



# **COLLATERAL WARRANTIES IN CONSTRUCTION PROJECTS: WHY YOU NEED THEM**

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## INTRODUCTION

Construction projects are crucial to societal development. They form the hallmark of infrastructural growth. These construction projects involve the expertise of professionals from various disciplines to ensure that the project moves from a mere paper design to a lasting structure, and this requires the execution of several construction contracts. Typically, under construction contracts, persons who are not privy to a contract cannot enforce a contractual right nor impose an obligation under that contract. However, the existence of collateral warranties in construction projects bridges the gap and allows persons who ordinarily would not have had a right to enforce a construction contract or seek compensation under a construction contract to do so. Simply put, collateral warranties in construction projects are agreements that grant third-party

stakeholders a right to enforce construction contracts to which they were never a party. For example, a client contracts a developer to build some office spaces, and the developer then engages a contractor to execute the construction. Ordinarily, the client is not privy to the contract between the developer and the contractor, however, the execution of a collateral warranty between the client and the contractor confers a right on the client to enforce the contract between the developer and the contractor. This article makes a case for the inclusion of collateral warranties in construction contracts by exploring the nature of collateral warranties, the recently decided *Toppan Holdings* case, and how Nigerian Courts may take a cue from the Court's decision in this case.

<sup>1</sup> A party who contracts construction companies for a construction project has no privity of contract with any other third-party contract by the construction company to work on the construction project.

# NATURE OF COLLATERAL WARRANTIES



Collateral warranties are often referred to as secondary agreements that complement a primary construction contract between a developer and contractor (see the example above). Many times, executing a collateral warranty is so that a third party of interest may enforce the provisions of a primary construction contract to which it is not a party. However, in recent times, especially in developed adjudication jurisdictions like the United Kingdom (UK), collateral warranties have been interpreted to mean construction contracts and for this reason, disputes arising from a collateral warranty may be resolved by adjudication based on the provisions of the Construction Act<sup>2</sup> ("the Act"<sup>3</sup>). For example, a key clause in a Collateral Warranty between Parkwood Leisure Ltd (a tenant) and Laing O'Rourke Wales and West Ltd (a contractor) which stated that **"the contractor warrants, acknowledges and undertakes that... it has carried out and shall carry out and complete**

**the works in accordance with the [design and build] Contract"**<sup>4</sup> was interpreted by the Technology and Construction Court to mean a construction contract.

In Nigeria, adjudication is currently not governed by any specific legislation hence, parties who intend to submit construction disputes to adjudication must include same in the construction contract. In the same vein, Nigerian Courts have not had the opportunity to interpret collateral warranties in construction contracts especially whether they could be resolved by adjudication in the event of a dispute. However, Nigeria being a common law jurisdiction can take a cue from the UK on how collateral warranties are interpreted particularly the reasoning of the Supreme Court in the recently decided case of Toppan Holdings Limited and Abbey Healthcare (Mill Hill) Limited v Simply Construct (UK) LLP<sup>5</sup>. "The Toppan Holdings Case".

## The Toppan Holdings Case<sup>5</sup>



Toppan Holdings Limited (THL) is the freehold owner of a care home that was built by Simply Construct (UK) LLP (Simply Construct). The care home was subsequently let by THL to Abbey Healthcare (Mill Hill) Limited (Abbey Healthcare). Upon completion of the construction, certain defects were discovered, and Simply Construct was asked to rectify these defects but failed to

do so. Four years after the completion of the work, Simply Construct executed a collateral warranty in favour of Abbey Healthcare (the 'Warranty'), and both THL and Abbey Healthcare commenced adjudication against Simply Construct to recover the losses incurred as a result of the remedial work carried out to rectify the defects.

<sup>2</sup> Housing Grants Construction and Regeneration Act 1998 (as amended).

<sup>3</sup> Under the Act, disputes arising from construction contracts are subject to the mandatory adjudication provisions of the Act. The Act goes further to imply the option to adjudicate in the event of a dispute arising from a construction contract even where parties have not included it in the contract.

<sup>4</sup> [2021] EWHC 2110 (TCC).

<sup>5</sup> Before the decision in the Toppan Holdings case, the only case that had considered whether collateral warranties fell within the meaning of construction contracts was the case of Parkwood Leisure v Laing O'Rourke [2013] EWHC 2665 (TCC) where the Court in considering the wording "warrants, acknowledges and undertakes" held that the collateral warranty was a construction contract.






# THE DECISION

1. The decision of the Adjudicator was in favour of THL and Abbey Healthcare when it held that the collateral warranty executed four (4) years after the completion of the project was a construction contract but Simply Construct failed to comply with the award.

2. THL and Abbey Healthcare then instituted an action at the Technology and Construction Court (TCC) to enforce the award, however, Simply Construct argued that the Adjudicator did not have jurisdiction to decide the dispute on the basis that the collateral warranty was not a construction contract. The Judge agreed with Simply Construct and noted that the collateral warranty having been executed four years after completion of the works cannot be construed as a "construction contract" and thus, not subject to adjudication.

3. The Court of Appeal in overturning the decision of the TCC noted that the date of execution relied on by the TCC was immaterial. It held that where the wording of the warranty includes an obligation to carry out and continue to carry out construction operations as in this case, such an obligation would be as Collateral Warranty contract in the construction contract.



Recently, however, the Supreme Court overturned the decision of the Court of Appeal when it handed down judgment in favour of Simply Construct. In arriving at its decision, the Supreme Court took a different approach in interpreting the collateral warranty. According to the apex court, the collateral warranty was merely a derivative promise in which Simply Construct promised to abide by what was already agreed upon under the building contract and nothing more. If the Collateral Warranty had included a promise to carry out a construction operation not already agreed under the building contract, it would have been interpreted to mean a construction contract subject to the statutory right of adjudication. It follows, therefore, that for a collateral warranty to be interpreted as a construction contract, its scope has to extend beyond what was agreed in the building contract.

# WHY SHOULD STAKEHOLDERS INCORPORATE COLLATERAL WARRANTIES IN CONSTRUCTION CONTRACTS?



Notwithstanding that there is currently no specific legislation on adjudication in Nigeria, adjudication is increasingly being used as a method of dispute resolution in high-profile construction projects. We believe that the inclusion of collateral warranties in construction contracts will hold parties accountable therefore, we recommend that these terms should be incorporated in construction contracts for the following reasons:

**1. Direct Contractual Connection:** It may be difficult for a stakeholder in a construction project to enforce any rights against a third party under a construction contract in the absence of a collateral warranty. Where stakeholders fail to incorporate or execute collateral warranties in construction projects, an action against a developer or contractor for defects in the construction project will most likely be based on a claim in negligence which more often than not fails because the stakeholder cannot establish a duty of care owed to it by the contractor or developer .

**2. Step-in Rights:** Collateral warranties may grant a stakeholder step-in rights if one of the parties in the underlying primary construction contract is unable to act or is insolvent. In this situation, a stakeholder may exercise its right under a collateral warranty and issue instructions to ensure that the project is completed per the

terms of the contractual contract.

**3. Increased Accountability:** The existence of a collateral warranty is a pointer to the fact that the contractor or sub-contractor is not only accountable to the party to which it has entered into a contract but also to third parties who were never privy to the construction contract. In this case, they are directly accountable to the third party.

**4. Secured Performance:** Warrantors give their assurances to ensure that the project is carried out per the terms of the contract. Incorporating collateral warranties in construction contracts remains one sure way of securing the commitment of contractors or sub-contractors not just to the party to which they entered into the contract but also to third-party stakeholders who have an interest in the construction project.

**5. Access to Adjudication:** Recently, Courts in developed adjudication jurisdictions like the UK have relied on the wording of collateral warranties to interpret them to mean construction contracts that entitle a person seeking a claim to explore adjudication as a mode of dispute settlement. Other jurisdictions like Nigeria where no specific legislation generally governs construction disputes can take a cue from the UK Courts, particularly in interpreting collateral warranties according to their wordings.



## CONCLUSION

Collateral warranties play a pivotal role in securing stakeholder interests in construction projects. The recent decision by the Supreme Court has created a clear path for Nigerian Courts to follow in interpreting collateral warranties. However, warrantors- developers, contractors, and sub-contractors must ensure that they are not exposed to unnecessary risks when signing a collateral warranty, particularly in the wake of an obvious tilt towards interpreting the commitment of warrantors based on how the collateral warranty is worded. Hence, parties seeking to execute a collateral warranty must seek proper legal advice to protect their individual and collective interests.

**Disclaimer: This article is for informational purposes only and is not intended to constitute legal advice. Interested persons are encouraged to seek advice from a qualified lawyer or legal professional regarding their specific circumstances.**

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