MDA PRESENTS

FIRST AID FOR CONTRACTS

Prevention is Cheaper than Cure

Third Edition – July/ August 2024

THE GOOD, THE BAD AND THE UGLY… INTERIM PAYMENTS, RETENTION AND THE MANAGEMENT OF RISK IN SUBCONTRACTS – THE GENERAL CONDITIONS OF SUBCONTRACT FOR CONSTRUCTION WORKS, FIRST EDITION (2018)

Author: Kristen Taylor

Subcontracting makes up a significant portion of the construction industry in Southern Africa and it is an effective way of involving small, medium and micro-sized construction companies, which have specialist skills. However, subcontracts are largely unregulated resulting in contractual risk simply being "passed down the line" – typically resulting in onerous terms to the extent that such terms may even be more onerous than those which exist in the principal contract. In particular, subcontracts often include:

- payment procedures where a subcontractor is only paid when the main contractor is paid by the employer ("*pay when paid*") or if the main contractor is paid by the employer ("*pay if paid*");
- unreasonable retention percentages and periods of retention after completion; and
- release of retention money.

Although these three issues all probably require discussion and further debate, this article looks at the release of retention monies when the subcontract has been terminated from the perspective of the General Conditions of Subcontract for Constructions Works, First Edition (2018) ("the GCC Subcontract Agreement"). In considering this unique issue, we will also canvas the nature of interim payments under construction contracts.

The GCC Subcontract Agreement states that prior to the commencement of the subcontract works, the parties must agree to the form of security to be provided by the subcontractor. Retention money is a popular form of security for due completion of work and to enable a fund to be available to rectify defects which have not been rectified by the contractor[1], or in this case, the subcontractor.

Clause 6.10.3 of the GCC Subcontract Agreement provides that interim payments due to the subcontractor for (1) the estimated value of the subcontract permanent works carried out and calculated in terms of the Subcontract Agreement up to the date of the subcontractor's said statement, (2) the amount for any subcontract temporary works or other special items for which separate amounts are provided in the subcontract pricing data, (3) any other additional amounts which are due to the subcontractor and (4) adjustments, shall be subject to a retention by of an amount (called the "retention money") being, the percentage retention of the said amounts due to the subcontractor until the retention money reaches the "Limit of Retention money" stated in the subcontract data.

One half of the retention money shall become due and shall be paid to the subcontractor when the contractor has issued a subcontract certificate of completion in terms of clause 15.14.4. The other half shall become due and shall be paid to the subcontractor within 14 days of the expiration of the subcontract defects liability period (which may be extended).

The GCC Subcontract Agreement paints a clear picture regarding the release of the retention money to the subcontractor when the works have been completed and upon expiry of the defects liability period but what is the position if this does not happen and the contract is terminated prematurely? Unfortunately, the GCC Subcontract Agreement does not expressly provide for this.

The answer to the question is not obvious. A subcontractor will most likely argue that in such a scenario, the retention money belongs to it and it forms part of the money due to it for works duly executed. On the contrary, the contractor will likely argue that the retention money belongs to it and such money would only become due to the subcontractor once the final works have been assessed.

Interim payments in construction contracts are provisional in nature and are subject to correction until the final payment certificate is issued. As the amounts certified in interim payment certificates are based on an estimate of the works executed by the subcontractor, the amounts do not accurately reflect payment for works actually executed by the subcontractor and thus, such interim payments constitute advances on payments on account of the subcontract price, which only falls due once the subcontractor has completed the works.

---

1 McKenzie Ramsden, 'Mckenzie's Law of Building and Engineering Contracts and Arbitration', 7th edition at pages 216 to 217.

There is a plethora of case law dealing with the status of interim payment certificates.

A construction contract is recognised as a contract of *locatio conductio operis faciendi*. The general rule in such contracts is, that, in the absence of contractual provisions to the contrary, the remuneration is due and payable only when the contractor or subcontractor has completed the entire work. [2]

As provided for in the GCC Subcontract Agreement, the subcontractor is entitled to receive interim payments. The incorporation of such a provision does not make the contract divisible.

In the case of Intech Instruments v Transnet Limited t/a South African Port Operations[3], the court found that the cancellation of a construction contract rendered interim or provisional payment certificates, issued in terms of the construction contract, to be of no force and effect. Intech could not rely on interim payment certificates. Such certificates are issued from time to time as the works progress, certifying that a certain amount of work has been done. They are issued in the expectation that the entire works will be completed. Where a client lawfully terminates a construction contract, the contractor's (subcontractor in this article) claims for retention monies and unpaid invoices are not self-standing claims, separate and independent from the remainder of the contract.

It is not uncommon for subcontracts to be terminated prematurely prior to final completion of the works and prior to a final payment certificate being issued. Unfortunately, the GCC Subcontract Agreement puts the parties into the ugly space of the unknown with regards to retention.

Parties to the GCC Subcontract Agreement should consider negotiating express terms of the contract upfront to deal with payment of retention should this occur, in an attempt to:

- mitigate the adverse affects caused by a delay of payment of retention money; or
- avoid incurring legal fees to force the contractor to make payment of retention money.

Ultimately, on early termination, the subcontractor ought to be paid for all measured work executed in accordance with the subcontract up to the date of termination.

---

2 Group Five Construction (Pty) Limited v The Minister of Water and Forestry (39161/05) [2010] ZAGPPHC 36 (5 May 2010) at para 13.
3 [2019] JOL 44981 (SCA).