

PAM
**/ PRACTICE
NOTE**

**/ RETENTION UNDER
THE PAM CONTRACTS
2006 AND 2018:
“SAME-SAME
YET DIFFERENT”**

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Notes:

- ¹ Under both Clauses 30.2 and 30.5, it is quite clear that Employers *may* retain the retention; i.e.; such retention would seem to be at the Employer's discretion. Nevertheless, it is doubtful if any Architect has ever sought their Employers' confirmation as to how this discretion is to be exercised and if any Employer has ever chosen not to retain this sum.
- ² [https://www.designingbuildings.co.uk/wiki/Retention_in_construction_contracts#:~:text=Retention%20is%20a%20percentage%20\(often,of%20them%20under%20the%20contract.](https://www.designingbuildings.co.uk/wiki/Retention_in_construction_contracts#:~:text=Retention%20is%20a%20percentage%20(often,of%20them%20under%20the%20contract.)
- ³ A question once asked by an Employer to the writer was “*why do we have to have provisions against latent defects; aren't the skills and workmanship of Contractors good enough for a defect free product?*”

In the real world, it is very unlikely that any building/product can ever be delivered without any defects and as much as defects are indeed related to a Contractor's skill (and the project's budget), it must also be remembered that many latent defects are inherent in the materials and construction methods we specify; for example, conventional, sand, cement and lime render (more commonly known as “plastering”) will always be prone to hydration cracks as the finished surface dries out.

Although construction technology has improved to help minimise the possibility of defects, it is, as noted earlier, unlikely that we shall ever be able to eliminate defects completely; hence the importance of the Retention Fund.

A reminder though to all readers; damage occurring due to *normal wear and tear* is not a latent defect. If any part of the building does suffer premature damage arising from normal wear and tear, there may exist the possibility that the defect lies in incorrect specification by the Architect and Consultants; this is left to the Professional Architect as the Contract Administrator to ascertain.

Practice Note: Retention under the PAM Contracts 2006 and 2018: “Same-same yet DIFFERENT”

Preface

This Practice Note (PN) is the fifth in a series of Notes issued to assist and clarify the administration of Building Contracts based on the PAM Contracts 2006 and 2018 for Architects, stakeholders and other interested parties.

The issue of Retention though is not one that exists in isolation and readers may find it beneficial to read this PN together with PN 2023-2, *Interim Certification under the PAM Contracts 2006 and 2018*.

As for all the PNs in this series on Contract Administration, the intention is to always try and deliver the message as directly as possible with any supporting information being consigned to footnotes. It is the writer's opinion though that these footnotes are as equally relevant and all readers are encouraged to *not ignore them*.

Introduction

With the PAM Forms of Contract, the Contractor is progressively paid for his work through the issuance of Interim Certificates. These certificates would indicate the value of the total amount of work properly executed along with a percentage of the total value of any goods and materials delivered to site. Contractors though do not get paid the above-mentioned total as under Clause 30.2, there has to be a deduction for “*...any amount which may be retained by the Employer under Clauses 30.5 and 30.6...*”. Clause 30.5 calls this retained amount the “*Retention Fund*”¹.

The intention of this PN is to try and help us understand the rationale behind the Retention Fund as well as the differences to the Fund between the PAM Contract 2006 and 2018.

Retention – what is it for?

A quick answer has it that; “*The purpose of retention is to ensure that the contractor properly completes the activities required of them under the contract*”².

This reply in itself, is perhaps, less than satisfactory. After all, only work which is *properly executed*, is to be included into any Interim Certificate and if the work is indeed, properly executed, isn't this in itself, evidence that a Contractor has properly completed (at least part of) the activities required of him under the contract? This is where we need to expand our consideration of what actually constitutes activities required under the contract.

A most convenient starting point would be to look into the issue of defects. If there is a **patent defect** in part of the work, it would follow that this part has not been properly executed; the defect would first require rectification before it is to be included into any Interim certificate.

If there are **latent defects**³ though, there can be no immediate requirement for any rectification (for unless we had a crystal ball to look into the future, we would be unaware of the existence of these defects, let alone their nature and extent) and we may proceed to deem that part of the work as being properly executed.

If after certification though, a defect would now appear, i.e., it changes from *being latent to being patent*; it would not be unreasonable for the Contractor to rectify this defect. If the defect should occur before Practical Completion, the rectification would automatically fall under his responsibility. If there are defects which become patent after Practical

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⁴ As seen under footnote 3, defects such as cracklines in plastered walls, are often already inherent in the types of construction we specify and although not explicitly provided for in the PAM Contract, it would be a fair assumption that the DLP is primarily meant for latent defects of this nature which may *appear within a reasonable time* after Completion; Contractors are certainly not expected to be perpetually responsible for defects which may appear.

This does not mean though that a Contractor bears no responsibility for defects which may be discovered after the expiry of the DLP; it is just that for defects discovered within the DLP, the PAM Contracts 2006 and 2018, have specific provisions for an Architect to instruct their rectification (please refer to Clauses 15.4 and 15.5). For **defects which occur after the expiry of the DLP**, the Employer's recourse would unfortunately lie outside of any provisions within the contract; i.e. they may have to lie in negotiation or legal action under tort law.

⁵ To be sure, retention is not the only form of financial leverage available to help ensure due performance by a Contractor; the PAM Contract also has provisions for the calling upon Performance Bonds, the issuance of Architect's Instructions (AIs) and the use of set-off (under Clause 30.4). It must also be remembered that to be truly effective, the retention also needs to be used in conjunction with the provisions for set-off.

⁶ This writer remembers being taught a *very long time ago* that the retention should be equivalent to the profit a Contractor can expect from undertaking the Contract. This is not unreasonable; a Contractor should be entitled to walk away with his profits only after he has completed all of his contractual obligations. Attempts to confirm this with most contractors have not been successful though as most are understandably, reluctant to divulge their expected or actual profit (or loss). Irrespective of whether this basis is indeed still applicable, the construction industry would seem to have settled for retention being within this range of 5 to 10%.

⁷ It goes without saying that any percentage set by the Employer must be AGREED upon by the Contractor and to ensure such agreement, this percentage (along with the Limit of Retention Fund) must be clearly spelt out in the tender documents.

⁸ The writer is still trying to find out the origins of starting off with a retention amounting to 10% up to a max. of 5% of the Contract Sum. Nevertheless, this sliding scale for retention does not seem unreasonable; when works first commence, the potential for latent defects are surely greater and the financial risks (to an Employer), arising from a Contractor's non-performance would as such, also be greater.

Completion; i.e., when possession and responsibility of the Site/Works have since passed back from the Contractor to the Employer, the PAM Contracts cater for this eventuality by having a *Defects Liability Period (DLP)*⁴ (under Clause 15.6) with the Contractor also being held responsible for the rectification of any defects which are discovered during this DLP.

If a Contractor had already been paid in full though for this part of the work, the reality is that the Employer and Architect may not have any leverage to force him to actually return and rectify the defect. This is where the Retention Fund comes into play; by being able to retain part of the amounts due to a Contractor, an Employer also retains some financial leverage to try and ensure that the Contractor does indeed return to complete his activities as required under the contract (such as the rectification of defects) before he is able to receive his payment in full⁵.

This incentive to return is not just to ensure a Contractor's due performance with respect to defect rectification but based on the wording in the Contract Forms as well as in practice, this would seem to have become the primary purpose of the Retention Fund.

Apart from the financial leverage the Retention Fund provides, it also ensures that the Employer does indeed, have some funds available from the contract (which may be *set-off* in accordance to Clause 30.4), to employ others to rectify the defects in the event a Contractor is unable or unwilling to do so. To ensure that the Employer is not *out-of-pocket* with regards to the cost of employing others to rectify any defects, Architects need to remember that the scale of the defects should ideally, never be greater than the coverage provided by the Retention Fund.

Retention as applied to the PAM Contract 2006

In applying the principle of retention, most building contracts allow for a specific percentage of any amount due to the Contractor to be **retained**; the percentages commonly found range from between 5 to 10%⁶.

For the PAM Contract 2006, the Employer may set the percentage which may be retained by clearly defining it under the **“Percentage of Certified Value Retained”**⁷ within the Appendix. If no percentage is specified, the PAM Contract 2006 sets the percentage at **10% up to a maximum amount** known as the **“Limit of Retention Fund”**.

This maximum amount/Limit of Retention Fund in turn, is also required to be specified in the Appendix. If this amount is not specified, the PAM Contract 2006 sets this maximum amount as **5% of the Contract Sum**.

What this means is that when a project commences, the following should occur:

- a. An Employer starts by retaining up to 10%⁸ from any progress payment due to the Contractor. As noted earlier, this money, as retained by him, is known as the **Retention Fund**⁹.
- b. As the works progress, the amounts payable to the Contractor as well as the amounts to be retained by the Employer would naturally grow. Once the Retention Fund reaches the amount specified under the **Limit of Retention Fund** though, the Employer is no longer entitled to retain any further amounts. In real terms, this sets the maximum amount an Employer can ever retain to be 5% of the Contract Sum¹⁰.
- c. Once **Practical Completion has been reached** and is certified by the Architect, the Architect is obliged to issue a certificate to the Employer within 14 Days of the date of the Certificate of Practical Completion (CPC), for the payment/release of **ONE HALF of the Retention Fund** to the Contractor with such payment/release having to be made within the Period of Honouring Certificates as set out in the Appendix.

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⁹ It must always be remembered that the Retention Fund belongs to the Contractor and is only being retained/held in trust by the Employer.
If a Contractor really does perform all the activities required of him under the contract satisfactorily, the Retention Fund should be released back to him.

¹⁰ The Contract Sum is the sum found under Article 2 of your PAM Contract; it is supposed to be the SUM the Contractor would be paid for carrying out the Works. The *actual* (and final) sum which is payable to a Contractor though, i.e., the final and total value of the Works, may end up being different. Like the other parts of the Articles of Agreement which require filling in, the general intention is that once they are filled in; they cannot be changed. If there can be no change to the Contract Sum, it would also follow that there can also be no change to the quantum under the Limit of Retention Fund.

- d. Upon the expiry of the DLP, the making good of all defects in accordance to Clause 15.6 and the Architect's issuance of the Certificate of Making Good Defects (CMGD), the Architect is obliged to issue a certificate to the Employer within 14 Days of the date of the CMGD, for the release of the **REMAINING BALANCE of the Retention Fund** to the Contractor with such payment/release having to be made within the Period of Honouring Certificates as set out in the Appendix.

Is this system of Retention under PAM Contract 2006 fair (and in the best interests of the Contractual Parties)?

Getting an answer to this depends on the context and whom you ask; most Contractors would probably tell you outright that the system is unfair. To examine how *equitable* it is, let's look at 2 examples.

Example 1 – The large, complicated project with lots of Nominated and Specialist Sub-Contractors.

Let us imagine that we are the Contractor for a very large and complex hi-tech factory or data centre. The Contract Sum is RM 100 Million, of which RM 50M is for work directly under you as the Main Contractor with the balance (RM 50M) to be carried out by Nominated Sub-Contractors (NSCs) through the award of Prime Costs (PC) Sums provided for in the Contract. A quick mental check will tell us that the Limit of Retention Fund, i.e.; the maximum amount the Employer may retain, would be RM 5M.

As a Contractor, you proceed diligently with your portion of the Works and now, you have reached a value of the properly completed works of RM 45M (with the Employer being entitled to retain RM 4.5M up to this stage). In the meantime, due the highly specialised nature of the work under the PC Sums, your Architect informs you that there are problems negotiating with the prospective NSCs and he is unable to award the PC Sums in accordance to your programme. Nevertheless, he has no objections for you to give notice if the Works are delayed with a view of claiming for an extension of time.

So, as a Contractor, you have completed almost all of the work directly attributable to you (90%); you have no control over any of the negotiations for the award of the PC Sums and as the Retention Fund has yet to reach its Limit, the Employer is still in a position of being able to retain up to 10% of the value of work which you have properly completed to date. A quick check on the difference between having 10% retained relative to having 5 % retained will surely have a major effect on your cash flow and your working capital.
Does this sound fair?

Now, let us further imagine that due to the difficulty in negotiations with the prospective NSCs, the Employer makes a decision to deal with them directly by omitting their portion of the work (and the PC Sums) from your contract in order to enter into direct contracts with these Specialist Contractors instead. As there would be less work for you as a Main Contractor (there would no longer be NSCs' work to manage and attend to), there would also correspondingly, be a reduction in the amounts due to you relative to the Contract Sum BUT since the Contract Sum does not change, your Limit of Retention Fund also remains unchanged; it remains at RM 5M even though the value of your work has reduced to RM 50M. **Less work, less responsibility BUT NO Change to the Retention the Employer can retain.** *Is this equitable to you as the Contractor?*

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¹¹ In return of sacrificing some of the comfort a sliding scale of retention would afford at the initial stages of a Contract (such as that found in PAM Contract 2006), there is now a much simpler and accessible method to calculating (and understanding) retention for the PAM Contract 2018 based on a single and constant percentage..

Example 2 – The “minor” renovation.

Now, let us move to an opposite end of the building spectrum; you are the Architect for the renovation of a private home which has been awarded with a Contract Sum of RM 500,000. Although the works have been progressing smoothly, your Employer comes to you one day to let you know he has just received a windfall (it could be an inheritance from an unknown relative or the mysterious discovery of bags of cash in his car boot) which he wants to utilise for his renovation. He tells you to upgrade the specification; stainless steel taps become gold, ceramic wall and floor tiles turn into imported Italian granite or marble and the entire house is now fully air-conditioned with the end result being that the Value of the Works has now increased from RM 500,000 to RM 1 Million.

With an increase in the value of the works, it would not be unreasonable to assume that any potential defects which may appear would also carry an increase in their potential rectification costs; i.e., the cost of replacing a piece of damaged, imported granite would be greater than that for replacing a damaged ceramic tile, BUT since the Contract Sum does not change, your Limit of Retention Fund also remains unchanged. **More work, more responsibility BUT NO Change to the Limit of Retention Fund. Is this fair (or prudent) to the Employer?**

Enter – PAM Contract 2018

Obviously, not all building contracts would fall under the above examples. If anything though, there will be many more variations which may throw the equitability of a contract off balance. Nevertheless, based on the above examples, it can be seen that basing the Retention Fund on the Contract Sum (*which may end up being very far from the value of work undertaken by a Contractor*) may not be reflective of provisions which should be made to ensure due performance under equitable conditions.

To help address this issue, the PAM Contract 2018 undertook the following changes:

1. There is no longer a sliding scale starting off with retention at 10% leading up to a maximum of 5% of the Contract Sum.
Retention for the PAM Contract 2018 is now standardised at a constant percentage of the value of works properly completed (the “Percentage of Certified Value Retained”) from commencement up until Practical Completion. If this constant percentage is not stated, the PAM Contract 2018 sets it at 5%.¹¹
2. There is no longer a Limit of Retention Fund, let alone one which is based on the Contract Sum.

What this means is that when a project using the PAM Contract 2018 now commences, the following should occur:

- a. An Employer starts by retaining the Percentage of Certified Value Retained (as in the Appendix) from any progress payment due to the Contractor. This money, as retained by him, is still known as the **Retention Fund**.
- b. As the works progress, the amounts payable to the Contractor as well as the amounts to be retained by the Employer would also naturally grow but as there is no longer a “Limit of Retention Fund”, the Retention Fund will continue to grow in tandem based on the above same Percentage of Certified Value Retained being applied to all interim payments until the Works reach Practical Completion.
- c. The release of whatever amounts that are to be found in the Retention Fund shall nevertheless, still follow the same procedure as set out under PAM Contract 2006; i.e. ONE HALF after Practical Completion with the REMAINING HALF after the making good of all defects found at the expiry of the DLP.

With the above measures, the Retention Fund is now based wholly on the actual work certified as being completed. If there are any omissions or additions of work relative to the original scope of the Contract (and as long as the Architect ensures that these omissions or additions are duly accounted for in his Interim Certification), there should now be provisions to ensure that the retention is reflective of the actual work carried.

Conclusion

To a large degree, the PAM Contract 2018 is based on the PAM Contract 2006; for the most part, the two versions are generally the same but there are differences, and it is this writer's opinion that the most significant difference between the two versions lies with how the Retention Fund is viewed and calculated. It is also this writer's opinion that this change alone (to a more equitable, sensible and practical method of dealing with retention) justifies the price of migration from the PAM Contract 2006 to the PAM Contract 2018.

PRACTICE NOTE | PN 2024-3

This Practice Note was authored primarily by Ar. Joseph Tan, reviewed by Practice Note Working Group, Professional Practice Committee 2024-25 and issued on 25 October 2025.

Practice Notes are a guide for Architects to rely on, and provides clarity on a particular subject but it should also be considered in relation to their respective projects. As in all practices, there are peculiarities and specific issues which PN may not or cannot cover. Therefore Architects must exercise their own judgement.