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# **TOP CONSTRUCTION CONTRACT ISSUES AND PRESSURE POINTS FOR THE PLAYERS**

## ***The Subcontractor's Perspective***

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A subcontractor client came to our office several years ago looking for help in getting paid. When we asked to see his subcontract agreement, he replied: “I don’t have one.” Dumbfounded, we asked why he didn’t have a contract with the general contractor. He answered: “Why would I ever sign a subcontract agreement. There is nothing beneficial for a subcontractor in a subcontract agreement.”

Most subcontractors know this, and most lawyers who represent subcontractors know this, as well. The major issue that a subcontractor could have on a project (getting paid timely) is dealt with by statute (Texas Prompt Pay Act) and the leverage for getting paid is also provided by statute (Texas Mechanics’ Lien). Intuitively, most would agree that the majority of the terms and conditions in a subcontract agreement are intended to benefit the general contractor, not the subcontractor.

However, sometimes more complicated legal issues can arise when a subcontractor is working on a project without a signed agreement. For this reason, and to have the contractual remedies most general contractors need to have over the subcontractors, the contractor will force the subcontractors to sign a contract.

Most, if not all, subcontract agreements have been prepared by the general contractor, although most subcontractor have their “preferred” form, which is almost never used unless the subcontractor has enormous amounts of leverage. For this reason, there are few widely-used standard form subcontract agreements. The AIA publishes a standard form subcontract (AIA A401) and the ConsensusDocs publishes one, too, but most subcontractors will be negotiating a form of agreement prepared by the general contractor. Even though most subcontracts are not on standard forms, there are typical clauses contained in these manuscript agreements that should be modified, if given the opportunity. One of the most important, and often overlooked, clause in the subcontract is the flow-down clause.

#### **A. Flow-Down Clauses**

Flow-down clauses are a common feature of subcontract agreements. Indeed, incorporate by reference runs rampant throughout the construction contracting world. For instance, the promissory note incorporates the deed of trust, the prime contract incorporates the general conditions, the Project Plans and Specifications, and the Specifications incorporate other documents (e.g., ASTM Standards) by reference.

The so-called flow-down clause is simply an incorporation-by-reference provision that is intended to make all of the Contract Documents, which together form the contract between Owner and General Contractor, a part of the subcontractor’s obligations to the contractor.

The issue, from the subcontractor’s perspective, is: just what exactly am I agreeing to. From the perspective of the subcontractor’s lawyer, the issue is attempting to harmonize potentially thousands of pages of contract documents. A typical flow-down clause looks like this:

The Subcontractor shall be bound to the Contractor by all terms and conditions of this Subcontract and its Attachments and, except as otherwise provided herein, also by the Prime Contract between the Owner and Contractor, which is incorporated in its entirety by reference into this Subcontract and is made an integral part of this Subcontract. The Subcontractor shall assume toward the Contractor all the obligations and responsibilities which the Contractor, by the Prime Contract, assumes toward the Owner. In the event of a conflict, inconsistency, or ambiguity within the Prime Contract itself or between the Prime Contract and this Subcontract, the terms of this Subcontract shall govern.

The first issue for the subcontractor (and his lawyer) is getting a copy and reading the Prime Agreement to know what obligations it contains. It is not uncommon for subcontractors to execute subcontract agreements without ever asking to see the Prime Contract, or any of the other documents that are, undoubtedly, incorporated.

Although subcontracts sometimes allow the subcontractor to review the Prime Contract at the general contractor's office, upon request, or the subcontract says that the Prime Contract has been made available to the subcontractor, the subcontractor should always send a written request for a copy of the Prime Contract and the attachments. These documents should be reviewed and stored in the subcontract file. General contractors are sometimes reluctant to provide the Prime Contract (particularly if it contains the Contract Price or other proprietary information), a subcontractor cannot make an informed decision without this documentation.

With the recent addition of the Contingent Pay Statute,<sup>1</sup> owners must now provide evidence of their ability to pay, so the construction team is getting more accustomed to sharing information with each other.

In addition to requesting and physically reviewing the Prime Contract, subcontractor should attempt to negotiate the following changes to the flow-down clause:

- Make the obligation mutual: insert a flow-up provision that provides that “Subcontractor shall have the same rights, remedies and defenses against the Contractor as the Contractor has against the Owner.”
- Limit the incorporation to specific items related to subcontractor's scope: “The Subcontractor shall be bound to the Contractor by all terms and conditions of this Subcontract and its Attachments and, except as otherwise provided herein, also by the Prime Contract between the Owner and Contractor, Specification Section XXXX and Project Drawings XX through XX, which is incorporated in its entirety by reference into this Subcontract and is made an integral part of this Subcontract.

As described in John Nassen's paper presenting the General Contractor's perspective, subcontractors must pay attention to other documents that may be incorporated by reference

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<sup>1</sup> The contingent pay statute (Tex. Bus. & Com. Code §56.001) requires a General Contractor to provide the Subcontractor with the Owner's financial viability to pay, plus the existence of adequate financial arrangements to pay for improvements for a pay-if-paid clause to be enforceable.

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