

PAYMENT REDUCTION - A RISK TO SUBCONTRACTORS

Clause 11 of the JBCC Principal Building Agreement distinguishes three different forms of construction guarantees / methods of security.

1. Variable Construction Guarantee: The contractor provides a construction guarantee from an approved guarantor which is normally a bank or insurance company. The value of this guarantee is initially 10% of the contract sum. This is enforceable until the final payment certificate has been issued to the contractor.
2. Fixed Construction Guarantee: The contractor provides a construction guarantee from an approved guarantor which is normally a bank or insurance company. The value of this guarantee is 5% of the contract sum. In addition to this a payment reduction of 5% of the value of each payment certificate up to a maximum of 5% of the contract sum is made. The security adjustment reduces when practical completion is reached.
3. Withhold in interim payment certificates an amount equal to 10% of the contract value. The security adjustment reduces when practical completion is reached.

The subject of this article is payment reduction as a form of risk to subcontractors. Payment reduction forms part of option 2 and 3 mentioned above.

A careful reading of clause 11.3 makes it clear that this option is in fact a compromise from the employers side to accommodate the contractor who failed to provide the required construction guarantee. If this clause (11.3.1) is implemented strictly the contractor will not receive any payment until a total of 10% of the contract sum has been withheld. A scenario like this will in most cases cause cash flow problems for the contractor. In order not to jeopardize the project, employers are lenient in this regard and withhold 10% of the value of every payment certificate.

It is important to realize that in the case of options 2 and 3 payment is withheld from the principal contractor as a form of security. The 5% or 10% should not be withheld from the subcontractors unless the principal contractor has agreed with the subcontractors to this.

Serious challenges emerges with this form of security if the principal contractor fails or struggles to reach practical completion. Failure to reach practical completion can be caused by single items not being completed to the correct standard. To withhold money from a subcontractor who has completed his scope of work in time and according to specification due to other incomplete items on the project by other parties is not fair. Subcontractors should therefore be careful when entering into a contract with principal contractors where payment are withheld as part of a security adjustment.

It is important that principal contractors realize that payment reduction as security is withheld from the principal contractor and not the subcontractors. The principal contractor must ensure that the necessary agreements are in place with subcontractors making it clear how payments will be withheld.

In a worst case scenario where the principal contractor fails to reach practical completion and 5% or 10% of payment has been withheld from all subcontractors, the principal contractor will probably find it difficult or be unwilling to pay the subcontractors who has completed their work satisfactorily. From there the premise of this writeup is derived that payment reduction as a form of security is a risk to subcontractors.

Subcontractors can reduce their risk, or at least understand their risk, by formalizing payment methods with the principal contractor. It is not unfair to expect full payment for work that has been completed according to specification and expectation.

In countries like Botswana and Zambia contractors and subcontractors often have a casual approach to contract conditions in general. All parties should ensure that the necessary agreements are in place and that the implications of payment reduction as a form of security are understood.

It is part of the business of MLC to ensure that the necessary agreements are in place with-in construction projects. Feel free to contact us. We will add value to your construction project.

Please refer to the next page for an extract from the JBCC Principal Building Agreement of the clauses discussed in this writeup.

11.0 SECURITY

11.1 The contractor shall:

11.1.1 Provide to the employer a JBCC® Guarantee for Construction, where applicable [CD], within fifteen (15) working days of acceptance of the contractor's offer and choose:

11.1.2 A JBCC® Guarantee for Construction – (variable) [CD] initially equal to ten per cent (10%) of the contract sum and keep such security valid and enforceable until the final payment certificate has been issued to the contractor [25.6]

Or ...

11.1.3 A JBCC® Guarantee for Construction - (fixed) set at five per cent (5%) of the contract sum [CD] and a payment reduction of 5% of the value of each payment certificate up to a maximum of five per cent (5%) of the contract sum [25.3.3]. The contractor shall keep such security valid and enforceable until the only or last certificate of practical completion has been issued

11.1.4 A JBCC® Guarantee for Advance Payment where an advance payment is required equal in value to the aggregate amount of all such advance payments [CD]. The contractor shall keep such security valid and enforceable until the advance payment is repaid [11.2]

11.1.5 Extend or provide a replacement JBCC® Guarantee for Construction - (variable) or (fixed) and/or a JBCC® Guarantee for Advance Payment at least twenty (20) working days before such security is due to expire [11.1.2-4]

11.2 The amount of the JBCC® Guarantee for Advance Payment may be reduced by the amount repaid by the contractor as certified by the principal agent in payment certificates. If the advance payment is not repaid by the date a certificate of practical completion is issued or practical completion is deemed achieved, or by the date of termination by the employer due to contractor default [29.9], the entire outstanding amount shall immediately become due and payable

11.3 Where the contractor fails to provide the security the employer may:-

11.3.1 Hand over the site to the contractor and withhold in interim payment certificates to the contractor an amount equal to ten per cent (10%) of the contract sum. The amount withheld shall be reduced at practical completion [19.0] to two and one half per cent (2.5%) of the contract sum and to zero per cent (0%) in the final payment certificate [25.6]

Or ...

11.3.2 Terminate this agreement [29.1.1]