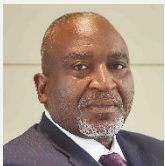


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TEMPLARS ThoughtLab

Mitigating Risks in Nigerian Construction Contracts

Introduction

In the Nigerian construction industry, the often complex and multifaceted construction contracts that regulate the relationship between parties can be a double-edged sword—promising lucrative outcomes but posing significant risks if not drafted and managed correctly. For contractors, avoiding pitfalls in these contracts is essential to ensure profitability and project success.

Issues such as ambiguous and insufficient contract terms, can quickly turn a promising venture into a costly nightmare. Successfully navigating this landscape requires a keen understanding of legal intricacies and strategic risk management.

Given the significance of construction contracts to the success of a construction project, we have, in this thought piece set out to identify potential pitfalls in drafting a construction contract and how best to mitigate these risks, by offering practical insights and strategies to enhance contract management. By understanding and addressing these challenges, contractors can safeguard their interests, ensure smooth project execution, and contribute to the sustainable growth of Nigeria's construction sector.

This article explores critical contractual terms including liability for employer-induced delays, effective communication of instructions, the impact of inflation on fluctuating contracts, disputes over payment valuations, comprehensive insurance coverage through Contractors All Risks (CARs) policies, and the omission of works. These areas of potential challenges will be discussed below and recommendations for mitigation will be proffered.



Employer-Induced Delays:

Incorporating provisions to mitigate employer-induced delays in a construction contract is crucial for safeguarding contractors against unforeseen time and cost overruns.

Employer/Client Induced Delay in Affecting Contract Time¹

Employer induced delays can arise from a range of factors, including the employer's failure to provide timely instructions, delays in granting site access, frequent design changes, and delayed payments for completed work. Such delays can significantly impact the overall timeline and lead to various contractual and financial repercussions and has led to a significant increase in construction disputes in Nigeria.

Incorporating provisions to mitigate employer induced delays in a construction contract is crucial for safeguarding contractors against unforeseen time and cost overruns. This can be effectively achieved by including clear extension of time clauses in the contract, which allow contractors to seek additional time for project completion when delays are caused by the employer. Additionally, a delay damages clause should be included to ensure contractors are compensated for any extra costs incurred due to such delays.

Ineffective Communication of Instructions through Agreed Channels²

Clear and timely communication is vital in construction projects, and the agreed channels for relaying instructions—typically through the architect or project manager—play a significant role. However, this can become an issue for contractors if the employer fails to use these channels effectively. Delays or misunderstandings in communication can disrupt workflow, lead to errors, and increase costs. The primary issue arises when the employer does not adhere to the established communication protocols. Conflicting or unclear instructions from multiple sources can also confuse the contractor and lead to mistakes. Additionally, the lack of documentation for verbal instructions or those not properly documented can result in misunderstandings and disputes over the agreed work.

To mitigate these issues, contractors can include specific clauses in the construction contract. One such clause is the designated communication channels clause, which ensures that all instructions from the employer are communicated through the appointed architect or project manager. This reduces the risk of conflicting directives.

Another important clause is the timeframe for issuing instructions, where the employer is required to issue all necessary instructions within a specified timeframe upon request from the contractor. The effect of this clause is that failure to issue instructions within the agreed time frame results in an extension of time for the contractor, thus, encouraging timely decision-making from the employer.

Furthermore, the documentation of instructions clause ensures that all instructions are documented in writing and acknowledged by the contractor before implementation, thus, preventing disputes over what was communicated.

Adverse Effect of Inflation on Construction Contracts³

Inflation can significantly impact construction contracts, particularly those with fixed prices, leading to financial strain on contractors. When the cost of materials, labour, and other resources increases due to inflation, contractors may find it challenging to complete projects within the agreed budget. This situation can result in reduced profit margins or even financial losses. Additionally, contractors may face difficulties in accurately estimating future costs, making it challenging to bid competitively for new projects.



Effective Communication

Clear and timely communication is vital in construction projects, and ensuring that instructions are relayed through designated channels reduces the risk of conflicting directives and costly errors.

¹ Ejohwomu Obuks, Oshodi, Olalekan, and Onifade Morakinyo Kehinde. (2016). Causes Of Conflicts In Construction Projects In Nigeria: Consultant's And Contractor's Perspective. Nigerian Journal of Technology. 35. 270. 10.4314/njt.v35i2.6.

² Ansah SK. Causes and Effects of Delayed Payments by Clients on Construction Projects in Ghana. Journal of Construction Project Management and Innovation. 2011 Nov 1; 1(1): 27-45.

³ Coleman, C. E., Muya, M., Chipulu, C. (2024). Preventing Contract Termination Pitfalls in Construction Projects: Insights from the Ghanaian Construction Industry. Journal of Civil, Construction and Environmental Engineering, 9(6), 175-187. <https://doi.org/10.11648/jjccce.20240906.11>



Inflation Impact

A price adjustment clause ensures that contractors are compensated for increased costs due to inflation, helping them manage inflation-related risks and protect their profit margins.

To address these issues, several clauses can be included in construction contracts. A price adjustment clause can be used to allow periodic adjustments to the contract price based on the Consumer Price Index (CPI) or another agreed-upon index. This clause ensures that contractors are compensated for increased costs due to inflation. Similarly, an escalation clause could provide a mechanism for adjusting the contract price based on actual cost increases documented by invoices and receipts. This helps contractors manage inflation-related risks by ensuring they are reimbursed for the increased costs.

Another effective measure is the use of cost-plus contracts, where the contractor is reimbursed for actual costs incurred, plus a fixed fee or percentage of the costs. This type of contract shifts the risk of inflation to the employer, ensuring that contractors are fully reimbursed for their expenses.

Pitfalls



Valuation of Completed Work

Payment disputes pose a significant challenge in construction projects, particularly where the parties are unable to ascertain the value of the work. Valuation of completed work is therefore critical to prevent payment disputes and to ensure both parties are in agreement on the outstanding payment

To mitigate these risks, it's essential to include specific clauses in contracts that ensure fair compensation such as an independent valuation clause, which allows for the appointment of a pre-agreed independent third-party valuer to assess the value of the work completed. This helps ensure that the revaluation is fair and reflective of the actual work done, protecting the contractor's interests and maintaining fairness in the compensation process.

Insurance and Bonds in Construction Contracts⁴

Contractors in Nigeria face significant risks in construction projects, including potential accidents, property damage, and delays. Without adequate insurance and bonds, contractors can be financially vulnerable to these risks.

To manage risks, construction contracts can include clauses such as insurance requirements, mandating contractors to hold Contractors All Risks (CAR) insurance. This ensures compliance with legal requirements and provides financial protection against unforeseen events. Performance bond clauses should also be included to guarantee the completion of the project as per the contract terms, providing security for the employer in case of default. Advance payment bond clauses ensure that funds provided as advance payments are used appropriately for the project, protecting the employer by ensuring the funds are utilized for their intended purposes.

While bonds are an effective way to manage risk, contractors must ensure that the terms of any such guarantees are restrictive and have defined triggers. This includes clearly outlining the conditions for calling on the bond, defining the scope of work which it would apply to and establishing a fair and reasonable process for resolving disputes.



Valuation

...it's essential to include specific clauses in contracts that ensure fair compensation...

⁴ Elizabeth Rivelli, Contractor Bonds vs. Insurance: What to Know <<https://www.procore.com/library/insurance-vs-bonds>>.

Variation of Contract (Omission of Works by the Employer)⁵

A contract variation refers to a change or modification made to an existing contract. Contract variations can sometimes lead to descoping or omission of certain tasks, deliverables, or services. The descoping or omission of works clauses allow employers to remove specific work scopes. They should be carefully drafted to limit circumstances and prevent reassignment to other contractors, to avoid financial losses.

To address this risk, the construction contracts should include several key clauses. One effective measure is the limited omission clause, which permits omission only under specific circumstances, with justification, documentation, and advance notice. This clause ensures that omissions are necessary and transparent. Another crucial clause is the non-reassignment clause which prohibits reassigning omitted works to another contractor without the original contractor's consent.

Additionally, a compensation for omitted work clause is desirable to ensure contractors are fairly compensated for work commenced and materials procured on a scope of work that is subsequently omitted.

Lastly, an advance notice requirement clause is essential. This clause requires the employer to provide the contractor with a minimum notice period before omitting any part of the work. The notice should include the reasons for the omission and the proposed adjustments to the contract. This ensures that the contractor has adequate time to adjust their plans and mitigate the impact of the omission.

Defect Liability Period⁶

The Defect Liability Period (**DLP**) in construction contracts is a standard clause that specifies the timeframe after project completion that the contractor shall be responsible for rectifying any defects that arise. This period typically ranges from 6 months to 2 years depending on the nature of the contract. While the DLP is intended to ensure quality and accountability, it can pose several challenges for contractors, including prolonged financial exposure for defects and unforeseen rectification costs.⁷ To mitigate challenges arising from extended liability, contractors can negotiate a defect liability clause which limits liability period and excludes certain defects.

Responsibility for Obtaining Regulatory Approvals

The assumption of responsibility for obtaining governmental licenses, consent or approvals by contractors entails considerable risks. The timeline for securing approvals is inherently uncertain due to administrative bottlenecks beyond the contractor's control. Moreover, the approval process often necessitates the employer's/client's provision of requisite documents, which can cause delays if not submitted in a timely manner.

To mitigate these risks, it is advisable for contractors to incorporate specific provisions into the contract. These provisions should clearly delineate the employer's responsibilities regarding document submission and establish a realistic timeline for approvals. Furthermore, contractors may wish to specifically exempt liability for the employer's failure to provide necessary documents required for the approval process.

⁵ Flora Ngo-Martins, Through the Eyes of the Contractor: Protective Measures to be employed by the Contractor against the Omission of Works by the Employer in Building Construction Contracts <<https://africaconstructionlaw.org/through-the-eyes-of-the-contractor-protective-measures-to-be-employed-by-the-contractor-against-the-omission-of-works-by-the-employer-in-building-construction-contracts/>>.

⁶ Etheringtons Solicitors, What are Defects and How Do Defects Liability Periods Work? <<https://etheringtons.com.au/what-are-defects/>>.

⁷ Jeremy Glover, Liability for Defects in Construction Contracts - who pays and how much? <<https://www.fenwickelliott.com/sites/default/files/Liability%20for%20Defects%20in%20Construction%20Contracts.pdf>>.

Conclusion

Suffice to say, navigating the complexities of construction contracts in Nigeria requires a deep understanding of the potential pitfalls and a strategic approach to risk management. By understanding and addressing the challenges associated with employer-induced delays, communication of instructions, inflation, payment valuations, insurance coverage, and omission of works, contractors can safeguard their interests, ensure successful project outcomes, and contribute to the sustainable growth of Nigeria's construction sector. Ultimately, effective contract management is crucial to unlocking the full potential of Nigeria's construction industry, and by prioritizing this aspect, stakeholders can work together to build a more resilient, efficient, and prosperous sector.