



briefing

Voice of the Specialist Engineering Contractor

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For further information on all
aspects of SEC Group and its
activities contact:

John Nelson
Executive Secretary
**SPECIALIST ENGINEERING
CONTRACTORS GROUP**
34 Palace Court
London
W2 4JG
Tel: **020 7313 4819**
Fax: 020 7727 9268
E-mail:
contact@secgroup.org.uk
Website: www.secgroup.org.uk

PROJECT BANK ACCOUNTS QUESTIONS AND ANSWERS

What is a project bank account (PBA)?

It is a **ring-fenced bank** account out of which payments are made directly and simultaneously by a client to a lead contractor **and** members of his supply chain.

What is meant by "ring-fenced"?

The PBA must have trust status which means that the monies in the account can only be paid to the beneficiaries – the lead contractor and supply chain members. The account would be held in the names of trustees who are likely to be the client and lead contractor (but members of the supply chain could also be trustees).

Do I get paid if the client or main contractor goes into administration?

The advantage of trust status is that an insolvency practitioner (administrator or liquidator) appointed to the client's or lead contractor's company cannot have access to the monies in the account due for payment to the supply chain.

So, payments do not come out of the lead contractor's own account?

That is correct.

I've been told that PBAs are only for big projects. Is this correct?

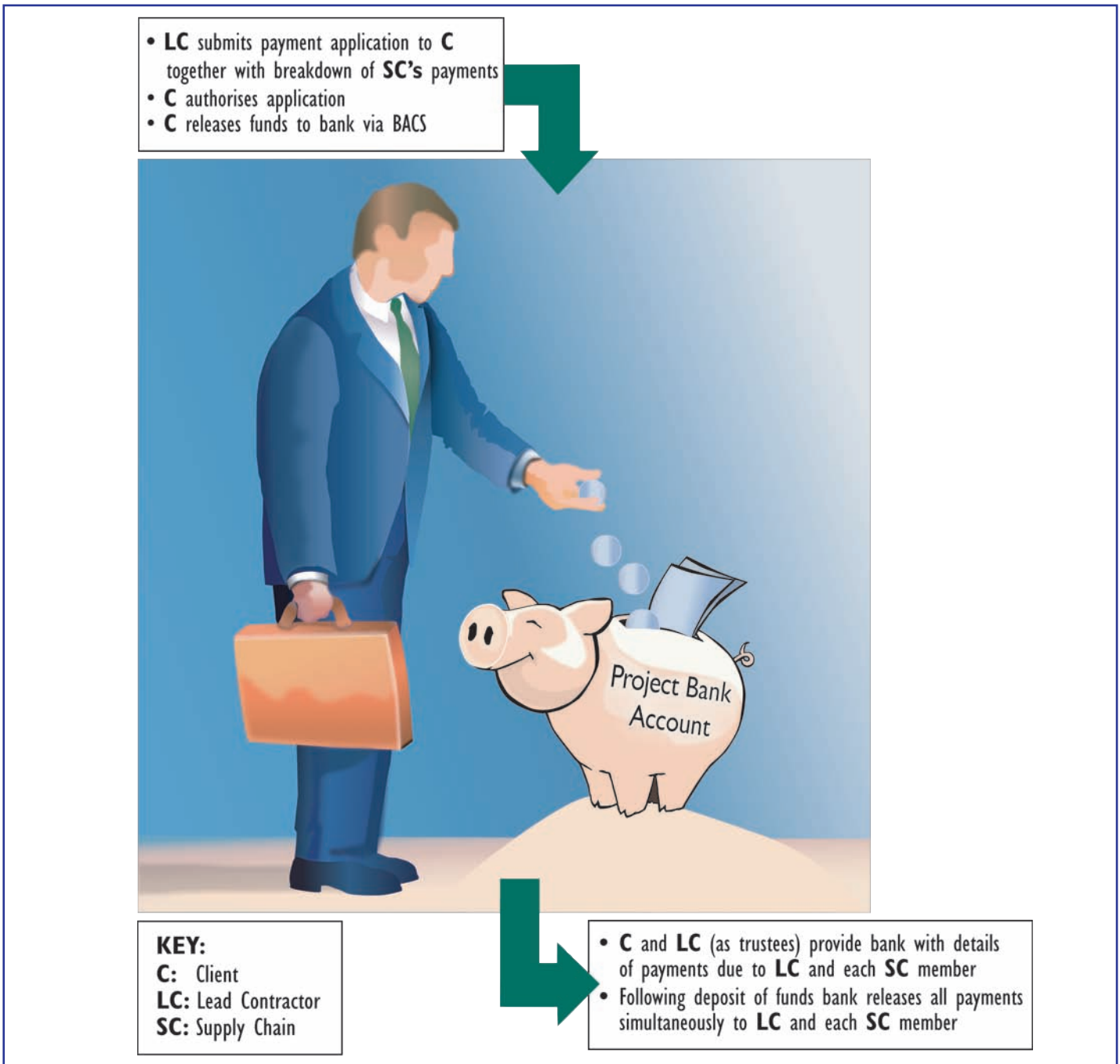
The simple answer is **No**. A PBA may be suitable for a £1m project or even smaller projects **if** there happens to be numerous sub-contractors.

Aren't PBAs already used on construction management and Private Finance Initiative (PFI) projects?

On a construction management project the client pays the trade contractors directly (following certification of the due sums by the

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construction manager). The client's account is **not** ring-fenced. If the client goes into insolvency the trade contractors are unlikely to receive anything. On PFI projects the consortium (the Special Purpose Vehicle) will have a joint bank account for the purpose of drawing down funding for the project. But the firms (i.e. specialist contractors and suppliers) physically delivering the project will not be paid directly out of this account.



Who supports the use of PBAs?

PBAs were first recommended in 2005 by the National Audit Office (NAO), the “watchdog” which audits the use of taxpayers’ monies. The NAO proposed that government clients should use PBAs because they provided payment security to the supply chain as well as producing cost savings to the client.

The Office of Government Commerce (OGC) – responsible for advising and guiding the government’s approach to procurement - launched its *Guide to best Fair Payment practices* in September 2007. This recommended that, as from 1 January 2008, public sector clients (e.g. those responsible for

procuring defence installations, prisons, courts, hospitals, roads and schools) should use project bank accounts where “**practicable and cost-effective**”. Research carried out by OGC indicated that clients could save up to 2½% of project costs by having PBAs. The Guide* was endorsed by the Public Sector Construction Clients Forum which represents the largest government procurers of construction works.

In July 2008 the House of Commons Business and Enterprise Committee endorsed the use of PBA's as a means of improving payment practices and facilitating integrated working. Central government procurers should make use of PBAs and the OGC were invited to monitor take-up and evaluate the benefits.

Although the OGC's recommendation on PBAs is directed at public sector clients there has been some interest in the concept from clients in the retail sector. SEC Group is aiming to interest more private sector clients in PBAs.

Aren't lead contractors going to oppose PBAs because they will be deprived of the use of their supply chains' cash?

The Guide to best 'Fair Payment' practices was signed by the Chairmen/Presidents of the industry's representative bodies including the Construction Confederation – which, at that time, represented the major UK contractors. Any reduction in margins incurred by lead contractors (in not having access to their supply chains' cash) could be offset by the reduction in costs to the supply chain in having a PBA. Moreover a PBA would promote greater harmony and teamworking which would, in turn, help reduce costs for all members of the project team. There should be less time spent on dealing with payment issues and consequently fewer disputes.

The Guide is downloadable at www.secgroup.org.uk

So, what are the benefits for the supply chain?

The two major benefits are:

- Once the client has deposited the monies in the PBA the supply chain's cash is safe since the PBA is ring-fenced.
- Payments out of the PBA are made simultaneously to everybody; the lead contractor, will not be in a position to delay payments.

In a 2006 survey of specialist engineering contractors (audited by Davis Langdon) SEC Group found that 65% of firms thought that their costs would be reduced through the use of PBAs. Most of the cost savings would be found in not having to chase outstanding monies or in not having to finance lengthy credit periods.

What about retentions? Will they be protected by a PBA?

PBAs will often be used to reinforce or facilitate teamworking. In this context retentions are not appropriate because they signify a lack of trust. If they are applied they can remain in the PBA until due for release. Consequently they would be protected from client or lead contractor insolvency.

What happens if a sub-contractor has done work for the lead contractor which was not originally procured by the client?

The lead contractor will, of course, directly owe the sub-contractor the monies for the work. Such monies wouldn't go through the PBA.

What about withholding? Can monies still be withheld by the paying party?

Yes, provided that payer (usually the main contractor) has issued a notice of withholding in time (i.e. before the final date for payment). If the full amount of the relevant payment has gone into the PBA it will be paid directly to the sub-contractor. PBAs do not cut across existing contractual/statutory obligations or entitlements but since the cash is not in the payer's pocket, there is no incentive to issue spurious withholding notices in order to hang on to it.

But, with cash going through a PBA, wouldn't lead contractors suddenly lose a slice of their turnover?

The thing to remember about a PBA is that it is only intended as a **safe receptacle for the cash**. It is not intended to affect entitlement to payment or liability to make payments. The lead contractor, therefore, remains liable for any amounts remaining which are not paid into the PBA. As each payment is agreed with the client the monies are lodged (electronically) by the client in the PBA. The lead contractor and client – as trustees of the account – mandate the bank to simultaneously make the stipulated payments to the lead contractor and supply chain. In effect the lead contractor is discharging payment to the supply chain albeit through the conduit of the PBA rather than through his own "pocket". For VAT purposes the main contractor will bill the client for the total value of the workand, similarly, sub-contractors will bill the main contractor. Therefore the payments will be entered in the contractor's books and used to calculate turnover*.

** Reference should be made to FRS5, the Financial Reporting Standard issued by the Accounting Standards Board in November 2003 (Application Note G60).*

How long do the monies remain in the PBA?

In respect of each payment the relevant monies will be in the PBA no longer than 5 days – the amount of time needed to discharge the payments electronically through BACS (other electronic payment systems may require 2 or 3 days).

Who gets the interest for the periods when the funds are in the PBA?

This is a matter for agreement between the client, lead contractor and supply chain. In practice it is likely that interest earned will go to discharge the cost of setting up the PBA.

Are the commercial banks supportive?

So far two banks – Barclays and Bank of Scotland – offer PBA arrangements. If you require details of the contacts of these banks please contact John Nelson (contact@secgroup.org.uk)

Do any of the standard contracts have PBA provisions?

Yes. Both the New Engineering Contract (NEC3) and the Project Partnering Agreement (PPC2000), published by the Association of Consultant Architects, have PBA provisions. The Joint Contracts Tribunal has recently published PBA provisions for its contracts.

Is there a need for any training in the use of PBAs?

PBA arrangements are not complex but it is advisable for clients, lead contractor and supply chain to

have training. The use of PBAs is likely to become more widespread and, therefore, firms may be interested in knowing more about them. If so contact should be made with the trade association. Alternatively, Brian Kilgallon at Rider Levett Bucknall (telephone: 0121 503 1612, email: brian.kilgallon@uk.rlb.com) can be contacted to provide advice and training. (Brian Kilgallon was directly involved in setting up the first PBA in 2001 on the Defence Logistics Headquarters project near Andover in Hampshire).

What additional contract provisions are required for PBAs?

The additional provisions will stipulate that a PBA is set up for the project and the procedures involved. Payments to the supply chain are likely to be made electronically (e.g. through BACs) by the bank. There will be an additional document – the trust deed. This will give trust status to the account and will be signed by the bank and the trustees with the beneficiaries (the lead contractor and supply chain) named on the deed. The trust deed won't be signed by the bank; it merely needs assurance that the deed has been put in place.

What can firms do to promote PBAs?

Payment systems in the industry are outdated. PBAs represent a modern approach that encourages teamworking and greater efficiency. The Government is committed to them. There is a win-win for all parties through reduction in costs or overheads. PBAs can be promoted in the following ways:

- Form alliances with lead contractors sympathetic to PBAs and invite public sector clients to set up PBAs (the management of the ProCure 21 hospital works programme is interested in this type of approach).
- Invite Public sector clients to use PBAs as recommended by the *Guide to Fair Payment Practices*.
- Consider the option – where appropriate – of providing two bids; one that takes account of a PBA and the other that reflects a traditional payment process.



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