

'Retention' in construction contracts: A snagging problem?

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IN AUGUST I raised the prospect of the CV19 crisis being used by parties in the construction industry as a means of triggering contract re-negotiations wholesale and putting significant pressure upon the construction supply chain. Whilst it has taken place, thankfully we haven't reached the all-out litigation armageddon which was potentially on the horizon.

Nevertheless, one aspect of construction projects that has continued to become an ever-present feature of dispute between parties is the use of contractual 'retention' as a means to create leverage and to protect cash flow.

The concept of 'retention' in construction contracts is pretty straightforward. The employer is entitled to retain some percentage of the value of the work being carried out pending the conclusion of a rectification or snagging period. Once that period is finished, the retention payment is issued to the contractor subject to any appropriate deductions.

The rationale is simple: it incentivises the contractor to complete the works to the appropriate standard required and avoids the scenario of the contractor leaving site fully paid without the job being complete. Inherent here is the recognition that pursuing the contractor will incur unrecoverable costs and time and so retention is a means to avoid the employer having

to 'invest' in forcing completion of the work.

The withholding of the retention has long been used by employers not only to obtain completion of snagging works but also as a means to obtain leverage against the contractor in respect of other matters in dispute which are not strictly about snagging e.g. disputes over variations, delay, extension of time, price, other breaches of contract.

A consultation published in February 2020 by the Department for Business, Energy and Industrial Strategy (BEIS) demonstrated how retention is actually being used - the feedback did not surprise those involved in the industry:

- Retention fails to provide contractor protection against employer insolvency
- Frequency of 'unjustified' late, partial or non-payment
- Significant negative impact on cash flow and cumulative impact on small firms
- A culture of mistrust with firms higher up the supply chain using retention as a lever in wider payment negotiations
- Use of retention along with 'pay when paid' provisions

Retention is frequently, and often erroneously, used as a mechanism for achieving commercial leverage. But it's not necessarily a safe way of doing so.

Contractors can bite back with the relatively quick and inexpensive process of 'adjudication' which has long been an integral feature of construction law in the UK.

Also, if retention, under the cloak of a dispute over snagging, is being used as a means to protect cash flow or create commercial leverage, a well-advised contractor may take the opportunity to investigate the financial affairs of the employer and find reason (along with non-payment of the retention) to go to court and obtain protective orders against the property and assets of the employer. A particularly bad prospect for employers involved in property development.

The 'pay when paid' provision highlighted in the consultation is curious given that the Housing Grants, Construction and Regeneration Act 1996 made such provisions (even if consciously agreed by both parties) ineffective. An employer attempting to use such a clause should beware.

Parties need to protect their own positions and present their arguments but should also be aware that provoking litigation (or adjudication) can be a very risky one. Retention is supposed to be a sensible and measured protection for the employer. Parties would be well advised not to go too far in using it for purposes for which it was not intended.

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