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Contractor Beware: That "Flow-Down Clause" May Not Flow as Far as You Think

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New York Appellate Division Rules That Broad Incorporation of Prime Contract Terms Does Not Bind Subcontractor to Arbitration Provision

In *Wonder Works Construction Corp. v. R.C. Dolner, Inc.*,[1] a prime contractor ("Dolner") which attempted to force its subcontractor ("Wonder Works") to arbitrate claims between them on the basis of a broad incorporation by reference of the prime contract's terms—which included an arbitration provision—was prevented from doing so where the subcontract contained no arbitration provision and no express incorporation of the owner-contractor arbitration clause, and where the prime contract itself was inconsistent as to subcontractor arbitrations.

After Wonder Works sued to dismiss the arbitration proceeding, a New York trial court had ruled that the general "flow-down" clause in Wonder Works' subcontract bound Wonder Works to the arbitration process set forth in Dolner's prime contract, and sent the parties to arbitration. Wonder Works appealed, and the New York appellate division overturned the trial court, because under New York law an arbitration agreement must be clear and unequivocal: broad flow-down clauses bind subcontractors only as to scope, quality, character and manner of work to be performed by the subcontractor. Therefore, where the prime contract and subcontract did not clearly express the intent that the subcontractor be bound to arbitration, the general incorporation by reference was insufficient to do so.

The case arose when Dolner received a notice of claim and demand for arbitration from the project's owner, seeking damages for allegedly deficient work. Dolner in turn demanded that its subcontractor Wonder Works be joined to the arbitration as a party. Dolner based its attempt to join Wonder Works to the arbitration on subcontract language that said "with respect to the Work, [subcontractor] agrees to be bound by every term and provision of the Contract documents," and which required Wonder Works "to assume toward [Dolner] all of the duties that [Dolner] has assumed towards [owner]." The subcontract also vested in Dolner "every right and remedy" against Wonder Wall as the prime vested in the owner against Dolner.

Dolner's prime contract included an arbitration clause, but it also had a joinder clause which limited parties who could be joined to those joined by the owner at its sole option. Then, in somewhat contradictory language,, the prime contract also required Dolner's subcontracts to include language which bound the subcontractors to the results of any arbitration between Dolner and the owner, and gave Dolner the right to allow any subcontractor to "participate" in such an arbitration.

While the case involved whether to give binding effect to the flow-down provision in the first instance, its outcome actually rests on the New York law governing arbitration clauses, which states that such clauses must be unambiguous in expressing a clear intent of both parties to arbitrate disputes. Those terms of Dolner's prime contract that addressed arbitration were not clear insofar as they addressed subcontractors. Certain language prohibited joinder except at the owner's sole option, and certain language gave Dolner the right to require any subcontractor to "participate" in an arbitration proceeding but bound subs to the outcome whether or not they participated. So, the court reasoned, the contract terms were too inconsistent

elementally to spell out any agreement between Dolner and Wonder Works to arbitrate, even if the flow-down clause were a proper vehicle for expressing such an agreement. Because New York law states that broad incorporation by reference clauses only bind subcontractors to prime contract terms with respect to their work, such a clause, by itself, could not bind a subcontractor to arbitration requirements governing the owner-contractor relationship in the absence of a clear and independent agreement to arbitrate between subcontractor and prime contractor.

The *Wonder Works* case provides some cautionary guidance to all parties to review each agreement they enter carefully. Casual reliance on standard forms or broad "catch-all" language may well backfire. In New York, it is clear that general contractors cannot rely on broad flow-down clauses to incorporate by reference prime contract dispute resolution provisions into subcontracts. This will require a specific review of every prime contract's disputes process and of standard subcontract language for consistency and to ensure that subcontracts expressly state the means by which the parties will resolve claims.

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Note

1. *Wonder Works Construction Corp. v. R.C. Dolner, Inc*., 901 N.Y.S. 2d 30 (N.Y. App. Div. 2010).