

Retention in FIDIC contracts: Is it time for a rethink?

Written by Jo Clarke

Introduction

In March 2026, the UK Government announced ambitious plans to prohibit the deduction and withholding of retention payments in construction contracts, as part of a wider push to tackle late payment and improve cashflow through the supply chain.¹ While this is still subject to consultation and implementation detail, the direction of travel is clear. For those using FIDIC forms of contract on international projects, this is a useful prompt to step back and ask a basic question: do we need retention, or are there better ways to achieve the same purpose?

Retention in the FIDIC forms of contract

The FIDIC Red, Yellow and Silver Books (1999 and 2017) provide for the deduction of retention in Sub-Clause 14.3 and the release of retention in Sub-Clause 14.9.

The amount of retention is calculated by applying the percentage of retention stated in the contract (typically 3%, 5% or 10%) to certain specified amounts due to the Contractor, until the limit of retention money (if any) stated in contract is reached (typically 5% of the Accepted Contract Amount²).

The release is in stages. The first half is released after issue of the Taking Over Certificate and the second half is released after expiry of the Defects Notification Period. The contract may also provide for release of percentages of retention upon taking over of Sections.

The Engineer/Employer is entitled to withhold certification of the estimated cost of any work which remains to be executed under Clause 11 [*Defects After Taking Over*]³ and (in the Yellow and Silver Books) under Clause 12 [*Tests after Completion*] until it has been executed.

The parties may agree that part of the retention will be released and substituted by a retention guarantee, in which case FIDIC includes an example sub-clause (in the 'Guidance' at Sub-Clause 14.9) and an example form of guarantee (in the 'Forms' section of the



Joanne Clarke
Partner

T +44 (0)20 3755 5732

joanne.clarke@howardkennedy.com

relevant Books). Among other things, the parties should agree the part of retention which will be released, the point at which the release and substitution will be made, and the expiry date of the retention guarantee.

What is the purpose of retention?

The primary purpose of retention is to provide the Employer with security in case the Contractor fails to perform its obligations by not completing the works or not returning to remedy defects – and on the flip side to provide the Contractor with an incentive to do so.

From the Employer's perspective, retention also provides important security in case the Contractor becomes insolvent and, for that reason, cannot complete the works or return to remedy defects. If the Contractor becomes insolvent, the Employer has immediate access to the retained funds to mitigate the impact.

Retention goes even further than this, however. The FIDIC forms do not restrict the Employer's use of retention money or require it to be ring-fenced. Retention may therefore operate as general security against any breach by the Contractor, not just as security for defects.

¹ See the UK Government's Department for Business & Trade publication '*Late payment consultation: time to pay up – government response*' updated on 24 March 2026: [Late payment consultation: time to pay up – government response \(web version\) - GOV.UK](https://www.gov.uk/government/consultations/late-payment-consultation-time-to-pay-up-government-response).

² 'Accepted Contract Amount' in the Red and Yellow Books. 'Contract Price' in the Silver Book.

³ In the FIDIC 1999 forms, Clause 11 is [*Defects Liability*].

Retention thus operates as a relatively low-cost 'insurance policy' for the Employer against failures by and insolvency of the Contractor, in addition to other security which the Contractor is usually required to provide.

Is retention effective?

There is continuing debate about how effective retention is at achieving these purposes and how healthy it is for construction projects. Does withholding part of the Contractor's payment ensure that the Works are of the required quality, or does it create unfair financial harm for the Contractor and inefficiency on the project?

The answer may well depend on which party you are asking. Research by the UK Government in 2017, which involved interviews with and surveys of a mix of employers, contractors and subcontractors, acknowledged the original purpose of retention as security for defects but found widespread dissatisfaction and evidence of abuse.⁴

The use of retention nonetheless remains widespread, probably because it is a well understood and relatively easy form of security which does go some way to affording protection for quality even if it has other flaws. There is no third-party provider to deal with, no underwriting, and (from the Employer's perspective) no upfront cost.

The convenience of retention from the Employer's perspective does, however, come at a cost. Retention directly affects the Contractor's cash flow. In projects with a tight margin, the retained amount can be equivalent to the Contractor's profit. The impact on cash flow can cascade through the supply chain, as similar amounts are often withheld at each tier. This feeds into the Contractor's pricing and the Contractor will likely price this into the contract sum.

From the Contractor's perspective, retention carries risks beyond pricing. It is a frequent source of dispute because of delayed release, partial release or non-payment by the Employer without clear justification. Contractors can spend significant time and money chasing release of retention, which the Contractor has

earned and should be paid in accordance with the contract. Retention also poses an important credit risk for the Contractor. Where retention is not protected or ring-fenced, it sits with the Employer as an unsecured debt. If the Employer (or an upstream contractor) becomes insolvent, the retained sums may be lost, and this is a well-recognised risk through the supply chain.

The UK Government's plans

Prior to its announcement in March 2026, the UK Government consulted about the future of cash retention in the construction sector and whether legislative reform was needed to address these concerns. It proposed two options:

- (A) a full legislative prohibition on the practice of cash retention in construction contracts and
- (B) the introduction of a mandatory retention deposit scheme under which retained sums would be ring-fenced in a protected account.

The Government favoured Option (A) (outright ban) because it was seen as simpler to implement, understand and enforce, and more effective in eliminating the problems of late and non-payment, particularly the loss of retention funds through upstream insolvency. By contrast, Option (B) (ring-fencing) was rejected on the basis that, while protective in theory, it would retain the underlying practice of retention and introduce additional complexity without fully addressing abuse or improving cashflow across the supply chain.

In terms of alternatives to retention, the UK Government recognises that:

'There is [...] a need to create a larger and more sophisticated surety market to support the construction sector and its clients if retentions are no longer a means of mitigating risk. This is likely to require the development of a range of solutions in order to meet the needs of both construction clients and the supply chain.'⁵

And therefore:

'To address concerns about build quality and surety

⁴ The research found that retention is widely used in the construction sector but frequently associated with late and non-payment, particularly due to insolvencies and payment practices higher up the supply chain. It concluded that retention imposes a significant financial burden, with billions of (British) pounds withheld at any one time, that contractors price this risk into tenders which increases

overall project costs, and that overall retention constrains cash flow and business growth. See the UK's Department for Business, Energy & Industrial Strategy (BEIS) Research Paper 17 dated October 2017 entitled '*Retentions in the Construction Industry*' at page 16: [Retentions in the Construction Industry](#)

⁵ See footnote 1 above.

alternatives, we will work with the Construction Leadership Council and construction clients to develop practical approaches to minimising defects, as well as working with the financial services sector to identify ways of developing the surety market for the construction sector.¹⁶

How are quality and insolvency risk managed in the FIDIC forms of contract?

As mentioned above, the FIDIC Red, Yellow and Silver Books (1999 and 2017) include provision for retention, which is the most obvious way in which the FIDIC forms provide security for quality of the Works – but they also contain other provisions aimed at ensuring quality and security for the Employer against the risk of Contractor insolvency.

Under these FIDIC forms, responsibility for quality control rests jointly with the Contractor and the Engineer/Employer. FIDIC incorporates mechanisms to support this, including quality assurance systems (Sub-Clause 4.9), inspection and testing (Sub-Clause 7.3), non-conformance and rejection (Sub-Clauses 7.5 and 7.6), and the Defects Notification Period (Clause 11). The way in which these mechanisms operate varies depending on the form used.

The shift from the 1999 to the 2017 editions is significant because the 2017 forms place greater emphasis on structured quality management and proactive contract administration. Where these mechanisms operate effectively, the need to rely on retention to secure the quality of the Works and compliance with defect rectification obligations is arguably reduced.

These FIDIC forms also provide the Employer with other tools, apart from retention, to protect itself financially against non-compliant work. The payment certification provisions in Sub-Clause 14.6 of the 2017 FIDIC forms allow the Engineer to withhold sums from Interim Payment Certificates where work does not comply with the contract or the Contractor fails to perform its obligations.

Arguably, these quality control mechanisms and

certification powers could stand as a substitute for retention, but they would not be effective against defects that only emerge at a later date and would not protect against the risk of Contractor insolvency.

Retention sits alongside and may overlap with other forms of security built into the FIDIC forms. For example, where the Contractor has provided a Performance Security (Sub-Clause 4.2), Advance Payment Guarantee (Sub-Clause 14.2) or Parent Company Guarantee (example forms of which are included in the FIDIC books) the Employer has readily-enforceable protection against Contractor performance risk and insolvency, while avoiding the adverse impact of retention on the Contractor's cashflow.

Retention in NEC compared with FIDIC

In the FIDIC forms, retention is assumed and embedded as the default position. NEC, by contrast, treats retention as optional and emphasises that it may not be necessary on a well-managed project. The NEC focus is proactive contract management, quality control and early intervention, with the expectation that defects should be identified and addressed as the works progress rather than being dealt with through retention.⁷ In practical terms, NEC invites parties to justify the use of retention, whereas FIDIC assumes its inclusion unless the parties decide otherwise.

The international view of retention

The UK Government's proposed move towards banning or reforming retention reflects a growing view internationally that retention creates more problems than it solves, particularly around cashflow and insolvency risk. The UK is not the only jurisdiction grappling with this issue. Other countries, such as New Zealand, have taken a different approach by requiring retention monies to be held on trust rather than banning them outright.⁸

If the UK Government's proposal to ban retention is implemented and proves successful, other countries may also consider banning or otherwise reforming retention.

⁶ See footnote 1 above.

⁷ See for example the '*NEC and CLC Guidance for Dealing with Retention Payments Under NEC3 and NEC4 Contracts*' dated November 2022: [NEC-and-CLC-Guidance-for-Dealing-with-Retention-Payments-Under-NEC3-and-NEC4-Contracts-Final-9-11-22-1.pdf](#)

⁸ In New Zealand, the Construction Contracts (Retention Money) Amendment Act 2023 brought in measures including holding retention funds on trust in a separate bank account. Similar provisions apply in certain states in Australia and in Canada and parts of the United States.

Where does this leave FIDIC users in an international context?

Many would argue that there remains a legitimate need for retention as a simple 'insurance policy' against non-performance by the Contractor, particularly on higher-risk and higher-value projects. The retention provisions in the FIDIC forms are clearly drafted, generally well understood and simple to use, and parties may choose to substitute a retention guarantee at an agreed point which will normally help the Contractor's cash flow.

The UK Government's proposal will shake things up however and there may be increasing pressure on parties internationally – in addition to FIDIC users in the UK who will be at the forefront of this shake up – to consider alternatives to retention more carefully.

These may include a wider variety of guarantees and bonds than are currently available (as noted by the UK Government, the surety market will need to be developed to cope with the proposed ban on retention), warranties for defects backed by insurance, project bank accounts, and potentially amendments to the procedures for taking over and defects notification which will have to be done carefully to maintain FIDIC's fair risk allocation.

What could FIDIC users be thinking about in practice?

Instead of including retention by default, decisions regarding retention can be made on a project-specific basis, so that retention is one tool among several, to be considered in the round. In practice, this comes down to a few key questions, the answers to which may help clarify whether retention will genuinely address a real project risk or is simply being included by habit.

What are the quality and insolvency risks?

What quality risks are being managed? Are they already covered by quality management, payment provisions and performance security? What is the likelihood of defects arising and when might they arise (during construction or post-completion)? What is the Contractor's track record? What is the Contractor's financial robustness?

Avoid duplication

If effective quality management and performance

security are in place and the Contractor is financially sound, is retention adding anything meaningful? Mapping out what each form of security covers may help ensure that mechanisms are not overlapping or creating unnecessary cost.

Consider the impact on cashflow

What will retention do to the Contractor's pricing and financial resilience? Retention will usually be priced into the contract and, on lower-margin projects, may directly affect the Contractor's ability to manage cashflow. This can influence the Contractor's performance, supply chain stability and overall delivery.

Think about substitution

Is it appropriate to release retention and substitute it with a retention guarantee at an agreed stage? For example, once risks reduce or the works are complete, a transition to a retention guarantee may provide sufficient protection for the Employer while improving cashflow for the Contractor.

Include clear drafting

If retention is included, the provisions on deduction and release (Sub-Clauses 14.3 and 14.9 in the 1999 and 2017 FIDIC forms) and for any retention guarantee should be clear, precise and workable.

Final thoughts

For international construction contracts based on the FIDIC forms, it is unlikely that retention will disappear any time soon. It is possible, however, that more countries will start to consider reforming retention regimes in the next few years, to follow the initiative of the UK and other governments.

Given this direction of travel, retention should not necessarily be the automatic or default position. In this context, it probably is time for FIDIC users to rethink retention – not to remove it entirely, but to use it more deliberately, where it genuinely adds value to the project.

I would be happy to answer any questions you may have regarding these issues. Please feel free to contact me at joanne.clarke@howardkennedy.com.