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# Using Flowdown Clauses for Risk Allocation






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## Contract Risk Flowdown



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Risk allocation should be at the center of every construction contract negotiation. Conscientious owners, contractors, subcontractors and design professionals should attempt to limit their own legal exposure by shifting duties, obligations and liabilities to

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other parties in the contracting chain, as leverage allows.

The use of a flowdown clause is one important method of achieving this goal. On its face, a flowdown clause pushes risks and obligations, and shares rights and remedies, assumed under a separate contract down the contract chain to another contracting party. For instance, an owner may require a contractor to pass down certain obligations to its subcontractors. Section 5.3 of the AIA A201 does this by requiring the contractor to include language in its subcontracts by which subcontractors agree to assume toward the contractor all the obligations and responsibilities that the contractor assumes toward the owner with respect to the subcontractor's work. In addition it provides the subcontractor with the benefit of all rights, remedies and redress against the contractor that the contractor has against the owner. Similarly, Article 2 of the AIA A401 mutually binds the contractor and subcontractor to the terms of the contractor's agreement with the owner to the extent such terms apply to the subcontractor's work.

Strategic use of flowdown clauses can provide benefits to contracting parties in a number of ways. Owners obtain assurance that subcontractors are on the same page as the contractor, at least contractually. Contractors may use such a provision to limit the subcontractor's right to progress payments or delay damages or increase the subcontractor's financial obligations per the terms of the various rights and remedies in the prime contract.

Obtaining the intended benefits of a flow-down provision requires that the contracting parties fully appreciate the way in which all of the "flowed-down" language and the parties' contract are intended to interact. It is virtually certain that a lazily constructed flow-down provision will have unintended consequences for the parties. Therefore, it is vital that all contracting parties have a firm grasp of what is required by the terms that flow down and whether any potential conflicts or ambiguities are created between the two agreements. In that regard, it is crucial that the parties carefully define what terms are included or excluded from the scope of the flow-down clause. For example, payment terms are often the subject of such exclusions.



Don't you wish every project went this smoothly?

To the extent the contract may contradict with flowdown language, the contract should carefully set forth – either specifically with regard to certain provisions or more generally in an order of precedence clause – which language governs. This is particularly the case with damage limitations, "pay-when-paid" clauses and disputes provisions. It is important to understand that certain clauses that make sense between the owner and contractor may not make sense further down the contract chain depending on the circumstances. The party to whom the additional obligations and responsibilities flow down to should make every effort to further flow such obligations and responsibilities down to lower-tiered subcontractors or suppliers.

Flowdown clauses can be a valuable risk management tool, but they must be properly understood and carefully applied.

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#### Marla McIntyre

For more than 25 years, Marla has educated contractors, subcontractors, bankers, public and private owners, legislators, educators, insurers, and attorneys on contract surety bonding and construction issues. She's the author of more than 100 articles, including an award-winning series for the Risk Management Association, and has written books, directories, informational brochures, and reports. Her extensive construction and risk management background includes stints as executive director the American Subcontractors Association of Metro Washington and the Surety Information Office. She also worked for Associated General Contractors of America, National Conference of States on Building Codes & Standards, Association of Major City Building Officials, and National Concrete Masonry Association. She served on the boards of the Construction Writers Association, and American Council for Construction Education and was active in the Construction Owners Association of America.

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