

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 2013 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

The meeting was well attended with 28 in attendance (details attached) and members were welcomed to the meeting by the Convenor.

Matters Arising

The notes from the meeting on 5 December 2012 were approved as an accurate account of the meeting.

Treasurer's Report

Mr Watt (Treasurer) gave the Treasurer's Report (attached).

Retentions

Mr Don reported that a Retention Paper (attached) had been prepared and circulated as agreed at the last meeting and he asked for any comments.

Mr Baxter felt that it would be beneficial if the paper also referred to sub-consultants.

It was acknowledged that there could be governance issues within certain organisations so a deadline for supporting the paper was set for 31 March 2013.

Members were asked to advise the Secretary (john.mckinney@nsc.org.uk) if they wished their organisation to be listed as a supporter of the CPG Construction Retention Paper.

Mr Don noted a couple of amendments he felt would be beneficial to include and these would be made before the paper was delivered to the Cabinet Secretary.

Mr Don invited Mr Wilson to discuss the Retention Clause prepared by the SEC Group which had been circulated with the agenda (attached).

Mr Wilson outlined the principles, and benefits, of the clause.

There were discussions about the best way to proceed with the clause and it was agreed that it would be preferable if it could be considered while the Procurement Reform Bill proceeded through the parliament.

It was agreed that it would be presented to the Bill Review Team by the three MSPs present at the meeting.

Solving the Prequalification Problem – Update on the Use of the sPQQ by the Scottish Government's Procurement & Commercial Directorate

Mr Robinson and Ms Blyth were welcomed by Mr Don and invited to present to the group on sPQQ.

Mr Robinson thanked the group for the opportunity to discuss sPQQ and reviewed how Pre-qualification questionnaires (PQQ) worked and the reasons for the government progressing its own standardised PQQ (presentation attached).

Mr Robinson stressed that sPQQ would be for the whole Scottish public sector and outlined the challenges which would be encountered to make it a success and how the government was looking to address these.

Mr Frew requested details of the standard questions within sPQQ and Mr Robinson said that he would supply the details.

Mr Alan Watt reported that sPQQ followed a similar question set to PAS91, which was the UK Government equivalent, to minimise duplication for contractors working on both sides of the

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 2013 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

border. He also noted that suppliers with ISO accreditation were not asked for information which was a pre-requisite of the ISO accreditation.

Mr Buchan highlighted certain local authorities which stated that they required Contractors Health and Safety Assessment Scheme (CHAS) accreditation to tender. Mr Robinson said that many of the CHAS details were to be included in sPQQ.

Mr Wilson highlighted the cost savings to contractors by reducing administration costs which should result in reduced tender prices.

Mr Monaghan thought it might be worthwhile developing a shortened PQQ for low level contracts therefore making it easier for SME contractors to bid for the work.

Mr Robinson agreed that this could be beneficial.

Mr Law felt that it sPQQ was a huge task and felt it was a positive development but had several concerns regarding the process.

Mr Sheridan felt that it would be beneficial if questions were included which would favour local contractors in the tender process.

Mr McGuinness asked how the evolution of sPQQ would be managed. Mr Robinson said that the Scottish Government would take feedback from the industry which would highlight development areas within the scheme.

Mr Baxter asked if Scotland Excel would use sPQQ and Mr Robinson confirmed that it would.

Mr Frew felt that sPQQ was a beneficial development and highlighted the recent cases of blacklisting in construction and asked if there was any provision within the scheme to identify any cases this could be happening on. Ms Blyth said that this was an urgent priority and the Scottish Government was looking to address this within sPQQ.

AOCB

Mr Monaghan updated the meeting on developments within Construction Scotland and it was agreed that a paper would be circulated with the minutes (attached).

Date of Next Meeting

Mr Don reported that details of the next meeting would take place on 5 June 2013 and full details would be circulated to members in due course.

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 213 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

Attendance

N Don MSP

M McCulloch MSP

E Murray MSP

J Baxter – ACE

J Blyth – SPCD

J Brown – FMB

R Buchan – RICS

J Downie – FPDC

A Ferguson – CLE

P Ford - ConstructionSkills

H Frew – UCATT Union

I Gracie – CIOB

I Honeyman – SBF

B Law – APS

S McCluskey – GMG Contractors Ltd

G McGinn – GMG Contractors Ltd

N McGuinness - SELECT

J McKinney – NSCC

E Monaghan – Homes for Scotland

T Pogson – Asset Skills

M Reid - SELECT

I Robertson – NSCC

G Robinson – SPCD

J Sheridan – MPA (Scotland)

S Thiam - ICE

Alan Watt – CECA Scotland

Arthur Watt – Association of Building Engineers

A Wilson - SNIPF

S Young – CECA/Breedon Aggregates

Apologies

G Barn – FMB

M Cowie – McClure Naismith

A Galbraith – SECTT

M Horner – University of Dundee

M Levack – Scottish Building Federation

I Rogers – SDF

A Seath – Fife Construction Forum

J Williams – GGF

**CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH
PARLIAMENT/ BRIEF NOTES**

TUESDAY 19 FEBRUARY 2013 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

CROSS-PARTY GROUP IN THE SCOTTISH PARLIAMENT ON CONSTRUCTION

ACCOUNTS FROM 23RD AUGUST 2012 - 19 FEBRUARY 2013

Full - FULL GROUP

S&T - SKILLS AND TRAINING SUB GROUP

P&W - PROCUREMENT AND WORKLOAD SUB GROUP

P - PLANNING SUB GROUP

S - SUSTAINABILITY SUB GROUP

<u>INCOME</u>		<u>TOTAL</u>		
23.08.12	Opening Balance			£726.17
	30 contributions & £40			£1,200.00
<u>TOTAL</u>				£1,926.17
<u>EXPENDITURE</u>		<u>V. NO.</u>	<u>GROUP</u>	<u>TOTAL</u>
25.09.12	Sodexo Ltd mtng 05.09.12	1	Skills	£146.40
16.10.12	Sodexo Ltd mtng 19.09.12	2	AGM	£193.20
03.12.12	Sodexo Ltd mtng 21.11.12	3	Skills	£146.40
12.12.12	SELECT - refund o/a double payt of Contribution	4		£40.00
19.12.12	Sodexo Ltd mtng 05.12.12	5	Full	£138.00
<u>TOTAL</u>				£664.00

BALANCE

£1,262.17

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 213 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

To: Cabinet Secretary for Finance, Employment and Sustainable Growth

Introduction

The Cross-Party Group (CPG) for Construction held a meeting on 5 December 2012 to discuss the issue of retentions. It was generally agreed that the withholding of retention monies, typically 3-5% but often more, on construction projects is an inefficient and outdated practice, which no longer fulfils its original intention of providing a measure of protection against defective work.

This reinforced the view previously expressed by the Scottish Government and the UK Government:

- Scottish Government's Procurement Manual:
"Cash retentions or other traditional means of assurance should not prevail purely by default or without adequate analysis"
- House of Commons Select Committee:
"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"
- Fair Payment Charter published by the UK Government:
"Any client arrangements for retention will be replicated on the same contract terms throughout the supply chain"

The CPG for Construction would request that the Scottish Government reinforces its position on the withholding of retentions on projects funded by the Scottish Government as follows:

1. Confirming and, if required, reviewing the Scottish Government's policy on the withholding of cash retentions.
2. Requiring that, where a retention is not withheld from the main contractor by the Scottish Government, there should be no retention withheld throughout the supply chain.
3. Identifying if any projects funded by the Scottish Government do withhold retention and at what value.

Eliminating Cash Retentions

a) Retentions add to the cost of construction projects

The withholding of money from all or part of the supply chain restricts cash flow, both temporarily and in some cases permanently, incurring costs which are ultimately borne by the client in terms of the administration of recouping withheld monies, company loans, overdraft facilities, lower credit facilities, the ability to leverage purchasing power, and disputes. Cash flow restriction is a common cause of insolvency and the demise of a sub-contractor part way through a project is costly to the client and likely to cause substantial delays.

Retention monies are not protected in the event of insolvencies within the supply chain resulting in the outstanding monies never being paid to those that have completed the work in good faith.

It was estimated that the effect per medium sized construction company (T/O approx £10m), which had a proportion of its work subject to retention, that the costs of the withheld retention and administering it cost approximately £50,000 per annum.

The whole supply chain, including clients, must likewise administer retentions which adds significant costs to be absorbed into tender prices and the public sector is the largest client group of the industry.

b) Retentions are no longer an appropriate mechanism to address defects

Due to the manner in which contracts are now sub-contracted out to a wide variety of supply chain members, the objective of withholding money from a business undertaking work in order to ensure that they to rectify any defective work has been removed.

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 213 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

The collective amounts withheld from individual sub-contractors by main contractors is substantial; however, the individual amounts on their own are not effective in ensuring that a sub-contractor will return to site to rectify defective work. In many circumstances, retentions continue to be withheld from all contractors in the supply chain and not just those where there is an issue with their work which leads to disputes and does little to address the issue of the defective work in question.

In reality, a sub-contractor is motivated to deliver quality work and rectify any defects by the need to maintain his reputation in order to win more work from the same client or main contractor rather than any retention withheld against him.

c) There are effective alternatives to retentions

- **Competent supply chain** - The best guarantee of quality lies in the choice of a competent and qualified supply chain. If a client or main contractor feels the need to protect against defective work then they should review their method of selecting their supply chain and use the information received through the pre-qualification process. If the current pre-qualification process is used effectively, would negate the need to withhold a retention.
- **Retention Bonds** - Retention bonds provide an effective alternative to cash retentions. In simple terms, they are agreements between a Specialist Contractor, its contractor or client, and a third party known as a surety provider, which acts as a guarantor between the two parties. The bond agreement states that in return for the main contractor **not** holding cash retention, the surety provider will undertake to pay the main contractor up to the amount that it would have had by way of cash retention should the Specialist Contractor fail to carry out the works or remedy defects. In order to draw on the bond, the main contractor must demonstrate that the defective work is down to the individual sub-contractor and there is an incentive on the sub-contractor to perform as the level of defects will have an adverse effect on his ability to obtain a future bond and the cost of it.
- **Project Bank Accounts** - Public sector projects elsewhere in the UK are now implementing Project Bank Accounts (PBAs) which are ring-fenced bank accounts with payments made directly and simultaneously by a client to members of the supply chain. PBAs not only assure certainty, security and promptness of payment but, where a retention is withheld for any reason, it is protected from use by the main contractor and in the event of insolvency.

Recommendation

Successful clients such as Scottish Water, The Olympic Delivery Authority and Network Rail have demonstrated that the withholding of retention is not necessary in today's construction industry.

The CPG for Construction believes that the Scottish Government could realise increased efficiencies from the construction sector as well as the desired reduction in the cost of public sector buildings and infrastructure by implementing the following policy on retentions:

1. Not withholding a cash retention on its projects
2. Introducing a policy that, where a retention is not withheld from the main contractor by the Scottish Government, there will be no retention withheld throughout the supply chain
3. Identifying if any projects funded by the Scottish Government do withhold retention and at what value.

This CPG Construction Retention Paper is supported by:

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 213 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

PROPOSAL FROM SEC GROUP SCOTLAND FOR LEGISLATION TO PROTECT RETENTIONS

EXPLANATORY NOTE

BACKGROUND

1. The current recession has highlighted the iniquities of the practice of cash retentions in the construction industry. Having provided a cash retention to a company up the supply chain that is now facing the prospect of insolvency there isn't anything that a firm can do to protect its retention monies. Consequently thousands of firms – mainly SMEs – have lost their retentions during this recession.
2. Retention monies are withheld from sums that were otherwise contractually due for payment; therefore, they belong to the provider of the work. Although contracts in the industry do not generally make clear the reason for the deduction of retentions it has generally been assumed that they are withheld in case of insolvency and failure to ensure that work and/or materials conform to the contract. In effect they are security for performance but there is no concomitant obligation on the other party to provide any security for payment. Moreover the burden of providing retentions ultimately falls upon the smallest and most vulnerable of firms in the supply chain.
3. The practice of retentions has already been condemned as bad practice by the House of Commons Business Select Committee on two occasions, the latest being in 2008 when the Committee published its report, *Construction Matters*. Many jurisdictions abroad have in place legislation for protecting retention monies. For example, in France, retention monies have to be placed with an independent stakeholder. In the state of Western Australia the Construction Contracts Act 2004 requires that they have to be held in trust. In the majority of the states in the United States there is legislation providing various degrees of protection for retentions including restrictions on the amount that can be deducted and the period over which they can be withheld. Last year the state of New Mexico introduced legislation to outlaw the practice.
4. Evidence provided to the House of Commons Trade and Industry Committee in 2004 indicated that in the overwhelming majority of cases retentions are simply used to aid the cash flow of the party withholding the monies. Research carried out by the Specialist Engineering Contractors' Group amongst local authorities has revealed that many authorities in Scotland rely on retentions to finance other works.
5. On public sector works those most at risk of losing their retention monies through insolvency are firms lower down the supply chain. Since public sector bodies do not go into insolvency, sub-contractors and sub-sub-contractors (tier two and tier three contractors) are vulnerable – respectively – to main contractor and sub-contractor insolvency. On private sector works tier two contractors are additionally exposed to the risk of client insolvency by virtue of section 113 Housing Grants, Construction and Regeneration Act 1996 (as amended). This allows for pay when paid provisions to operate where a third party payer goes into insolvency.
6. The draft statutory provision attached to this Explanatory Note, therefore, imposes a statutory obligation upon those deducting retention monies to place such monies in a separate trust account. This provision has been drafted as an amendment to the proposed Procurement Reform Bill (in which case it will only apply to public sector works). But it could also be introduced in the Scottish Parliament as a Member's Bill to

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 213 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

apply to all construction operations in Scotland.

7. There already exists statutory precedents for protecting monies which are made available to another party for specified purposes. These exist within landlord and tenant legislation. Under section 42 Landlord and Tenant Act 1987 (which applies to England and Wales) there is an obligation upon the landlord to place in a trust fund service charges paid by contributing tenants. The landlord's recourse to the trust fund is strictly limited to defraying those costs for which the service charges where payable. Part 4 of the Housing (Scotland) Act 2006 and the Tenancy Deposit Schemes (Scotland) Regulations 2011 provide protection for deposits made by tenants as security for performing their obligations under the tenancy agreement. Such deposits have to be placed in a tenancy deposit protection scheme.

CLAUSE 1

8. The definition of "*bank*" in the Banking Act 2009 refers to UK institutions (that is, those incorporated under the law of any part of the UK) having permission under Part 4 of the Financial Services and Markets Act 2000 to carry out the regulated activity of accepting deposits. In practice this includes all the clearing banks but excludes building societies.

There is excluded from the definition of "retention monies" *performance damages* which are applied in the event that contractually specified levels of service delivery or outputs are not met and *liquidated damages* applied in the event that there are delays to performance.

CLAUSE 2

9. This clause acknowledges that retentions may not be deducted by the public sector client but, in practice, it is often the case that they will still be deducted by the tier one contractor. But, whoever initiates the deduction of the monies, will become a statutory trustee of the monies.

CLAUSE 3

10. It is important that the beneficiaries are given details of the trust account to ensure that such account has, in fact, been established, and that it is solely for the purpose of depositing the retention monies.

CLAUSE 4

11. This provision makes clear that the party which initiates the deduction of retentions (that is, the public body or tier one contractor) has the option of either complying with the statutory requirements or not deducting retentions at all. Where the statutory requirements are not adhered to retentions cannot be deducted under tier two or tier three contracts.

CLAUSE 5

12. This is intended to be a long-stop period. It does not seek to override contracts providing for a shorter period or section in the Housing Grants, Construction and Regeneration Act 1996 (as amended) which outlaws payments being made conditional upon the happening of some event under a contract further up the supply chain.

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 213 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

CLAUSE 6

13. Recourse to the trust account is obviously permitted in respect of the purpose(s) for which the retention was deducted.

CLAUSE 7

14. Whilst section 6 gives the trustee the right of recourse to the retention fund in respect of the purpose for which the retention was deducted, section 7 places an obligation upon the party to the construction contract with the trustee to replenish the fund. This obligation will not extend to retentions already deducted from contractors in the supply chain which have already gone into insolvency or whose works and/materials are not in conformity with their respective contracts and such insolvency or lack of conformity was the reason for the trustee having recourse to the fund.

SECTION 8

15. This is inserted for the removal of any doubt.

SECTION 9

16. Whilst adjudication may, in practice, apply to all types arising under this provision, recourse to the courts or arbitration is not included.

SECTION 10

17. This is self-explanatory.

DRAFT RETENTIONS CLAUSE FOR INCLUSION IN PROCUREMENT REFORM BILL

PROTECTION OF RETENTION MONIES ACT 2013

An Act to provide for the protection of retention monies in the construction industry in the event of the insolvency of the party holding such monies*

Trust funds for retention monies

Section X

- x (1) In this section –
- (a) “bank” has the meaning given to it by section 2 of the Banking Act 2009;
 - (b) “beneficiaries” includes the parties listed in paragraph (g) of this subsection;
 - (c) “construction contract” has the meaning given to it by section 104 Housing Grants, Construction and Regeneration Act 1996 (as amended) but the reference in *subsection (6)* to “construction operations” is confirmed to construction

* The short and long titles in the event that this provision becomes a Member’s Bill.

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 213 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

operations in Scotland;

- (d) "insolvency" has the meaning given to it by section 113 Housing Grants Construction and Regeneration Act 1996 (as amended);
 - (e) "month" means a calendar month;
 - (f) "public body" includes any body whether or not incorporated which derives at least half of its funding from the public sector;
 - (g) "retention monies" include any sums withheld from payments otherwise due to a payee under a construction contract by way of security for current and future performance other than performance damages or liquidated damages;
 - (h)
 - (i) "tier one contractor" refers to a party who enters into a construction contract with a public body;
 - (ii) "tier two contractor" refers to a party who enters into a construction contract with a tier one contractor;
 - (iii) "tier three contractor" refers to a party who enters into a construction contract with a tier two contractor.
 - (i) "trustee" is the party under *subsection 2* upon whom is placed the obligation to hold retention monies in trust.
- (2) (a) Where a public body withholds retention monies under a construction contract such monies shall be held in trust for the benefit of the tier one, tier two and tier three contractors.
- (b) Where a public body does not withhold retention monies under a construction contract but the tier one contractor withholds retention monies from his tier two contractors, such monies shall be held in trust for the benefit of the tier two contractors and their tier three contractors.
- (3) (a) The trustee shall establish a trust account at a bank solely for the purpose of depositing the retention monies and shall be solely liable for the cost of establishing and maintaining such account.
- (b) The trustee shall maintain a record of all amounts of the retention monies individually contributed by each beneficiary and shall provide each beneficiary with details of the trust account.
- (c) Each beneficiary shall have an entitlement to a share of the interest earned whilst their respective retention contributions are in the trust account in proportion to the amounts of such contributions.
- (4) (a) Where a party designated as trustee under *subsection 2* fails to comply with any of the requirements of this section he shall not be permitted to deduct any retention monies and this prohibition shall apply to all construction contracts in the supply chain as between tier one and tier two contractors, and tier two and tier three contractors.

CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH PARLIAMENT/ BRIEF NOTES

TUESDAY 19 FEBRUARY 213 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP

- (b) Where in contravention of this subsection any retention monies have been deducted they shall be refunded immediately and are recoverable under the relevant construction contract as a debt exclusive of any counterclaim.
- (5) Subject to *subsection (6)* the trustee shall ensure that all outstanding retention monies are released to each beneficiary no later than the expiry of twelve months following the date of handover of the works.
- (6) The obligation under *subsection (5)* to release the retention monies is without prejudice to the right of the trustee to use the monies in accordance with the purpose for which such monies have been withheld under the construction contract to which the trustee is a party.
- (7)
 - (a) Where under *subsection (6)* the trustee is a public body the tier one contractor shall forthwith replenish the account to the extent of the contributions of each of its tier two contractors provided that the reason for the withdrawal by the trustee from the account was not due to their insolvency or their work and/or materials not being in conformity with their contract and this provision shall apply *mutatis mutandis* to tier two contractors in respect of their tier three contractors.
 - (b) Similarly where under *subsection (6)* the trustee is a tier one contractor its tier two contractors shall forthwith replenish the account to the extent of the contribution of each of their tier three contractors provided that the reason for the withdrawal by the trustee from the account was not due to their insolvency or their work and/or materials not being in conformity with their contract.
 - (c) Failure by the tier one contractor or tier two contractor, (as the case may be), to comply with *paragraphs (a) or (b)* shall entitle the affected beneficiaries to the immediate release by the other party under their construction contracts of any outstanding retention monies.
- (8) The provisions of this section should prevail over any inconsistent express or implied terms of any construction contract to which this section applies.
- (9) In the event of any dispute or difference arising under or in connection with the provisions in this section a party to the relevant construction contract shall have the right to refer such dispute or difference to adjudication in accordance with section 108 Housing Grants, Construction and Regeneration Act 1996 (as amended) and, where applicable, in accordance with the Scheme for Construction Contracts (Scotland) Amendment Regulations 2011.
- (10) The commencement date for this section shall be provided by order of the Cabinet Secretary for Infrastructure, Capital Investment Cities and shall apply to construction contracts entered into on or after this date.

**CROSS-PARTY GROUP FOR CONSTRUCTION IN THE SCOTTISH
PARLIAMENT/ BRIEF NOTES**

TUESDAY 19 FEBRUARY 2013 AT SCOTTISH PARLIAMENT, EDINBURGH, EH99 1SP