

BY-LINED ARTICLE

Flow-Down Clauses and Incorporation by Reference in Construction Contracts

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Flow-down clauses—also referred to as pass-through or conduit clauses—are common in construction contracts.¹ Such provisions state that the subcontractor is bound to the contractor in the same fashion as the contractor is bound to the owner in the prime contract. Flow-down provisions help to ensure that the subcontractor's obligations to the contractor mirror the contractor's obligations to the owner.

Most flow-down clauses fall into one of two categories: clauses limited to the scope of work or more-general clauses encompassing non-scope-of-work related obligations, such as payment or dispute resolution. Typically, a clause that is limited to scope-of-work issues will identify the work to be done by the subcontractor and state that, with respect to the designated work, the subcontractor is obligated to the prime contractor in the same manner and to the same extent that the prime contractor is obligated to the owner.² In contrast, a more-general clause might specify that to the extent the terms of the prime contract apply to the subcontractor's work, the subcontractor assumes all the responsibilities, obligations, rights and duties that the prime contractor has to the owner.³

Despite the seemingly simple nature of flow-down relationships, it can be difficult in practice to determine which contractual obligations will actually flow down. A flow-down clause that is expressly limited to issues concerning the scope of work can be anticipated to be enforced accordingly.⁴ However, if a court finds a flow-down provision to be ambiguous—as may occur with a more-general clause—it is likely to follow traditional contract interpretation principles and look to evidence of the parties' intent to determine which obligations flow down.⁵

One way to potentially limit the uncertainties associated with dependence on court interpretations of flow-down clauses is not to rely upon a generalized flow-down provision in situations where a scope-of-work provision is not warranted, but rather to expressly state when a particular clause in a contract is intended to flow down.⁶ This approach may increase the up-front time and expense associated with negotiating and drafting, but it can decrease the potential for problems later.⁷

Another area of concern is whether the language of the flow-down clause provides for reciprocal obligations. If a subcontractor agrees to be bound to the contractor in the manner that the contractor is bound to the owner, there should also be, in most instances, an agreement that the contractor is bound to the subcontractor in the manner that the owner is bound to the contractor. Consideration of reciprocal rights is particularly important because a subcontractor will often seek to enforce the flow-down provision to its benefit.⁸

A closely related concept to flow-down clauses is incorporation by reference. Subcontracts usually incorporate prime contracts by reference. A prime contract can be incorporated into a subcontract by listing it as one of the subcontract documents—or there may be an explicit incorporation provision.⁹ Particular provisions may be incorporated, or the prime contract can be incorporated into the subcontract in its entirety. A typical incorporation provision might state that "the terms of the prime contract are incorporated into and made part of the subcontract," or words to that effect.¹⁰

If an incorporation is for an express purpose, it will be limited to that purpose.¹¹ However, if the incorporation of the prime contract into the subcontract is not expressly limited, the authority is mixed on whether administrative or dispute-resolution clauses will be incorporated.¹² A variety of clauses have been held as incorporated by reference from prime contracts into subcontracts under general incorporation provisions¹³, including provisions relating to arbitration and other dispute-resolution mechanisms¹⁴, indemnity¹⁵ and change-order procedures.¹⁶

If a prime contract is incorporated by reference into a subcontract, the terms of the prime contract should be reviewed thoroughly. As a general rule, a subcontractor will be held to the terms of an incorporated prime contract whether or not the subcontractor has read the prime contract, particularly if the subcontract contains language stating that the subcontractor has received a copy of the prime contract, or that a copy of the prime contract has been made available to the subcontractor.¹⁷ If the incorporated document includes further incorporations (e.g., a prime contract that incorporates specifications), all the relevant documents should be reviewed.

Some court decisions suggest that a document must be in existence in order to be incorporated by reference.¹⁸ Therefore, if a subcontract is finalized and executed before the prime contract, incorporation of the prime contract is potentially challenging, to say the least.

Finally, where there is either an incorporation-by-reference or flow-down clause, an order-of-precedence provision should be considered. Such a provision may clarify which document(s) will govern any inconsistencies that exist.¹⁹

Flow-down and incorporation-by-reference provisions are common in construction contracts. Care and attention in the drafting of such provisions may help minimize the potential for unintended consequences.

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Notes

1. See generally 2 Philip L. Bruner & Patrick J. O'Connor, Jr., Bruner and O'Connor on Construction Law § 5:126. As an example of a flow-down provision, AIA Form 401-2007, "Standard Form of Agreement Between Contractor and Subcontractor," provides the following:

Article 2. MUTUAL RIGHTS AND RESPONSIBILITIES

The Contractor and Subcontractor shall be mutually bound by the terms of this Agreement and, to the extent that the provisions of AIA Document A201-2007 apply to this Agreement pursuant to Section 1.2 and provisions of the Prime Contract apply to the Work of the Subcontractor, the Contractor shall assume toward the Subcontractor all obligations and responsibilities the Owner, under such documents, assumes toward the Contractor, and the Subcontractor shall assume toward the Contractor all obligations and responsibilities which the Contractor, under such documents, assumes toward the Owner and the Architect. The Contractor shall have the benefit of all rights, remedies and redress against the Subcontractor that the Owner, under such documents, has against the Contractor, and the Subcontractor shall have the benefit of all rights, remedies and redress against the Contractor

that the Contractor, under such documents, has against the Owner, insofar as applicable to this Subcontract. Where a provision of such documents is inconsistent with a provision of this Agreement, this Agreement shall govern.

2. See Stephen A. Hess, *Flow-Down Clauses*, Construction Briefings, October 2008, at 4–5.
3. See *id.* at 5–6.
4. See, e.g., *Encon Utah, LLC v. Fluor Ames Kraemer, LLC*, 210 P.3d 263, 268–69 (Utah 2009).
5. Jeff Jury, *Everything Flows Downhill—Or Does It? Flow-Down Clauses in Construction Contracts*, Construction Briefings, June 2007, at 4–5, 10–11.
6. See *id.*
7. See Hess, *supra* note 2, at 6–7. Of course, identifying clauses that flow down implies that others do not, so care must be taken not to inadvertently block the flow-down obligations not specified. See *id.* at 7.
8. See T. Bart Gary, *Incorporation by Reference and Flow-Down Clauses*, 10(3) *The Construction Lawyer* 44, 46–47 (1990).
9. See Hess, *supra* note 2, at 4.
10. No specific language is necessary to incorporate a document by reference, and language such as "subject to" or "furnished in conformity with" could potentially be sufficient to incorporate a document by reference. See Gary, *supra* note 8, at 44.
11. See *Guerini Stone Co. v. P.J. Carlin Constr. Co.*, 240 U.S. 264, 277 (1916).
12. Compare *Bussanich v. 310 E. 55th St. Tenants*, 723 N.Y.S.2d 444, 445 (N.Y. App. Div. 2001) ("Under New York law, incorporation clauses in a construction subcontract, incorporating prime contract clauses by reference into a subcontract, bind a subcontractor only as to prime contract provisions relating to the scope, quality, character and manner of the work to be performed by the subcontractor.") with *Sime Constr. Co., Inc. v. Washington Pub. Power Supply Sys.*, 621 P.2d 1299, 1302–03 (Wash. Ct. App. 1980) (finding that where an incorporation clause is "general and unlimited," both contract specifications and procedural provisions of a prime contract are incorporated by reference).
13. See Gary, *supra* note 2, at 46.
14. See *generally* 6 Philip L. Bruner & Patrick J. O'Connor, Jr., *Bruner and O'Connor on Construction Law* § 20:32. The majority rule appears to be that broad general incorporation language is sufficient to incorporate an arbitration provision. This is especially true where the federal policy of favoring arbitration is implicated or where the incorporation provision at issue includes a references to "remedies." See *id.*
15. See *generally* 3 Philip L. Bruner & Patrick J. O'Connor, Jr., *Bruner and O'Connor on Construction Law* § 10:20. Although indemnity obligations may potentially be subject to incorporation by reference, there is also case law holding that general incorporation by reference language is insufficient to bind a subcontractor to the indemnity provisions of the prime contract, particularly where the subcontractor could be required to indemnify the prime contractor for its own negligence. See *id.*
16. See, e.g., *Sime Constr. Co., Inc. v. Washington Public Power Supply Sys.*, 621 P.2d 1299 (Wash. Ct. App. 1980).
17. See Hess, *supra* note 2, at 7.
18. See, e.g., *Local 1316 v. Superior Contractors & Assocs., Inc.*, 608 F. Supp. 1246, 1249–50 (N.D. Ga. 1985); see also Gary, *supra* note 2, at 48.
19. See Jury, *supra* note 5, at 10.