numerous sub contractors on the project.

I would welcome hearing your views on the above and should you require any further information please do not hesitate to contact the undersigned.

C Underwood
Operations Director

12 August 2002

APPENDIX 10

Memorandum by Euro Windows

I understand that you are holding a short inquiry on the above subject and offer our company's experience.

We are a commercial aluminium double-glazing company, undertaking fabrication and installation of windows and doors, mainly to the public sector and in particular to social housing and education projects. We work both as main contractors and as sub-contractors on such schemes. Our turnover is in the region of £5.5 million per annum and contracts undertaken can start from a few thousand to over a million pounds.

The process of retentions is simply inefficient, especially on small contracts. As an example, I have recently spent months chasing a retention of around £100 following the expiry of a one year defects period. By the time retention is payable, often staff have moved on, the file has been archived and the costs on both sides to clear the matter inefficiently accumulate. The situation is further exaggerated and prolonged when acting as a sub-contractor to a main contractor or acting as a main contractor with sub-contractors requiring their retention payments.

One could simply say that it was uneconomic to chase such amounts but is it right to just give up on an amount of money that represents a large portion of the profit on a contract? Being unable to receive this for at least six or 12 months after a project is completed seems absurd and the cashflow situation could simply deter smaller firms from undertaking larger contracts, limiting expansion, growth and investment.

Of course, the purpose of retentions is to ensure defects work is performed before the final cheque is issued and the contractor or sub-contractor disappears into obscurity. In reality, for quality reputable companies, it is not the retentions that force the defects work to be completed, but a desire to be professional, to do a good job and to get repeat work.

A company such as ours relies on repeat business and the chance to tender time and time again for past clients. Retentions are an administrative burden and a financial burden upon us all.

If local authorities can be made to eliminate retentions, and if they are prepared to work together with reputable companies, improving processes and improving communication throughout projects, then a more effective way of working will result.

Andrew Knights ACA
Accountant

16 August 2002

APPENDIX 11

Memorandum by The British Constructional Steelwork Association Limited

1. The British Constructional Steelwork Association (“BCSA”) is the national organisation for the constructional steelwork industry: its Member companies undertake the design, fabrication and erection of steelwork for all forms of construction in building and civil engineering.

2. BCSA is a member of the Specialist Engineering Contractors’ Group and fully endorses the submission to the Select Committee made by that body.

3. The practice of retention has caused difficulties for members of BCSA for many years. Members are usually in the sub contract position in the contractual chain, and by virtue of the work they do, are one of the earliest trades on site.

4. It has been commented⁵⁶ that retention depends specifically on a mechanism being drafted within the specific contract executed by the parties. Nevertheless, the writer continues, retention “because of its familiar nature in standard forms of contract” is now a readily accepted feature of construction contracts. In other words, retention is regarded almost as a standard feature or “given” of construction contracts, although in truth it is purely contractual in nature. Retention has found its way into most of the standard forms of contract used in the industry; although some now allow bonds as an alternative, as yet this is not often used (see paragraph 10 below as to the BCSA position).

5. Typically, the standard forms of contract used within the industry, and the variations on them made by individual contractors and clients, provide for one half of the retention to be paid back upon practical completion of the sub-contract and for the other half to be retained until issue of the final certificate under the main contract—in theory, this is usually a year after practical completion of the whole project. This may mean a wait of some years for the sub contractor early on site and can lead to absurd situations. For instance, some years ago one BCSA member undertook the steelwork for a hospital. The second half of retention was not repaid at the end of the project because the landscaping was not completed properly. The landscaper could not of course replant until the following year, after which a further 12 months defects liability period was required. The steelwork contractor finally received payment about four years later. There was no question of defects in the steelwork. The Specialist Engineering Contractors’ Group submission contains any number of similar examples.

6. Linking payment of the second half of retention to actions occurring under a different contract creates significant difficulties for BCSA members. They have no influence on when or whether the certificate is issued; if the payment mechanism fails or breaks down (for instance, if a certifier is in dispute with its client) they have no available remedy. There is no obligation on the contractor to advise sub contractors when a certificate has been issued, so unless the sub contractor maintains a constant vigilance, it will not know when it has become entitled to be paid. This leads to the situation where some sub contractors employ a staff member purely to chase outstanding retentions. This is wasteful and an unnecessary expense in an industry seeking

⁵⁶Darren Gill of Bouygues UK, in this dissertation as part of an MSc degree at King’s College London.

to improve its efficiency. Also, as a trade early on site, BCSA members are at risk of insolvency up the chain for a considerable period of time.

7. Even where allowed contractually, direct payment client to subcontractor cannot take place once an intervening contractor becomes insolvent.⁵⁷ Also, once steelwork is erected it becomes, by operation of law, part of the land and thus the property of the landowner, whether paid for or not. Retention of title clauses are therefore of limited use.

8. There is an argument that linking payment to an event taking place under another contract, whether specifically in the context of retention or otherwise, is not an “adequate mechanism for determining what payments become due under the contract and when”, as required in construction contracts by Section 110 of the Housing Grants, Construction and Regeneration Act 1996. This has never been tested in court, however.

9. The percentage of contract value retained is usually 3 per cent or 5 per cent, although occasionally more. Over a number of years, the average profit margin in the steel construction industry, through boom and bust, is reckoned to have been 3 per cent. To have more or less the same figure, or at least a large proportion of it, outstanding for a number of years is a strain on constructional steelwork companies—overwhelmingly SMEs—and inhibits the development of the industry.

10. To ameliorate the situation, six years ago, BCSA introduced a scheme whereby BCSA members would offer bonds in the place of cash retentions, thus preserving the perceived protection offered by retentions while enabling monies to be paid more quickly to members. This swiftly proved its worth, putting more than £2 million over 57 projects into BCSA members’ hands in the first year, at a cost of £21,422 for bonding. This scheme is now at risk from the Office of Fair Trading, who are investigating the position with a view to requiring the resolution setting up the scheme to be withdrawn. Although individual members will not be prevented from offering bonds instead of retentions, while standard forms of contract, and variations imposed by clients and contractors, contain retention provisions, individual sub contractors have little power to change the status quo.

11. Retention is overwhelmingly regarded as a protection for the project client. It is ironic therefore that results from the Housing Forum Demonstration Projects Report in February 2002 shows that defects are fewer on projects without retention. In the case of constructional steelwork in particular, retention is in any case arguably useless to protect clients. If defects occur throughout the course of the contract, then the steelwork contractor will simply not be paid until such defects are rectified. Once the project is practically complete, if defects appear in the steel frame (a fairly rare occurrence), cost of putting this right is likely to outstrip by far the 1½ per cent or 2½ per cent of the project value retained. It is properly an insurance matter.

12. By the very nature of their work, steelwork contractors have substantial assets in the form of premises and machinery; they are not “fly by night” organisations that will disappear as soon as a claim occurs.

13. The system of retention is outdated, wasteful and a significant burden on the industry. The construction industry in general is being challenged to improve its efficiency, yet clients, by the use of retention—including Government which has committed itself to becoming a “best practice” client—are inhibiting industry’s efforts in this direction.

14. The British Constructional Steelwork Association calls for the phasing out of the use of retentions in all public sector contracts.

Marion Rich

Director of Legal and Contractual Affairs

24 September 2002

APPENDIX 12

Memorandum by the Electrical Contractors’ Association

The Specialist Engineering Contractors’ Group has made a submission to the House of Commons Select Committee for Trade and Industry dated September 2001 on the use and abuse of retentions in the construction industry.

The Electrical Contractors’ Association is the premier body representing the electrical installation industry and is committed to supporting its members in providing the very highest standard of service to clients using the construction industry. The Association has been at the forefront of promoting change in the procurement of construction services for the benefit of clients and our members alike.

Non-adversarial procurement has been proved to work through the Cost Reduction In a New Era (CRINE) initiative practised by many oil companies in the development of North Sea structures. Oil companies will talk about real cost savings of over 30 per cent (when compared on a like for like basis) and a significant reduction in construction defects. This has been achieved by moving away from the traditional construction tendering processes to non-adversarial alliancing and partnering techniques.

⁵⁷ *British Eagle International Air Lines v Compagnie Nationale Air France* [1975]1 WLR.

A feature of the traditional tendering approach is one of mistrust and confrontation. Retentions, that is the withholding of money against a contractor's interim payment for work executed, is symptomatic of this mistrust. The fact that this retained money is not held in trust, and is fully available for the use and benefit of the payer, and will be lost to the recipient in the event of the payer's insolvency, breeds nothing but a spirit of mistrust. Because title to this money is held by the payer, there is a temptation to delay payment for any reason, often spurious, for as long as possible, allowing the payer to benefit from interest free credit at the expense of the payee. This situation serves to foster the adversarial and confrontational relationships which are a feature of the construction industry and which only work to the detriment of all concerned.

Following recent accounting scandals it seems curious that money so retained can appear as an asset in the payer's accounts with no indication that it is in fact a committed expenditure and so can give a false impression of a company's financial position. In addition, the payee will have to show retention monies as income to the Revenue, and so be subject to assessment months, and often years, before actual receipt of the payment.

We are pleased to note that an ever increasing number of professional construction clients have realised the harm retentions cause to the industry and have abolished them from their current procedures. We commend the Specialist Engineering Contractors' Group submission to you, and will always be available should you require further evidence of the way the holding of retention monies is being abused, and works against the best interests of all those involved with and using the construction industry.

David Pollock
Director

25 September 2002

APPENDIX 13

Memorandum by Frank Griffiths Associates Limited

1. *The stated reason for retentions*

While it is true that one reason for retentions is the hope that they provide an incentive to contractors to avoid or eliminate "defects", probably the more widely used intention is "*to encourage contractors to return to remedy defects or to have the money available to employ others in their default*".

It is also true that retentions do not always achieve any of these ends.

This is because it is often difficult to persuade contractors to return to remedy defects during the "usual" 12 months defects liability period. Sometimes contractors will "save up" defects until the end of the 12 months when they will return in order to obtain the release of the retention.

In the meantime, the occupiers, who are not necessarily aware of the contractual obligation or have lost patience waiting for the contractor to return, will have the defect repaired at their own expense.

1a. *Are there changes that can be made that are more likely to have an impact on defects?*

Yes.

- The construction contract should be extended to include a strict service obligation for at least 5 years⁵⁸ with the fee payable (and withholdable) monthly. Accredited contractors should be required to hold a ring-fenced fund or unconditional insurance to secure the service in the event of their insolvency or other failures. We have recommended this provision for many years and note that the Highways Agency has introduced similar requirements into their design and build contracts recently.

We comment on a scheme introduced by the Federation of Master Builders (FMB) in the appendix to this letter and add the view of an FMB member.

ZERO DEFECTS

Otherwise, the most persuasive reason for abandoning retentions would be for the industry, or at least the contractor concerned, to demonstrate a history of zero defects. While there have been reports of some contractors moving in this direction we do not believe that the industry's performance is sufficient to have justified the mounting of the sustained campaign we have witnessed nor the acceptance of the demand to abolish retentions unless in consideration of the requirements of 1a above.

⁵⁸ The reason for recommending 5 years is (a) that the consequences of misuse, inadequate attention by the user or external factors such as, but not limited to, weather, make the implementation of warranties increasingly difficult with time and (b) because the limited statistics available suggest that the probability of major defects arising reduces significantly after about 5 years service.

MINIMISING CONSEQUENTIAL COSTS

The development of a comprehensive, national defects database that records types, rectification costs AND consequential costs of defects to clients would enable all concerned to identify the most common and costly defects that arise.

That information would allow clients to establish whether their proposed consultants and contractors are familiar with such defects and how to avoid them. Those consultants and contractors should also be able to demonstrate their freedom from such defects. Adding such criteria to the selection process, coupled with the 5-year service obligation should offer powerful incentives to avoid defects.

The Building Research Establishment operated a database that sought to provide a database to record defects some two decades ago. However, it received limited information from the supply side and, apparently, none was sought from clients.

In the mid 1990s BRE was awarded a contract by the then Department of the Environment to extend the use of the database but for reasons that are unclear it was abandoned.

We believe that such a database could be a major tool in improving the minimisation of defects but that it would require a major publicity programme to encourage clients to make the reports. However, as the public sector is such a large client of the industry, perhaps it could lead this initiative.

ROGUE TRADERS

A significant proportion of defects are suffered by the clients of rogue traders.

At a meeting held on the 17 May 1999, chaired by Mr Nick Raynsford MP, then the Minister for London and Construction, we responded to five questions raised by the DETR and presented a proposed solution based on registration, feedback and insurance.

The Department accepted an alternative scheme from the trade associations. I believe that it has been admitted the trade association scheme has failed. I also believe that our proposals remain viable.

Two and three no longer appropriate if the answer to 1a is followed.

4. *Consultants and supply only contracts*

Consultancy contracts should be covered by appropriate professional indemnity insurance. Supply contracts should have a warranty appropriate to their anticipated life or for at least five years, whichever is the shorter. (Please see Footnote above).

5. *I am unaware of clients that have disposed with retentions except to replace them as suggested in 1a above.*

6. *What obstacles exist for public sector clients?*

None if the above proposals are introduced.

If retentions were to cease, what would happen to the consequent savings made to the industry?

In spite of the pressure from parts of the industry for retention to cease, we do not believe their abandonment should be contemplated unless replaced by one of the options described above from which we believe that significant savings will result. More importantly, there should follow great improvements in value as outlined below and elsewhere in this letter.

Consequential Costs—More reasons to press for “Zero Defects”

The cost to the industry of remedying defects has been estimated at 2 per cent of construction costs. This sum is equivalent to the level of profit sought by many Main Contractors. It is also the level of many retentions held. However this ignores the often much greater consequential cost to clients that together should increase the pressure to move towards zero defects. (One has only to consider the consequences of defects in construction or inadequate maintenance on the rail industry to appreciate this point.).

7. *There is still much room for improvement in the payment systems and their security. The proposals made in the Chartered Institute of Purchasing & Supply’s 1994 report to Sir Michael Latham could be enhanced now.*

We appreciate the opportunity to tender our views on this and other topical issues. However, in conclusion may we enter a plea for resources to be concentrated on implementing the best of the many reports made over the last 15 years (mainly Egan and Latham) and to commission further research only when it is clear that the means of implementing the results are likely to be available.

We would be pleased to expand on any point.

We are copying this letter to the Confederation of Construction Clients and the Chartered Institute of Purchasing and Supply.

Frank Griffiths

26 September 2002

Annex

Note on the MasterBond Warranty offered by the Federation of Master Builders

Extracts from the FMIB website:

- By arranging your building inspection through your local authority building control department you can insure the work of your own selected builder with MasterBond warranty (providing your builder meets the scheme's standards.
- A MasterBond warranty protects against defects due to faulty workmanship or materials for the first two years, and against structural defects for a further eight years—that's a total of 10 years peace of mind
- MasterBond warranty adds just 1.5 per cent to the total cost of the job (including the cost of VAT)

Hence the scheme requires that the client:

- Ensures that the chosen contractor meets the scheme's standard.
- Arranges for inspection through their local authority building control department.
- Chooses to pay an extra 1.5 per cent of the (eventual) total cost of the job,

For a scheme that:

- Offers a warranty against defects due to faulty workmanship or materials for only the first two years.
- That is within the financial limits of the policy.

Clearly, the scheme does not meet the criteria set out in our answer to Question 1A.

Note of a discussion with a local member of the Federation of Master Builders:

Contractors should have no difficulty in accepting retentions if they are confident in their work and that the client will pay.

He added:

Extended supply-chains can result in considerable effort in administrating retentions.

APPENDIX 14

Memorandum by Tesco Stores Ltd

My name is Kevin Pleass, I am the Operations Director for Tesco Stores Ltd (UK) and have the responsibility for our construction programmes, with a value of over £0.5 billion per annum, in the UK alone.

I know my colleague, Huw Davies, has previously written to Professor Klein on this subject, however, I just wanted to re-confirm our position with regard to the use of retentions in the construction industry.

Tesco's position is that we are opposed to their use and are gradually phasing them out of all our construction related activity. We have commenced this with our partnering contractors and believe that the process is out-dated and goes against the best interests of client/supplier relationships.

Our experience tells us that where there is a need for some kind of claim related discussion with a supplier, that this can be dealt with through the normal processes. Holding a modest amount of money as a retention, which would primarily only cover the resolution of defects, is an out-dated process that only adds to the financial burden, particularly with smaller companies. This penalty is principally passed on by main contractors to small sub-contractors who effectively have to fund and ultimately charge that cost back through their pricing policy.

If you have a particular need to do so, it is simple to introduce performance bonds against high quality/specialist installations where the risk to clients is much higher. Again, we use this policy very occasionally, where we feel it is necessary.

This policy is just one part of Tesco's commitment to make a step change within the construction industry.

We have made great progress, working with our suppliers over the last few years on this subject and continue to do so. Further innovations that both benefit their business and ultimately ours.

I trust this information is helpful to you and I will be happy to provide further details, if the committee so wishes and I look forward to hearing the outcome of the Committee's inquiry.

Kevin Pleass
Operations Director

26 September 2002

APPENDIX 15

Memorandum by UMIST

I have only today become aware of the enquiry and hence my response is somewhat rushed. I am the Director of Estates at UMIST responsible for all construction work at my university. I am a member of the Association of University Directors of Estates (AUDE) and having checked with the Chairman and Deputy Chairman of our association I can confirm that they have not been made aware of this inquiry and have not therefore submitted comment. They are now doing so and it will be with you no later than Friday 4 October 2002. The University Sector is a major client in the construction industry and your consultation would be the weaker if it was not to be heard.

My own university has reviewed the role of retentions in the construction procurement process and has implemented changes that we believe deal with the major issues arising from them.

We have ceased to retain retention sums on progress payments. We believe that these achieve nothing other than to produce cash flow issues for contractors and sub-contractors which are handled by them including costs within tenders to cover for the cash flow. This provides no benefit to any member of the supply chain.

We retain a retention from final payments just before practical completion. We release this, not after a fixed period, but in line with an agreed programme for dealing with defects. If the contractor does not deal with defects in line with the programme then we are free to use the retention to correct defects using alternative contractors. We are working to develop a service level agreement which the contractor agrees to for post contract completion work and release of the retentions will be linked to the contractor performance against the service level agreement.

I hope this is helpful.

V Slater
Director of Estates

27 September 2002

APPENDIX 16

Memorandum by the University of Cambridge Estate Management and Building Service

I heard last night that there is an inquiry into retention in the construction industry and have discovered that the deadline is today. I am sure that the huge majority of clients of the industry are unaware of this review; I imagine that some of the larger, repeat clients (particularly the larger retail, and infrastructure clients such as Highways Agency, Railtrack and BAA) may be aware of the inquiry, but the retention issues are remarkably different for the huge majority of clients who do not have an extensive programme of repeat business.

Most building projects in the British construction industry have a large number of defects when it comes to "practical completion". The well-known reasons for this include notable shortages of skilled operatives, low profit margins resulting in insufficient supervision, the considerable fragmentation of the industry with many contractual and information interfaces on most building sites, and, largely resulting from the above, the common practice in the industry these last few decades of leaving "snags" (defects) until the end of a job hoping that remedial action will either be done by someone else, or not required at all.

For relatively straightforward contracts, particularly where there is repeat business, it is possible to reach a situation through market forces or by negotiation whereby the "snagging list" of defects is relatively short and that can be associated with a zero or low level of retention. However, it is common knowledge that for the majority of clients that it is difficult, or in many cases impossible, to get sub-contractors down the supply chain to return to site to rectify a significant list of defects unless there is a financial reason to do so. To end the practice of retention would exacerbate this situation, and certainly would deprive clients of their ability to trade retention in exchange for high standard of work. Also, it might well lead to holding back larger sums in a less structured way during the payment process, and surely this would be more damaging and risky to the whole supply chain.

I am sure that your Committee will be aware that main contractors and sub/specialist contractors set-off the cashflow disadvantage of retention in their quoted prices for work, so that in practice they are not disadvantaged. By the same token, clients should in theory be able to demand cheaper prices in the absence of retentions, but the Committee should be aware that the cost, and warranty implications of getting defects

corrected when the supply chain will not return to site to do so, are considerably greater than any possible saving achieved by reducing prices following a decision not to impose retention.

Although well aware of the arguments (particularly those from specialist contractors) against retention, I would urge your Committee to conclude that it would be unwise and unbalanced to impose an end to retention. Suppliers can avoid retention by completing building work to the standards achieved in other industries. There could be restraints on mis-use of the retention system (if legislation is deemed necessary) without the strong intervention of a total ban.

Evidence of the above can be made available, and I hope that evidence is being sought from a representative sample of clients. I understand that the Association of University Directors of Estates intend to send you their comments by next Friday.

David M Adamson

27 September 2002

APPENDIX 17

Memorandum by Masons

1. INTRODUCTION

1.1 Masons is a law firm with offices in six offices in the UK. We are rated by both Chambers and Legal 500 as the leading legal advisor to the construction and engineering industry, acting for all parties to construction projects. The views expressed in these submissions are not made on behalf of our clients or any industry bodies, many of whom will no doubt be making their own representations based on their experiences. We aim to assist the Committee by providing an overview.

1.2 In compiling these submissions, we have aimed to address the themes raised by the Committee in its Press Notice. Some are outside our experiences but we hope that the information and comments which we can provide is of some assistance.

1.3 Throughout these submissions we use the term “contractor” to cover both main contractors and sub contractors unless otherwise stated. We use the term “employer” to mean the procurer of construction services.

2. DOES RETENTION ACHIEVE ITS OBJECTIVES?

2.1 Retention is essentially a conditional debt owed by the employer which provides material against which the employer can make set-offs or cross claims. There are a couple of features of this which are peculiar: first, it comprises money which the Contractor is actually entitled to be paid under the Contract (usually as a result of a certificate having been issued); secondly, the total retentions grow during the lifetime of the works as further sums are certified and payments are made. Reference is often made to “retention funds”, however, retention is only a “fund” when a Trust has been set up (this is dealt with below).

2.2 The amount of money retained is usually 5 per cent (half of which is released on substantial or practical completion of the works, the other half to follow once defects have been made good). Where major defects exist, it may well be that the retained monies would actually be insufficient to cover the cost of putting the defects right. On the other hand, in a large project with minimal defects, the amount retained may well be disproportionate to the costs involved in rectification.

2.3 Accordingly, the system of retention has historically been regarded as an incentive to contractors to avoid or eliminate defects rather than necessarily providing effective security in the event of defects.

2.4 It is probably a generally held view in the industry that whilst the system of retention *can* achieve its purpose, it does so in a way which damages cash-flow and trust in the industry as a whole. Furthermore, in trying to protect themselves, the parties to construction contracts can become unnecessarily exposed to legal complexities which arise in relation to trusts and bonds. Finally, it is generally accepted that contractors’ loss of cash flow as a result of the retention system is ultimately likely to be reflected in the price for undertaking work.

3. THE ALTERNATIVES TO RETENTION; ARE THEY MORE EFFICIENT AND COST EFFECTIVE?

3.1 The main contractual alternatives to retention are:

- Retention Bonds.
- Retention Trusts.
- Insurance.
- No retention at all.

We shall make brief comments in relation to each.

3.2 Retention Bonds

3.3 Two types of bond are available and used as an alternative to cash retention: the On-Demand (or unconditional bond) and the Conditional bond. The major difference between the two is that the Conditional bond generally requires fault or responsibility to be proved or established before money is paid out.

3.4 The difficulty of using a Conditional bond instead of the normal retention system is that an attempt to call in such a bond often precipitates a dispute as to whether the call is justified. For employers, ready access to a cash retention is clearly preferable to having to prove that the contractor has defaulted. On the other hand, the risk to a contractor in relation to an on-demand bond is significant as the employer does not have to establish the existence of defects to secure payment. For these reasons, the use of the Joint Contracts Tribunal "Bond in Lieu of Retention" has not been widespread.

3.5 A number of sub contracting bodies have urged their members to insist on Retention Bonds instead of cash retention. However, main contracting bodies are concerned that if their members are required to accept retention bonds from sub contractors whilst, at the same time, being required to accept traditional retention provisions in their main contracts, they will be unfairly deprived of the ability to share the retention risk with their sub contractors.

3.6 A universal system of retention bonds would effectively force contractors to obtain bonds for 3-5 per cent of their total turnover. It is doubtful whether this would be practicable.

3.7 RETENTION TRUSTS

3.8 While retention bonds protect employers, retention trusts protect contractors, however they are hardly an alternative to retention; rather they have emerged to ensure that, in the event of employer insolvency, the contractor can still access the money to which it has an entitlement. Otherwise, the contractor runs the risk of not recovering its money.⁵⁹

3.9 Most of the widely used standard forms provide that the employer's interest in any retention shall be fiduciary as trustee. This creates a contractual obligation on the employer, for which specific performance may be ordered by the court, to set aside its own property in order to give effect to the trust. This is usually in the form of a designated bank account.

3.10 So the creation of a retention trust is merely a way of handling the retained money and protecting the contractor in the event of employer insolvency. It does not solve the underlying issues which have been raised and, due to the complexities of trust law, can create other problems—even where a trust fund is properly constituted.

3.11 INSURANCE

3.12 It has long been an option for contractors to take out a defects policy; the premium for such a policy would normally be borne by the contractor, whose cash-flow would not suffer as there would be no retention of moneys otherwise due. Employers on the other hand, would have the security of knowing an insurance policy was available to meet the cost of any defects in the contractor's work which the contractor failed to rectify.

3.13 Many commentators feel there is already an abundance of insurance related provisions in standard form contracts; most notably the Joint Contracts Tribunal suite of contracts. Taking out yet more policies may become unduly burdensome. Furthermore, depending upon the precise terms of individual policies, the employer may find it difficult to obtain payment under the policy and might therefore prefer access to a readily available retention fund. A further difficulty might arise in relation to the costs of premiums which contractors will wish to see passed on to employers in any event. Although there may be a benefit to contractors' cash flow, there may be no eventual benefit in relation to reductions in project costs.

3.14 NO RETENTION AT ALL

3.15 This may seem a radical proposition, but we are sure the Committee will have received many submissions supporting the benefits obtained by scrapping retentions altogether. To date, a number of high profile public and private employers have dispensed with retentions, generally as a side-effect of moving towards more progressive types of procurement, such as partnering or prime contracting.

3.16 If contracting parties carry out a project as part of a longer term strategy, one of the incentives for the contractor to aim towards zero defects is the award of future work. Both NHS Estates and Defence Estates have done away with retention from their prime contracting arrangements. It has been noted that when employers or main contractors announce that they are abandoning retentions, it is often because they

⁵⁹ . . . it being a principle of insolvency law that a company's property on a winding-up, other than preferential debts, rank equally and if there are insufficient funds for them to be paid in full, they abate in equal proportions between themselves. In the case of *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] the House of Lords held that it is contrary to public policy for the courts to give effect to contracts which purport to nullify that principle.

are focusing on fostering closer, partnering style relationships with a smaller number of contractors/sub contractors.

3.17 Some commentators have argued that the use of stage or milestone payments would eradicate the need for retention on the basis that the contractor would receive payment upon completion of defined sections of the work. In practice, as a stage becomes close to completion, or a milestone is approached, completion of “snagging” items would become a pre-requisite to payment; rather in the same way as retention operates now except the whole of a stage payment would be retained rather than a minor percentage of such amounts. Whilst milestone payments are appropriate in certain circumstances, our experience is that contractors are generally reluctant to abandon the traditional valuation system of payment.

4. EVIDENCE ON THE EFFECTS OF RETENTION

4.1 We would refer the Committee to three surveys which may be of assistance.

4.2 The first is the report published by the BSRIA on behalf of Goodmarriott & Hursthouse Ltd and the Specialist Engineering Contractors’ Group, dated March 2002. The survey appends case studies of trade associations which have introduced alternatives to retention.

4.3 Another survey which may provide useful information, albeit from eight years ago, is the “Construction Sector Retention Survey” carried out by Richard Hopper⁶⁰ which in part deals with security of payment issues as looked at in section 3 above.

4.4 Finally, the Reading Construction Forum produced a booklet entitled “Financial Protection in the UK Building Industry—a guide for clients and the construction supply chain” which gives the results of a survey they carried out among industry groups including clients and contractors.

4.5 There are two further consequences of retention for the solvency of contractors. The first concerns credit factoring, the second concerns the effect of the insolvency of the superior party.

4.6 A contractor can improve its cash flow by factoring its debts, ie by selling them to a credit financier in return for immediate discounted payment from the financier. Retention is however universally excluded from factoring agreements. The continuing use of retention therefore not only restricts cash flow but impedes measures available to the contractor to improve cash flow in the form of credit factoring.

4.7 Retention also has an effect on the way simple property developments are funded. For example, during the last recession we represented contractors in many cases in which the developer had arranged bank funding for a significant percentage of the contract sum, with the balance being self funded. Often, the developer went into receivership or liquidation immediately after practical completion when tenants and purchasers could be compelled to complete their agreements for lease or purchase but leaving the contractor exposed in respect of its retention. This can be seen as unfair especially as it is impossible for the contractor and sub-contractors to retain legal title to materials fixed to the land.

5. CONCLUDING SUBMISSIONS

5.1 We believe that the majority of submissions the Committee receives in relation to this inquiry will show industry-wide disapproval of retentions. However, there is likely to be some divergence between different sectors of the industry over what to use in replace of this discredited system. For example, we would expect specialist contracting organisations to call for the universal use of bonds. The obvious point should be made, however, that trust funds and bonds have only been developed because of the existence of retentions. Without retention, such devices would be unnecessary.

5.2 One of the options available to the Committee would be to recommend that retention provisions are prohibited—a matter which we would submit is relatively straightforward using existing legislation. Other countries (including a number of American States and France) have legislation in place capping the amount of permissible retention.

5.3 In the US, Stockenberg and Woodbury (1996)⁶¹ point out:

“No other industry has a concept like retention. Who besides contractors will tolerate the withholding of payments for an excessively long period of time for work that has been satisfactorily performed? Do patients withhold 10 per cent of their doctor’s bill for a year to see if the operation really worked?”⁶²

5.4 In the above article, the authors stopped short of advising the abolition of retention, and instead drafted a model bill including provisions for “line item release” (that is, release of retention to sub-contractors as they complete their work rather than being further retained with reference to completion of the main

⁶⁰ Mr Hopper is a partner at Davis Langdon & Everest. His survey was published in “Contemporary issues in Construction Law: Volume 1—Security for Payment”, published by Construction Law Press (1996).

⁶¹ “Retainage Revisited: a time to revise and reform” (1996) 16(1) *The Construction Lawyer* 41.

⁶² At page 48.

contract works). It is notable that the new JCT Domestic Form of Subcontract for use with JCT Main Contract forms, which ultimately will replace the currently used DOM/1 form, provides for the first half of retention to be released on practical completion of the subcontract works, followed by release of the second tranche when defects under the subcontract have been made good. Under this provision, the second tranche will generally be released earlier than under DOM/1, which provides that the second tranche is retained until issue of the Certificate of Making Good Defects under the Main Contract.⁶³

5.5 From the legal point of view, perhaps one of the strongest arguments against retention is that two legal remedies, under the doctrines of equitable set-off and abatement, are available which offer employers the same protection when defects are present, but without permitting the withholding of sums that are actually due.

5.6 Both these doctrines came into maturity in the middle of the 19th Century.⁶⁴ In the present context, the scenario would be that the employer withholds money from a payment to the contractor alleging defects. If the existence of defects is disputed, the contractor would seek payment for work it alleges is completed; the employer would then be able to advance either of the following arguments:

5.6.1 That its cross claim for defective work, being so closely connected to the contractor's claim for payment, is such that it would be unjust not to allow it to be set-off. The court would then embark upon an examination of the facts in determining whether defects exist such that the employer is entitled to damages for rectification and associated costs.

5.6.2 As a defence to a contractor's claim for payment, that the value of the claim should be reduced or abated by the value of goods or services which are not in accordance with the contract. Again, an examination and valuation of the alleged defective work will be required.

5.7 Of course, the exercise of these rights presupposes that the parties are in dispute. One way of avoiding such disputes would be for parties to make provision in their contract for the contractor to produce, upon practical completion, a bond to cover the defects liability period, in consideration for which the employer would agree to forebear from exercising abatement or equitable set-off. Contractors may prefer the option of producing a bond at that late stage of the works, rather than at the beginning for the length of the project.

5.8 Given the availability of these two legal doctrines, a prohibition of retention provisions would not leave employers without a remedy against defective work. In the absence of the contractual right to retain money from sums actually due, only sums genuinely attributable to defects could be lawfully withheld.

5.9 We hope the above submissions assist the Committee in its inquiry.

Masons

September 2002

APPENDIX 18

Memorandum by the University of Leicester, Estates Office

I refer to the letter dated 27 September from my colleague Vic Slater, Director of Estates at UMIST. As Vice-Chairman of the Association of University Directors of Estates I was not aware of this inquiry until Mr Slater contacted me on Friday and therefore it has not been possible to submit a response by the due date. In view of the volume of construction work undertaken throughout the Higher Education sector, it is important that you have the opportunity to hear our views.

The sector commissions directly or indirectly something around a billion pounds of new construction each year and the issue of retentions is of great importance in achieving adequate quality. Although some institutions with a large and continuing capital programme are able to consider alternative ways of providing incentives and use contractors to provide better quality and fewer defects at the first attempt, the majority of the sector is not in this position and relies heavily on individual capital projects using traditional methods of contract and control with local contractors who require simple, but effective, methods of influencing their work.

The removal of retention sums on progress payments may be relatively easy to deal with, although their removal does place the client at a higher risk from overvaluation and subsequent overpayment, particularly should the contractor go into liquidation.

However, since the sector is not generally in a position to establish more long-term relationships with contractors related to repeat business and the partnering approach favoured by Egan, it is unlikely that the removal of retentions on practical completion will be realistic. For most of the sector this is the only mechanism which ensures that the contractor returns to complete defects which arise during the Defects Liability Period.

⁶³ However, failure to agree that subcontract defects have been made good might lead to more adjudication.

⁶⁴ See *Rawson v Samuel (1841)* Cr & Ph 161 for equitable set-off, and *Mondel v Steel (1841)* 8 M&W 858 for abatement.

There may be a case for looking at the relationship between the main contractor and sub contractor so as to insure that sub contractors are paid the appropriate amount for the work they have undertaken and only a proportion of the main contractor's retention is withheld from the sub contractor.

I think that it would be most unfortunate for the sector if your Committee were to impose an end to the system of retentions since the quality of contractors varies so much and a sector-wide change of this sort could have the opposite effect to that intended, particularly for smaller clients.

It may interest you to know that a small group of representatives from the sector are currently looking at this issue to ascertain whether there are any lessons which can be shared to improve the quality and the effectiveness of the retention system.

I hope that these comments are helpful in your deliberations.

S P Britton
Director of Estates

4 October 2002

APPENDIX 19

Memorandum by H&V News

EDITOR'S COMMENT

H&V News, the weekly newspaper for the heating, ventilating and air conditioning industry, has reported on the retentions issue for many years.

During that time a myriad of contractors and installers have expressed their frustration and outrage at a system that is blatantly abused for the benefit of clients and main contractors. Although intended to be a way of protecting upstream parties against defects and premature system failure, the mechanism is instead exploited as a cynical method of withholding cash from specialist contractors that have worked on the project. Specialists have consistently found that they are forced to spend considerable time and money attempting to cover retentions, which in some cases can be up to 10 per cent of the contract value. With profit margins often around 2 per cent, failure to win back retentions can make a contract to sub-economic. Smaller contractors are particularly vulnerable to the impact of retentions, and there is little doubt that many firms will have been forced into liquidation due to cashflow problems stemming from this contract condition. They are particularly exposed by upstream insolvency, which often leaves them with little chance of obtaining their money.

The findings of the H&V News retentions survey outlined in this report clearly indicates the strength of feeling in the sector and the urgent need for reform.

Any action that can be taken by the Select Committee to limit the negative impact of retentions would be a major step forward for the HVAC industry, which accounts for over £1 billion of the construction sector's £8 billion turnover.

Adam Northcroft

H&V NEWS RETENTIONS SURVEY

Key findings:

- 57 per cent of respondents lost retentions in up to 10 contracts over the last decade due to an upstream insolvency
- Some 70 per cent of firms have lost up to £30k from unrecovered retentions following upstream insolvency
- Some 25 per cent of larger companies claim to have lost at least £50k in unrecovered retentions

Respondent profile

The vast majority of the respondents were small or medium-sized businesses (SMEs). Some 81 per cent of those that replied to the survey were SMEs, with the remaining 19 per cent having more than 50 employees.

Lost contracts

Some 57 per cent of the respondents claimed to have lost retentions in up to 10 contracts over the last decade due to upstream insolvency. A further 33 per cent had lost retentions in up to 20 contracts over the same period, while a significant 10 per cent had lost their money in over 20 contracts.

The profile changes when the larger companies are split out. In this category over 75 per cent of respondents claimed to have lost retentions in 10 contracts or more over the last decade due to upstream insolvency, with 25 per cent saying they had lost their retention in over 20 contracts due to this reason.

Unrecovered retentions

The survey revealed that a massive 70 per cent of respondents lost between £5–30k due to upstream insolvency (37 per cent between £5–10k and 33 per cent between £20–30k). Other findings showed that 7 per cent had lost over £50k, 2 per cent between £40–50k and 5 per cent between £30–40k.

Again the situation is shown to be worse for larger companies. Here, some 25 per cent of respondents claim to have lost more than £50k due to retentions. A further 50 per cent had lost between £20–30k and 12 per cent lost between £40–50k.

H&V NEWS RETENTIONS SURVEY

Comments:

As part of the survey, respondents were asked to make any comments that they wished. The response was revealing and the comments are listed below.

“High risk/late payment at the ‘doers’ end of the m&e business, means we have more in common with the gambling sector than m&e.”

“A ban would save on the disproportionate administration involved in monitoring retentions and chasing for the cash.”

“The hidden cost of chasing the sums is just as high and we are hardly ever paid retentions unless we chase it. It is never on time. It is like living with a parasite that will never go away.”

“Unpaid retentions are seen as further profit by most building contractors. It costs us dearly.”

“I mentally write-off retentions at the time of tendering.”

“It can be up to 2.5 years in some cases when we receive the final retention.”

“Just silly excuse after silly excuse. Some 12 months later nobody wants to know or the relevant parties are no longer employed.”

“The period the retention is held is usually much longer than the 12 months and is only recovered after rigorous pursuit.”

“Consider the effect and cost of pursuing late retentions release—staff time and interest costs.”

“Very good idea to ban retentions.”

“Asking for retentions seems to annoy. You chase too hard and you make an enemy. Damage caused that may never be made good.”

“We have not passed on retentions to our sub-contractors for years without any problems. Retentions are out of date.”

“Policing and collecting is very expensive. Working capital completely tied up.”

“Should not be allowed. How about all parties take out a bond!!”

“We do very little contract work, but the ongoing costs of dealing with and claiming retentions is very high.”

“Managing and recovering retentions is an expense adding considerably to overheads.”

“We are a young, quickly growing company and have had only one retention lost due to insolvency. However, we have a large amount of money held in retentions which could be used to fund the growth of the company.”

“Many main contractors seem to view retentions as a bonus they wish to keep. The administration cost to recover them is usually totally disproportionate to the amount involved.”

“Overdue retentions are equally onerous especially to the cash flow and retentions generally adversely affect cash flow.”

“Collecting retentions takes up more time than collecting the first 95 per cent of the contract sum. It is a pain.”

“Retentions take a lot of time and effort to recover. Once the job is signed off the main contractor has no interest in whether sub contractors are paid.”

“Should not be allowed. How about all parties take out a bond.”

“Retentions could be fenced by the client and released, when due, to the contractor with no outstanding defects.”

“Unpaid retentions are seen as further profit by most main building contractors. It cost us dearly.”

APPENDIX 20

Memorandum by the Joint Contractors Tribunal

RETENTION IN JCT STANDARD FORMS OF CONTRACT

1. Traditionally, most JCT standard forms of contract have contained retention or retention type provisions. The basic purpose of retention is the same wherever used within the JCT suite of contracts but the contract provisions contain variations in treatment.

2. Under the Standard Form of Building Contract JCT 98 an appendix item is included so that the agreed amount can be stated. A nil percentage can be inserted, if that is what is required. The retention percentage is 5 per cent unless a lower amount is stated. A footnote in SFBC JCT 98 states: “Where the Employer at the tender stage estimates the Contract Sum to be £500,000 or over, the Retention Percentage should not be more than 3 per cent”. JCT has recently agreed to adopt 3 per cent retention as the default position in the SFBC JCT 98 and to delete the above footnote. Under the Management Contract, which is normally for use on large-scale projects a retention percentage of 3 per cent is expressly provided.

3. Retention is held in the full amount stated on specified items (it does not apply to every item of account) until practical completion of the works. Upon practical completion, which is generally certified by the architect/contract administrator, half the retention is released. The remaining half of the retention is held until the issue of the Certificate of Completion of Making Good Defects.

4. The rules relating to the holding and release of Retention under these forms are set out in the contract and differ depending on whether the client is in the private sector or a local authority. These rules include the provision of trust status for retention monies, the use of separately identified bank accounts where requested (not included in Local Authority version) and notices where the right to withhold and/or deduct against any retention is to be exercised.

5. The Agreement for Minor Building Works provides for payment of work in progress at 95 per cent prior to practical completion and at 97½ per cent following practical completion or at some other agreed amount. The retained amount is therefore reduced by one-half in the certificate following practical completion and with the balance released in the final certificate. There are no detailed rules governing the retained amounts. The Intermediate Form of Contract operates in a similar way but has no provision for varying the stated amount of retention; however, it does include rules relating to the holding and release of monies. The Measured Term Form of Contract does not contain retention provisions.

6. Historically, JCT has provided retention provisions to meet the particular needs of a specific contract. The principal reason for the inclusion of retention provisions has been to provide a fund from which the employer may pay others should the contractor fail to make good any defects that arise during the defects liability period. In addition, retention gives the employer some protection against the inclusion in progress payments of work that contains latent defects. To a far lesser extent, the retention provisions may act, in some instances, as an incentive to the completion of outstanding work.

CONTRACTOR'S BOND IN LIEU OF RETENTION

7. In January 2000, JCT issued an optional clause for use with private versions only of SFBC JCT 98 (the Local Authorities having requested that it should not apply to the Local Authority version of this contract), which provides for a contractor's bond in lieu of retention.

8. The explanatory note accompanying this optional provision read as follows:

“The JCT has been requested to consider providing in its Forms an optional alternative to Retention. It therefore decided to discuss with the British Bankers' Association (BBA) and with the Association of British Insurers (ABI) the terms of a standard bond to be given in lieu of Retention. These terms have been agreed.

“JCT decided to offer the use of this bond by means of an optional clause which Employers could include in their Contract. An optional clause 30.4A has therefore been provided for use with the Private versions of the Standard Form of Building Contract (JCT 98) together with related amendments to the JCT Nominated Sub-Contract documentation. Before providing similar optional clauses for other JCT Forms, the JCT would like to receive some feedback on the use of clause 30.4A and its accompanying bond. Users should kindly send their comments to JCT Ltd at its offices: 9 Cavendish Place, London W1M 0NR.”

9. A copy of the agreed Model Form of Bond in lieu of Retention is attached for information.

10. In January 2001 the JCT Council considered the use of this optional provision. The only feedback received at that time was from a local authority that had asked that the optional provision for a contractor's

bond in lieu of retention should not be extended to other forms of contract. JCT Council decided that no case had been presented to extend the use of this optional clause. However, because of the growing discussion on the use of retention, rather than any compelling evidence, it was subsequently included in the JCT Domestic Sub-Contract and the Construction Management Trade Contract; but in both of these instances its terms were only acceptable to the British Bankers' Association and not to the Association of British Insurers, despite the latter's previous agreement on the optional clause for use with the SFBC JCT 98.

11. JCT has not received any evidence to suggest whether or not the contractor's bond in lieu of retention is widely used. It would seem that if such bonds are to be only generally available from banks the uptake would be slow because their use will impact directly upon a contractor's borrowing facility.

NEW JCT FORMS OF CONTRACT—MAJOR PROJECTS FORM OF CONTRACT

12. The JCT is currently finalising a new contract for use on larger projects and where the client is an organisation that is familiar with construction projects and their administration. This new contract does not provide for many of the detailed procedures often included in construction contracts and does not specifically provide for retention. Retention was omitted because it was felt that, between the clients and the contractors likely to use this form, it would be of limited value.

13. Feedback on the operation of this contract, particularly with regard to the absence of specific retention provisions, will be invited. It is felt that such evidence is desirable in the debate which JCT is to hold on retention.

RETENTION UNDER JCT CONSULTANCY AGREEMENT

14. JCT only produces one such agreement and this is for use in connection with the Building Contract for home owner/occupier where a consultant is appointed. The Consultancy Agreement does not provide specifically for retention but it can, in effect, be achieved through the use of the stage (milestone) payments that are provided for. In principle, there is no reason why retention should not apply equally to consultants, which in practice it probably does because of the way the payment of the fee is structured. However, the principal reason for retention, as referred to in paragraph 6, would not apply in the same way.

THE USE OF RETENTION IN PRACTICE

15. The risks that retention provides for can to some extent be managed out of the system but a residual risk will remain. It is a matter of how one is disposed to risk whether this needs to be provided for by a retention fund. JCT's member organisations (which include employers, contractors, sub contractors and consultants) have differing views with regard to the effectiveness of retention and to date a compromise has been established in respect of each of JCT's various forms of contract. If no such provision is made, one is reliant on the contractor/sub-contractor to fulfil its obligation or otherwise to resort to adjudication or other proceedings to recover remedial costs. Where long-term relationships are created and a framework agreement is employed, other factors will encourage the performance of one's obligations; however, many projects will remain, quite properly, outside such agreements. Where retention is used the contractor/sub-contractor generally has the right to return to make good defects. This right gives the contractor/sub-contractor the potential for reducing the cost of remedying any defects. The absence of a retention provision may mean this right to return to make good defects would be removed by some clients.

16. The absence of retention means that, should the contractor not remedy any defects that may occur, other means of redress are necessary. Under the JCT Major Projects Form of Contract the Employer may instruct the Contractor to remedy any defect. The Contractor is obliged to comply with any instructions within a reasonable time and at no cost to the Employer and, should it not do so, the Employer may after giving notice to the Contractor engage others to make good defects. The Contractor shall be liable to pay the Employer's additional costs of engaging others. Alternatively, the Employer may decide not to rectify such defects and in these circumstances may give notice of the appropriate deduction it intends to make in the calculation of the amount due to the Contractor. Insolvency of the contractor is the greatest threat to this practice of dealing with defects, and performance bonds may be used where it is thought appropriate to cover this risk; however, the use of performance bonds may impact on a contractor in a similar way to the contractor's bond in lieu of retention.

17. JCT recognises, although it has not received directly any scientific evidence that such provisions are being inappropriately operated, that the wrongful use and operation of retention causes real problems and it is axiomatic that misuse would cause concerns to those from whom any retention is wrongly held.

ABOLITION OF RETENTION PROVISIONS

18. JCT's member organisations have differing views as to the appropriateness of retention provisions and on the universal abolition of such provisions under construction contracts. JCT continues to respond to these changing views, and the absence of retention provisions in the soon to be published Major Projects Form demonstrates flexibility on the part of our member bodies.

Paul Hibberd
Secretary-General

4 October 2002



Bond in lieu of Retention

See Note 1

BOND dated the _____ day of _____ 20 _____

issued by _____

of _____

_____ (hereinafter called 'the Surety')

in favour of _____

of _____

_____ (hereinafter called 'the Employer')

1 By a building contract ('the Contract') between the Employer and

of _____

_____ (hereinafter called the 'Contractor')

the Employer has agreed that he will not exercise his right under the Contract to deduct Retention from amounts included in Interim Certificates provided the Contractor has taken out this Bond in favour of the Employer.

See Note 2

2 The Surety is hereby bound to the Employer in the maximum aggregate sum of

_____ (figures and words)

until the Surety is notified by the Employer in writing of the date of issue of the next Interim Certificate after Practical Completion when the maximum aggregate sum shall be reduced by 50 per cent.

3 The Employer shall, on a demand which complies with the requirements in clause 4, be entitled to receive from the Surety the sum therein demanded.



- 4 Any demand by the Employer under clause 3 shall:
- (i) be in writing addressed to the Surety at its office at

_____ ,

refer to this Bond, and with the signature(s) therein authenticated by the Employer's bankers; and
 - (ii) state the amount of the Retention that would have been held by the Employer at the date of the demand had Retention been deductible; and
 - (iii) state the amount demanded, which shall not exceed the amount stated pursuant to clause 4(ii), and identify for which one or more of the following such amount is demanded:
 - (a) the costs actually incurred by the Employer by reason of the failure of the Contractor to comply with the instructions of the Architect under the Contract; and be accompanied by a statement by the Architect which confirms that this failure by the Contractor has occurred;
 - (b) the insurance premiums paid by the Employer pursuant to the Contract because the Contractor has not taken out and/or not maintained any insurance of the building works which he was required under the Contract to take out and/or maintain;
 - (c) liquidated and ascertained damages which under the Contract the Contractor is due to pay or allow to the Employer; and be accompanied by a copy of the certificate of the Architect which under the Contract he is required to issue and which certifies that the Contractor has failed to complete the works by the contractual Completion Date;
 - (d) any expenses or any direct loss and/or damage caused to the Employer as a result of the determination of the employment of the Contractor by the Employer;
 - (e) any costs, other than the amounts referred to in clauses 4(iii)(a), (b), (c) and (d), which the Employer has actually incurred and which, under the Contract, he is entitled to deduct from monies otherwise due or to become due to the Contractor; and identify his entitlement;
- and
- (iv) incorporate a certification that the Contractor has been given 14 days' written notice of his liability for the amount demanded hereunder by the Employer and that the Contractor has not discharged that liability; and that a copy of this notice has at the same time been sent to the Surety at its office at

See Note 3

Such demand as above shall, for the purposes of this Bond but not further or otherwise, be conclusive evidence (and admissible as such) that the amount demanded is properly due and payable to the Employer by the Contractor.

- 5 If the Contract is to be assigned or otherwise transferred with the benefit of this Bond, the Employer shall be entitled to assign or transfer this Bond only with the prior written consent of the Surety, such consent not to be unreasonably delayed or withheld.



- 6 The Surety, in the absence of a prior written demand made, shall be released from its liability under this Bond upon the earliest occurrence of either
- (i) the date of issue under the Contract of the Certificate of Completion of Making Good Defects; or
 - (ii) satisfaction of a demand(s) up to the maximum aggregate under the Bond; or
 - (iii) _____ (insert calendar date).
- See Note 4
- 7 Any demand made hereunder must be received by the Surety accompanied by the documents as required by clause 4 above on or before the earliest occurrence as stated above, when this Bond will terminate and become of no further effect whatsoever.
- 8 Notwithstanding any other provisions of this Bond nothing in this Bond confers or purports to confer any right to enforce any of its terms on any person who is not a party to it.
- 9 This Bond shall be governed and construed in accordance with the laws of England and Wales.

IN WITNESS hereof this Bond has been executed as a Deed by the Surety and delivered on the date below:

EXECUTED as a Deed by: _____

for and on behalf of the Surety: _____

EXECUTED as a Deed by: _____

for and on behalf of the Employer: _____

Date: _____



Notes

These Notes will not appear on the Bond issued by the Surety.

- 1 The terms of Annex 3 have been discussed with the British Bankers Association and the Surety Panel of the Association of British Insurers. The Tribunal understands that a Bond which embodies the terms of this Annex is, at the proposed Surety's discretion, available to Contractors where the Employer has incorporated into the building contract on the Standard Form of Building Contract 1998 Edition, Private version, incorporating Amendments 1 to _____, the optional clause 30.4A.
- 2 The figure to be inserted here is the amount stated in the Appendix pursuant to clause 30.4A.2. It is understood that a Surety will, at additional cost to the Contractor, and which may be subject to other terms and conditions of the Surety, provide for a greater sum than that stated in clause 2 if, due to variations, and had Retention been applicable, that amount would have increased. The reduction by 50% of the maximum aggregate sum at the date of issue of the next Interim Certificate after Practical Completion matches a similar reduction had Retention been applicable.
- 3 The inclusion in clause 4 of the words "but not further or otherwise" is to make clear that the Contractor would not be prevented by the terms of clause 4 from alleging, under the Contract, that the Contractor was not in breach on any of the matters stated in clause 4(iii)(a) to (e).

Any demand by the Employer under clause 4 of this Bond must not exceed the costs actually incurred by the Employer and is not to be in excess of the amount stated in clause 4(ii).
- 4 The Surety requires an actual expiry date or (if earlier) a date that is capable of being ascertained on the face of the Bond. Where this is not possible, alternative terms should be discussed with the Surety.

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