

Retention money: Does it belong to the contractor or the employer?¹

The burning question

Under a typical construction contract, when one considers retention money,² does it belong to the contractor or the employer?³ No doubt the answer to the question will vary according to the role that the particular party to whom the question is posed plays in the contract. A contractor will typically argue that it belongs to him, and that it is his money as it forms part of the money due to him, as having been earned for progress made during the works' execution. The employer, on the other hand, will argue that it is his security fund and, accordingly, his money until certified as due to the contractor.⁴

But why does the answer to this question matter? Eventually the money will become due and be paid out to the contractor, at least in part.⁵ The simple answer is that it becomes particularly relevant in the case where a contract is terminated prematurely, and the works have not yet been completed.

Practical examples always illustrate the point best. The most interesting ones are considered in case law and are dealt with in more detail below. However, to summarise, what would be the case if a contractor went into liquidation before he had completed the works? The foremost question in this scenario will become whether the retention money is subject to the estate of the contractor and under the control of the liquidator for the benefit of the contractor's creditors (*concursum creditorium*), or, as it was held by the employer as a security fund, would it rather constitute an asset owned by the employer and thus available to him to be used for the completion of the works?

To avoid this article becoming a long-winded thesis, the comments herein are limited to the case of a cash retention being held as a percentage deducted from each interim payment certificate. For the same reasons, a retention security in the form of a bond is also not discussed herein and consideration is given only to contracts where there is no explicit provision for the release of retention money on premature cancellation or termination outside of the terms of the contract (such as in the case of a repudiation). The intention of the article is to stimulate discussion on the subject and to inspire drafters of construction contracts to deal with the matter upfront.

¹ By Dr Tanya Nicole Hendry, LL.D., LL.M., LL.B., M.Inst.D., MCI Arb, FFA Arb, SCL(UK), a director of CSSI (Construction Support Services international).

² It is not always defined as retention money or a retention security. Different contracts may use different terms, but the concept is usually the same.

³ Or client, depending on what the specific contract defines this party as.

⁴ By the principal agent, engineer, or whichever party is assigned the certification duties under the relevant contract.

⁵ If deductions are made to correct defects, it may not be in full.

Retention money: A general proposition

Contractors have long sought to argue that when a percentage is deducted from payment certificates for a retention security fund, the deducted money belongs to the contractor, and, as the argument goes, that it is money deducted from a payment that has been certified to be due to the contractor. But is that correct?

Turning to Finsen's commentary on the JBCC Agreements,⁶ in which he observes that the purpose of withholding retention monies is to provide the employer with a form of security for the due performance of the contractor's obligations.⁷

McKenzie⁸ regards retention money to be withheld or '*... set aside as security for the due completion of work and to enable a fund to be available to rectify defects which have not been rectified by the contractor.*'

Normally, retention money is released when the contract is completed.⁹

What is the position when the works are not yet completed? In order to establish what the status of retention monies is in such a case (i.e. before the works are completed) the status of interim payment certificates must first be considered. In other words, is the certified amount (and accordingly the percentage deducted therefrom as retention) a reflection of the work completed?

Interim payment certificates

In *Thomas Construction (Pty) Ltd (in liquidation) v Grafton Furniture Manufacturers (Pty) Ltd*¹⁰ the erstwhile Appellant Division decided, among other issues, on what the position was with regard to interim payment certificates. The court held that they merely constituted advance payments against works that still had to be executed and completed and that they do not necessarily reflect what work had been completed.¹¹

Therein lies the first problem a contractor would face in arguing that the retention money belongs to him. Any amount applied as a percentage to the then interim payment certificate

⁶ Finsen, *The Building Contract, A Commentary on the JBCC Agreements*, Second Edition, Juta, 2015, at p. 98.

⁷ A part of it may be utilised to rectify defects that the contractor failed to rectify despite demand from the employer to do so (typically during the defects notification period).

⁸ Ramsden, *McKenzie's Law of Building and Engineering Contracts and Arbitration*, 7th Edition, Juta, 2014, at pp. 216 – 217.

⁹ Conditions of contract: See FIDIC Red and Yellow Books – Sub-clause 16.4; or GCC 2010 – Clause 9.3.2.3; or JBCC 2014 – Clause 29.4.

¹⁰ 1988 (2) SA 546 (A).

¹¹ Finsen, p. 164.

(as with the payment reductions), will not necessarily be reflective of actual amounts due for work actually completed.

As the nature of an interim certificate is provisional or '*interim*' (as the name states) and may become subject to change, the amounts reflected therein are not necessarily payments certified for work actually done, but rather advances on payments on account of the contract price, which only falls due once the contractor has completed the works. Accordingly, any deductions considered, and made from such advance payment amounts, are not the contractor's money – nor is it owned by the contractor. Consequently, any such money would only become due to the contractor once he had fulfilled all his obligations.¹²

Although it has previously been held that a contractor is entitled to all money retained as retention up to the time of termination,¹³ the court in *Intech Instruments v Transnet Ltd t/a South African Port Operations*¹⁴ also held that this decision must be treated with some caution. The court strongly voiced its finding that an interim payment certificate is not a reflection of an amount due for work actually completed. It remains interim in nature.

What does the contract say?

The extent to which monies are to be retained and when and to what extent the contractor will become entitled to payment of retention monies, are matters to be determined by the terms of the contract.¹⁵ Ordinarily, it is on completion, or, in some instances, a portion of the retention money will be released on achieving practical completion and the balance after the relevant defects notification period has expired.

If nothing is pleaded as to any implied or tacit term entitling a contractor to payment of retention monies before completion, or on cancellation, the court (or an arbitrator) will not be able to assist the contractor. The same applies where there are no explicit terms dealing with a release of retention before completion.

The court or arbitrator will have to hold that if the contract does not deal with it, then the contractor has failed to establish and prove its entitlement to those funds.

Alternative considerations

An interesting point to consider is a possible claim for the value of work properly done in the form of a notional claim. The claim for retention monies would then be subsumed within that claim.¹⁶ Or, phrasing it in a different way, if an argument is made that there is a tacit or an

¹² Finsen, page 99. The caveat here is that this is the case in most construction contracts, but not necessarily all of them.

¹³ *Cambrian Collieries Co v Jenkins & Sons* 23 NLR 431.

¹⁴ (3690/2008) [2017] ZAKZDHC 49 (1 November 2017), at paragraph [105].

¹⁵ *Id.*, paragraph [106].

¹⁶ *Id.*, paragraph [107].

implied term in the contract dealing with the process after premature cancellation, or which provides what the position is with regard to monies withheld as a retention security, there may be merit in the contractor's contention that there is a requirement to compile a report on the status of the portion of the works executed by the contractor, and then to commence with the issuing of a preliminary final account after completion of such a report.¹⁷

Another question for debate is whether it could be said that the contractor has a lien in respect of retention money which is not yet due.¹⁸ But these are matters for another article...!

Dr Tanya Nicole Hendry

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¹⁷ Depending on the terms and conditions of each particular contract.

¹⁸ ***Conress (Pty) Ltd and Another v Gallic Construction (Pty) Ltd*** 1981 (3) SA 73 (W); ***UP Construction v Cousins*** 1985 (1) SA 297 (C).