MacRoberts LLP

Project Bank Accounts in Scotland

15 Key Questions

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Project Bank Accounts (“PBAs”) in Scotland

In September 2016, the Scottish Government published the following documents relating to the use of Project Bank Accounts (PBAs):

- “Implementing Project Bank Accounts in Construction Contracts” (23 September 2016) (referred to in this note as “the Guidance”)
- “Scottish Government Template Trust Deed” (referred to in this note as “the Trust Agreement)
- “Selection Stage Notices and Contractual Enabling Clauses” (referred to in this note as “the Enabling Clauses”)

In this note, we consider some key questions arising from this initiative.

1. What is a PBA?

A PBA is a bank account that is opened for a construction project for the purposes of holding money in trust for the benefit of named beneficiaries and dispersing payment direct to those named beneficiaries.

The account will be opened in the joint names of the Employer and the Main Contractor in the capacity of trustees.

Once money is deposited into the account, the Employer and the Main Contractor as trustees will have no beneficial interest in the money. All that the Employer and the Main Contractor will be able to do is operate the account as trustees for the benefit of the named beneficiaries.

Provided a legal trust is created under Scots law, the Employer and the Main Contractor will have no beneficial interest in the money once it is deposited in the account and will hold the money as trustees for the benefit of named beneficiaries, therefore if either the Employer or the Main Contractor becomes insolvent the money in the PBA will not form part of the insolvent estate, and will therefore be protected for the benefit of the named beneficiaries.

The named beneficiaries will be the Main Contractor and suppliers within the Main Contractor’s supply chain.

2. How are the PBA arrangements set up?

Five key aspects of the PBA arrangements are as follows:

- **Enabling Clauses**: there will be clauses in the main contract and supply chain contracts that deal with the operation of the PBA arrangements and payment from the PBA.
- **Trust Agreement**: there will be a separate Trust Agreement entered into between the trustees (Employer and Main Contractor) and the beneficiaries of the trust (Main Contractor / supply chain members) that sets up the legal trust and sets out arrangements for payment from the PBA.
- **Additional Party Agreement**: there will be a procedure for adding additional supply chain members to the Trust Agreement – this is called the Additional Party Agreement.
- **Banking Infrastructure**: there will be banking infrastructure set up with the bank that holds the PBA – the Employer and the Main Contractor as account holders and trustees will enter into an agreement with the bank.
- **Joint Instruction**: there will be an agreed process for the Employer and the Main Contractor issuing joint instructions to the bank for the release of money to the named beneficiaries – this will involve the Employer and the Main Contractor each signing a single joint instruction in an agreed format which is then delivered to the bank. Online banking facilities might be available for use.

3. In what sequence are the documents entered into?

The PBA documents are entered into in the following order:

1. **Main Contract**: the main contract will be entered into first.
2. **Trust Agreement**: the Enabling Clauses contain an obligation to enter into the Trust Agreement within seven days after the main contract is signed (Clause 1 of the Enabling Clauses).
3. **PBA Bank Mandate**: The Trust Agreement then provides for the PBA Bank Mandate to be signed within 14 days following the execution of the Trust Agreement (Clause 3.1.1 of the Trust Agreement).

4. What is the benefit of the PBA arrangements?

Benefits of the PBA arrangement include:

- **Faster Payment**: supply chain members get paid quicker as payment is dispersed direct to the supply chain members from the PBA at the same time as payment is being made to the Main Contractor; rather than being cascaded down the supply chain.
- **Insolvency Protection**: once money has been deposited in the PBA, provided a legal trust has been created under Scots law, it will be 'ring fenced' in the event of a Main Contractor insolvency or another upstream supply chain insolvency.

5. In what projects will PBAs be used?

PBAs will be used where the project is being procured by a Scottish Government body and is above the specified financial thresholds.

5.1 Scottish Government body

PBAs apply to Scottish Government and relevant bodies in scope of the Scottish Public Finance Manual (SPFM).

This means the constituent parts of the Scottish Administration (i.e. the core SG, the Crown Office and Procurator Fiscal Service, SG Executive Agencies and non-ministerial departments); bodies sponsored by the SG (means those commonly referred to as non-departmental public bodies (NDPBs) - NDPBs include Executive NDPBs, Public Corporations and NHS Bodies); the Scottish Parliament Corporate Body; and bodies sponsored / supported by the Scottish Parliament Corporate Body.

5.2 Financial Thresholds

PBAs are to be used in all projects (subject to certain exceptions described at point 6) where the estimated award value is at least:

- £4,104,394 for building projects; and
- £10,000,000 for civil engineering projects.

It is also likely that PBA arrangements will be used where pre-procurement project estimates are marginally below these thresholds and where contract award values unexpectedly come in below the thresholds levels.

6. Are there circumstances where PBAs might not be used?

PBA arrangements might not be applied in above threshold contracts, in whole or in part, for a number of reasons as provided for in the PBA documentation:

- **Self-Delivery / Use of In-House Sub-contractors**: paragraph 14 of the Guidance provides that "If the successful bidder (i.e. tier 1) gives a firm undertaking to self-deliver and/or use subcontractors (i.e. tier 2) from within the parent company to which the tier 1 also belongs, such that one, other or a combination of both is more than 75% of the main contract award value, then the commissioning body **may choose** whether or not to proceed with the PBA."
- **Non-Deployment**: paragraph 102 of the Guidance provides that "The PBA should not be deployed for a tier 2 or tier 3 firm if they have been unable to become a named beneficiary before at least 50% of their contract payments have been made by their employer. The other payment process should remain for the duration of the sub-contract. The reasons should be fully documented by the relevant employing party and made available to the commissioning body, who shall relay to Scottish Government (for feedback purposes)." – it should however be noted that this guidance is not expressly implemented in the Enabling Clauses.
- **Supply chain elects not to participate**: Clause 6 of the Enabling Clauses anticipates that some supply chain members may not wish to participate in the PBA arrangements. If this is the case then the Main Contractor is required to obtain written reason from the supplier and provide a copy to the Employer.
- **Main contractor excludes supply chain members**: Clause 7 of the Enabling Clauses permits the main contractor to exclude a supply chain member from participating in the PBA arrangements for the following reason:
  - The Contractor, acting reasonably, decides that it is not appropriate or reasonable in all the circumstances for the supplier to participate in the PBA arrangements.
  - The main contractor's decision will be deemed to be reasonable if it falls within one or more of the following (non-exhaustive) grounds:
    - the value of the sub-contract is below 1% of the main contract award value (excluding VAT);
    - the duration of the sub-contract is less than one calendar month;
    - the payment provisions of the sub-contract are more frequent than those set out in the main contract, or
    - the payment provisions of the sub-contract cannot otherwise be aligned with the payment provisions of the main contract. The Guidance provides the example of materials charged as an aggregated bulk across several sites.

However, where the main contractor wishes to exclude the supplier only on the first ground above (value less than 1%) but the supplier nevertheless wants to participate in the PBA then the main contractor is to ensure that the supplier can participate (See Clause 8 of the Enabling Clauses).

7. Who can participate in the PBA arrangements?

If the style Enabling Clauses are followed then in practice all sub-contractors of any tier should be able to participate in the PBA arrangements regardless of the value of their sub-contract (subject to the exclusions described at 6. above).

Each party in the supply chain from the main contractor down should be (i) informing their suppliers of the PBA arrangements, and (ii) inviting their suppliers to participate in the PBA arrangements (see Clauses 2 and 3 of the Enabling Clauses).

Although the Guidance and Enabling Clauses refer to supply chain contracts with a value of at least 1% of the main contract award value, in respect of supply chain contracts below that value the intention is that the relevant suppliers can ask to join and if they do so should be permitted to participate in the PBA arrangements (subject to the exclusions described at 6. above) (See Clause 8 of the Enabling Clauses).

8. How do supply chain members participate in the PBA arrangements?

Supply chain members will participate by having suitable enabling clauses in their supply chain contract and by either by being a party to the initial Trust Agreement or by joining the Trust Agreement by way of an Additional Party Agreement.

9. What is an Additional Party Agreement?

It is an agreement by which a supply chain member will become a party to the Trust Agreement and join the PBA arrangements.

It is intended that this will be a tripartite agreement among the two trustees (the Employer and the main contractor) and the relevant supplier chain member (whether that is 2nd, 3rd or 4th tier supplier etc.) (See Clause 5 of the Enabling Clauses, the style Additional Party Agreement attached to the Trust Agreement and paragraphs 97/98/99 of the Guidance).

In terms of Enabling Clauses 5 and 8, the Employer, the Contractor and the subcontractor or Supply Chain Member shall execute the Additional Party Agreement **as soon as practicable** following the appointment of any such additional subcontractors or Supply Chain Members. Suppliers wanting to participate will no doubt want to see that the Additional Party Agreement is being prioritised to make sure it is entered into quickly and in any event before their first payment is due.

10. What will main contractors need to do?

Main contractors will have to:

- Provide completed account-opening forms, internet banking forms and trust documents (including (where known) subcontractor beneficiaries) as part of their tender
- Check that the main contract PBA clauses, Trust Agreement and banking agreement are in acceptable terms
- Put in place processes / resources to implement the PBA arrangements
- Make payment applications in the correct format indicating the allocation of payments to named beneficiaries
- Consider how to step down the PBA provisions into their sub-contracts and how to procure that the opportunity to participate in the PBA is cascaded down its supply chain. (See Clauses 3 and 4 of the Enabling Clauses)
- Consider any reasons for excluding supply chain members from the PBA arrangement
- Make arrangements for having Additional Party Agreements processed with the Employer and relevant supply chain members
- Consider how the PBA arrangements impact on its commercial proposal

11. What will supply chain members need to do?

Supply chain members will have to:

- Take early steps to see that the PBA arrangements are being prioritised in the context of its contract in order to see that the PBA arrangements are in place before the first payment
- Check that the supply chain contract PBA clauses, Trust Agreement and Additional Party Agreement are in acceptable terms
- Make sure that the contractual time scales for payment in their sub-contract are closely aligned with the expedited time periods for direct payments from the PBA
- Have the Trust Agreement or the Additional Party Agreement signed up as soon as possible
- Obtain a certified true copy of the Trust Agreement
- Obtain details of the PBA bank account
- Obtain a copy of the agreement between the bank, the Employer and the Main Contractor in order to fully understand the PBA arrangement
- Obtain a copy of a letter from the bank confirming that the bank has received a copy of the Trust Agreement and that the bank confirms that it accepts that the funds in the PBA are trust property (see paragraph 77 of the Guidance)
- Provide its bank details for payment
- Consider how to step down the PBA provisions into their sub-contracts and how to procure that the opportunity to participate in the PBA is cascaded down its supply chain (See clauses 3 and 4 of the Enabling Clauses)
- Consider any reasons for excluding supply chain members from the PBA arrangement
- Consider how main contractor contra-charging clauses are likely to operate in the context of the PBA

12. How will the PBA arrangements integrate with the existing payment clauses?

In accordance with the Housing Grants, Construction and Regeneration Act 1996 (as amended), payment provisions in a construction contract should include for a 'due date', a payment notice, a last date for issuing a 'pay less notice' and a 'final date for payment'.

The PBA arrangements will need to integrate suitably within that framework. Therefore, for example, in respect of a particular application for payment it would seem practical that payment should be made into the PBA after the last date for issuing a 'pay less notice' – once the last date for issuing a 'pay less notice' has passed then there will be certainty as to how much is to be paid in respect of the particular interim payment. If payment was made into the PBA earlier, then it is possible that the commissioning body could pay too much into the account and that would result in reconciliation being required at subsequent payments.

If such an approach was taken then the last date for issuing a 'pay less notice' would need to be a date sufficiently in advance of the 'final date for payment' so as to enable money to be deposited into and disbursed from the PBA to the named beneficiaries by the final date for payment, taking into account the practical requirements for operating the PBA and the possible need to deal with a 'pay less notice'.

There is also the issue of how a 'pay less notice' issued by the commissioning body will impact on the allocation of payment among the named beneficiaries of the PBA; as it is possible that the 'pay less notice' itself will not deal with the issue of allocation among the named beneficiaries. It is possible that the main contractor will require at least some time to assess the implications of the 'pay less notice' and how it impacts on the main contractor and the other named beneficiaries. The main contractor may of course need to issue one or more corresponding 'pay less notices' down the supply chain.

The drafting between the Enabling Clauses and Trust Agreement will need to be consistent and compatible.

At all levels of the supply chain, the PBA arrangement does not affect an employer's contractual right to evaluate the amount due to an employed party i.e. the former can still adjust a payment application submitted by the latter.

13. Who will pay the bank charges on the PBA?

Clause 3.6 of the Trust Agreement provides that any bank charges, money transmission costs and other disbursements incurred in the establishment and operation of the PBA will be borne by the Employer, such charges not to be paid out of the PBA, but paid directly by the Employer to the Bank.

14. Will disputed amounts be paid into the PBA?

No.

Paragraph 118 of the Guidance confirms the intention that the ability of a PBA to ring-fence deposits relates only to payments which have been certified under the main contract. It does not apply to money relating to a dispute between businesses in the supply chain, which cannot be held in a PBA.

However, businesses could make separate arrangements (outside the PBA) to hold money until a dispute is resolved.

PBAs do allow payments to be made more quickly once a dispute has been resolved.

15. Will retention be paid into the PBA?

No.

It is not the intention that the PBA will become a repository for unpaid cash retention.

However once retention becomes payable then the payment should be processed through the PBA in the same way as other payments.

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