



**HARRISON
LAW GROUP**

HLG CONSTRUCTOR

B U L L E T I N

November 2007

Volume 1 | Issue 5

By: Mike Pappas

This article is Part II in a series of articles about the dangers lurking in the files of businesses in the construction industry. This article focuses on “flow down provisions” and “incorporation provisions” pursuant to which obligations contained in other documents or contracts are imposed upon subcontractors by reference in standard subcontract agreements. These two items, often overlooked, typically explode when the project is not going well and the owner, general contractor, or subcontractor try to enforce a contract provision. At that time, it is often too late to do anything about them or take any steps to protect yourself and your business.

Flow Down Provisions

Flow-down provisions require subcontractors to assume all of the obligations and responsibilities towards the contractor that the contractor assumes towards the owner. Typically, contractors are required under the prime contract to structure their agreements with subcontractors in such a way that the contractor’s obligations in the prime contract are “flowed-down” to the subcontractors. The danger arises when subcontractors are not provided with or do not read the prime contract, and are not, therefore, familiar with the

obligations contained therein.

A typical flow-down provision requires the subcontractor to “assume toward the contractor all obligations and responsibilities which the contractor assumes towards the owner and the architect.” See, AIA Document A401-1997.

For general contractors and owners, flow-down provisions provide the ability to predict and control the rights and obligations of all parties on the project throughout the course of construction. Flow-down provisions can be especially dangerous to subcontractors since they were, by their nature, negotiated long before the subcontractor was in the picture. Flow-down provisions often include terms that are not favorable to subcontractors’ positions, or which require them to assume risks that are not accounted for in their project price. Thus, it is vitally important for subcontractors to know all terms which flow-down to them on every project. Likewise, it is equally important for the general contractor to remember that flow-down clauses are two-way streets. Not only does the subcontractor assume certain obligations not specifically enumerated in the subcontract, but the general contractor also assumes obligations to the subcontractor that do not appear in the four corners of the subcontract itself.

Incorporated Documents Provisions

Incorporated document provisions typically set forth a listing of other documents that, while not attached, are made a part of the agreement. The incorporation provision creates a danger of uncertainty by including other terms into the current contract, which are often not at hand to evaluate at the time the document is reviewed or executed. The danger from incorporation provisions arises when the incorporated documents are not provided or are not read and they contain conflicting or additional terms not included in the document to which they are incorporated.

The dangers of both flow-down and incorporation provisions can be seen in the following case.

A subcontractor entered into a subcontract for a project which specifically incorporated the terms, conditions and provisions of the prime contract. The prime contract contained a flow-down provision which required subcontractors to assume all duties and obligations toward the general contractor that the general contractor assumed towards the owner. The subcontractor never obtained a copy of the prime contract. The subcontract contained a claims provision that required the subcontractor to submit its claims to the

Time-Bombs, Part II, Continued

general contractor with “sufficient time to allow the contractor to submit claims to the owner.” Upon encountering a condition that gave rise to a claim, the subcontractor, believing that it was being diligent, submitted a formal written claim to the general contractor within seven (7) days of the occurrence. However, unbeknownst to the subcontractor, the prime contract required the general contractor to submit its claims to the owner within five (5) days of the occurrence or they were “forever waived.”

Based upon this requirement, the owner denied the subcontractor’s claim. Accordingly, the subcontractor filed for arbitration, which was mandated by the provisions of the prime contract. At the arbitration, the arbitrator upheld the owner’s denial of the claim, reasoning that that the subcontractor failed to comply with the incorporated provisions of the subcontract when it failed to timely submit its claim. The fact that the subcontractor did not have a copy of the prime contract and did not know of the five day notice requirement was not an excuse. To add insult to injury, the general contractor was awarded the costs of the arbitration, including its attorneys’ fees, because the prime contract had a prevailing party provision which was incorporated into the subcontract as well.

In the above case, had the subcontractor taken the time and invested the funds to obtain, read and understand the provisions of the prime contract, which were incorporated by reference into the subcontract at the time the subcontract

terms were being negotiated, the loss might have been avoided. The subcontractor could have simply delivered its notice of claim within the time frame allotted, or the time frame could have been negotiated to include more days before the subcontract was executed. Additionally, needless legal fees could have been avoided had the subcontractor known and appreciated that the prime contract contained an arbitration provision and a prevailing party provision which entitled the prevailing party to recover its expenses and attorney’s fees as well.

The effects of flow-down and document incorporation provisions can be easily managed during the subcontract negotiation process. The parties, with knowledge of the provisions, can often negotiate a more equitable process which does not put the subcontractor at a disadvantage. In the event that the objectionable terms cannot be negotiated, the subcontractor, with knowledge and an understanding of all of the obligations included in subcontract, is able to more accurately determine its risk exposure, and can then price the project accordingly.

Conclusion

Flow-down and document incorporation provisions are a fact of life in the construction industry. Flow-down provisions are supposed to allow the parties to share risks and stand in relatively equal positions with respect to their counterparts on the project. They also allow for the rights and obligations of all parties on a project to be determined at the commencement of the project and for the consistent treatment of all claims or issues that arise on the project. For general contractors and owners, flow-down

provisions provide predictable risk allocation and defined participation in the project by all. For subcontractors, the benefits are often lost due to failure to recognize and address obligations imposed by flow-down provisions during negotiation of the subcontract. Additionally, document incorporation clauses often incorporate documents which subcontractors never obtain, much less read and appreciate. As such, parties to these clauses are frequently surprised to discover that they are obligated to comply with terms and obligations they have never seen. Actively procuring and reviewing all documents that are incorporated into the subcontract during subcontract negotiation phase will prevent the effects of these time bombs in your files.

If you would prefer to receive this newsletter via email, please contact us at postmaster@harrisonlawgroup.com

Harrison Law Group is a full service law firm with a concentration in construction and surety law.

HLG Constructor Bulletin is designed to provide our clients and colleagues with informative and useful material regarding construction law developments. However, this newsletter is not intended to offer specific advice or opinions to any of our readers and any application of the matters discussed herein are dependent upon specific facts and circumstances of individual situations. If legal advice or other expert assistance is required, the services of a competent professional should be sought. If you would like to be added to our mailing list or wish to furnish comments, suggestions or address corrections, please contact us at the address below, by e-mail at postmaster@harrisonlawgroup.com, or at our web site located at www.harrisonlawgroup.com.

© 2005. All Rights Reserved. Adam C. Harrison, P.C.
t/a Harrison Law Group



40 W. CHESAPEAKE AVE., STE. 600
TOWSON, MD 21204-4891
410.832.0000 410.832.9929 fax

700 TWELFTH ST., N.W., STE. 700
WASHINGTON, D.C. 20005-3945
202.783.1515 202.783.1650 fax

110 BAPTIST ST.
SALISBURY, MD 21801-4911
410.860.0040 410.860.0054 fax