

Flow-Down Clauses: Avoid the Flash Flood

By D. Scott DeGraffenried

Contractual flow-down clauses are powerful. They transfer significant obligations. Figuratively, they convey the imagery of a flash flood to those who are unprepared. That is because parties often fail to ponder their impacts, only to find out later that the clause affects them in a way that they never anticipated. In terms of legal disputes over these clauses, the outcome is seldom insignificant.

Make Sure Basic Contract Rights/Obligations are Fulfilled.

In general, flow-down clauses provide that a subcontractor is subject to the same rights and obligations to which the prime contractor is subject under the prime contract. They systematically ensure that an owner's expectations of quality and contract administration run through the whole project. They function by incorporating the prime contract into the subcontract by reference.

Standard rules of contract apply. General contractors wanting to make flow-down clauses enforceable need to provide subcontractors with an opportunity to review the prime contract. Many general contractors are reticent to do this, not wanting to divulge financial or proprietary information. But that information can be redacted while still providing the subcontractor with the key elements. After all, it will prove difficult to bind a subcontractor to a document that it was never allowed to see.

Assuming the prime contract is made available, subcontractors need to read it. They need to understand the obligations they are adopting, as well as the benefits they receive. That they did not understand the rights and obligations that flow down because they did not read the prime contract is not a viable defense.

What if there is a Conflict Between the Prime Contract and Subcontract?

Good contracts are precise. Unfortunately, many flow-down clauses are written too broadly. Parties often draft comprehensive subcontracts. But if they contain flow-down clauses that incorporate the prime contract's terms wholesale, it may invalidate terms of the subcontract, or at a minimum create a conflict. Determining which of the conflicting provisions governs may require a court's involvement—an expensive alternative.

Courts generally try to read the two contracts harmoniously. But if conflicting terms cannot coexist many courts hold that the subcontract's specific terms govern.

This played out in *Centex/Worthgroup, LLC v. Worthgroup Architects, L.P.* There, the architect was a subcontractor to a design builder. Their subcontract contained a flow-down clause. The design builder sued the architect. The prime contract and subcontract contained opposing limitation of liability clauses. The architect argued that the limitation in the prime contract governed because that would have offered greater protection. The court disagreed, holding that the subcontract was more germane to the parties' dealings. Through this case, we learn that if any party is relying on terms of a prime contract saving them through a flow-down clause, that reliance may be misplaced.

Parties try to avoid conflicting terms with language that limits the flow-down clause to terms only applicable to the subcontractor's work—namely, only the terms that address performance. This occurred in *Encon Utah, LLC v. Fluor Ames Kraemer, LLC*, a seminal Utah case. In *Encon*, the parties' subcontract contained a flow-down clause with



D. Scott DeGraffenried

limiting language. There were conflicting termination provisions between the prime contract and the subcontract that the parties were litigating. The court reasoned that termination provisions were standard contract terms and therefore not sufficiently specific to apply to the subcontractor's work. So the court held that the subcontract governed.

Limiting a flow-down clause, as in *Encon*, is a good option. Disputes can arise, however, as to what is "applicable." Another good option is to include an order of precedence clause, which identifies which contract controls if there is a conflict. But even then, problems could arise if a dispute involves more than just the prime contractor and subcontractor (e.g., the owner) where application of flow-down provisions may prove determinative of a multi-party dispute.

Parties would perhaps be best served by going one step further: taking inventory of the prime contract's and subcontract's terms at the outset, identifying any that conflict, and then addressing in express terms how the conflicts will be handled under all reasonably predictable circumstances—both on the upstream and downstream sides. That would allow the documents to function consistently. This may require more robust and specific

flow-down provisions than what parties are used to. But as they say, “an ounce of prevention”

What Flows Down when there is No Conflict?

Many disputes arise over which terms flow-down, even in the absence of conflicting terms. These disputes usually arise with more general terms of a prime contract (e.g., dispute resolution clauses, forum selection clauses, etc.). And they arise even where parties utilize language limiting the flow-down clause (above). Frankly, jurisdictions are less than consistent on this point. Many courts have determined that the applicability factor goes beyond performance requirements and does account for the prime contract’s general provisions. Other cases, however, maintain the hard line that only terms applicable to the subcontractor’s performance requirements flow down. Encon is representative; but it was also dealing with conflicting terms, perhaps making the decision to uphold the subcontract’s terms easier. Uniformity is lacking because disputes of this nature are analyzed on a case-by-case basis. But considering the lack of uniformity, parties need to understand that with flow-down clauses, they may be subject to the prime contract’s more general terms. Therefore, as with conflicting terms, parties need to address these issues in the beginning.

Conclusion

Flow-down clauses are a mainstay. Parties will encounter them more often than not. So understanding and accounting for their potential impacts is crucial. Nobody wants to be caught on the wrong end of a flash flood. ■

D. Scott DeGraffenried is an attorney at Salt Lake-based Holland & Hart. His practice focuses on construction litigation. He is a member of both the State Bar of Arizona and the Utah State Bar. He graduated from Arizona State University, Sandra Day O’Connor College of Law in 2007. He can be reached at 801-799-5800.



collaboration
innovation
transformation

DESIGN THAT MAKES A DIFFERENCE

daybreak charter school



babcock design group

babcockdesign.com
slc utah | boise idaho