

# MDA PRESENTS



## FIRST AID FOR CONTRACTS



Fourth Edition – Sept/ Oct 2024

### THE ROLE AND IMPACT OF NEC SUBCONTRACT FLOW-DOWN CLAUSES ON PROJECT RISK MANAGEMENT

+ Author: Shirley Mann

**In construction and engineering contracts, the New Engineering Contract (NEC) suite is renowned for its emphasis on collaboration and clarity. Among its various mechanisms, NEC contracts include flow-down clauses.**

Flow-down clauses are provisions included in subcontracts that mirror or reference the terms of the main contract but are distinct from back-to-back contracts. While back-to-back contracts and flow down clauses serve similar functions, flow-down clauses offer more flexibility and precise risk allocation compared to back-to-back contracts.

Back-to-back contracts are typically drafted by simply replicating the terms of the main contract in the subcontract without much customization. This often

leads to broad, non-specific obligations being placed on the subcontractor, even if they are not directly related to the subcontractor's scope of work. By contrast, flow-down clauses allow for more targeted and relevant risk allocation.

The purpose of flow-down clauses is to ensure that all subcontractors are bound by the same obligations and responsibilities as the primary contractor, but with a focus on more targeted and relevant risk allocation. Unlike back-to-back contracts, which often involve a direct replication of the main contract's terms without considering the subcontractor's specific scope, flow-down clauses allow for a more nuanced approach.

They tailor the risk allocation to match the nature of the subcontractor's work, ensuring that the subcontractor is only held accountable for obligations that are directly relevant to their tasks. This alignment between all contractors is critical for managing project risks in a balanced and precise manner, fostering clear expectations and promoting collaboration.

Alignment between all the contractors is critical for several reasons:

### 1. Risk Management and Alignment

Flow-down clauses ensure that the risks borne by the main contractor under the main contract and the risk management strategies that are implemented at the top level, between the employer and the main contractor, permeate through to all subcontractors involved in the project.

By using flow-down clauses, the main contractor can align the subcontractor's responsibilities and obligations with those they have under the primary contract. This alignment helps prevent gaps in risk allocation. By tailoring the responsibilities to the subcontractor's specific scope of work, flow-down clauses provide a more efficient distribution of risks, reducing the potential for confusion or contradictions between the main contractor's and subcontractor's obligations. This approach promotes a clearer and more manageable framework for the entire project, enhancing overall collaboration and minimizing potential disputes.

This can mitigate the risk of legal disputes and claims can arise from inconsistencies between the main contract and subcontracts by aligning the legal and

contractual obligations of all parties. This coherence simplifies dispute resolution processes and reduces the likelihood of protracted legal battles, which can be costly and time-consuming.

Example: If the main contract includes specific terms regarding project timelines, these can be incorporated into the subcontractor's agreement through flow-down clauses.. This ensures that all parties work towards the same timelines, reducing the risk of delay claims or penalties.

### 2. Flexibility

Unlike back-to-back contracts, where the entire set of terms in the main contract may be replicated in the subcontract, flow-down clauses allow for selective transfer of rights and obligations. This flexibility means that only the most relevant rights and obligations are transferred to the subcontractor.

**Benefit:** Flow-down clauses can be customized, allowing the main contractor to pass on only the relevant rights and obligations that fit the subcontractor's scope of work. This avoids overwhelming the subcontractor with obligations that do not pertain to their specific role, making it a more efficient and targeted way to manage risks.

### 3. Legal Clarity

Flow-down clauses ensure that the subcontractor is legally bound to meet the key obligations and standards set in the main contract. This provides clarity on expectations between the main contractor and subcontractor, reducing the potential for disputes.

Example: A flow-down clause might specify that the subcontractor must comply with the health and safety standards outlined in the main contract, but it would do so in a way that directly applies to the subcontractor's specific scope of work. Unlike a back-to-back contract, which would simply replicate the main contract's terms verbatim, a flow-down clause tailors these obligations to ensure clarity and relevance for the subcontractor, minimizing ambiguity and leading to smoother execution of the works.

#### 4. Tailored Enforcement

Flow-down clauses allow the main contractor to manage subcontractors differently depending on their roles and responsibilities. Different subcontractors may have different levels of involvement or risk in a project, and the flow-down clauses can reflect this.

**Benefit:** Tailoring obligations allows for more practical enforcement. For example, the subcontractor handling structural works may have more rigorous compliance requirements than one providing landscaping services, and the flow-down clauses can reflect these distinctions.

#### 5. Consistent Legal Obligations Across Multiple Subcontracts

In larger projects, multiple subcontractors may be involved. Flow-down clauses ensure that the obligations of all subcontractors are aligned with the main contract, creating a consistent approach to managing risk and reducing the likelihood of conflicting obligations across the project.

#### 6. Preserving Relationships with Key Stakeholders

By allowing for customized obligations and reducing ambiguity, flow-down clauses can help preserve relationships between contractors, subcontractors, and employers. This approach can lead to smoother collaboration and reduce friction, particularly if disputes arise.

**Benefit:** Maintaining clear, balanced obligations encourages positive working relationships, as subcontractors are less likely to feel burdened with excessive or irrelevant obligations. This can lead to better performance and cooperation on the project.

#### Potential drawback and risks

While flow-down clauses offer numerous benefits in construction contracts, they also come with potential drawbacks and risks. These primarily relate to issues of enforceability, clarity, and the complexity of implementing these clauses effectively.

One of the primary risks of flow-down clauses is ambiguity where the clauses are not carefully considered or carelessly included. These clauses often reference terms and obligations from the main contract, which can sometimes lead to confusion if the subcontractor does not have a complete understanding of those terms or if they are unclear or overly broad.

Flow-down clauses may sometimes unfairly pass on unintended or inappropriate risks to the subcontractor. The main contractor may attempt to pass down all of its obligations from the primary contract, including risks that the subcontractor has little control over or is not equipped to handle.

Flow-down clauses often mean that subcontractors are expected to accept obligations from the main contract without directly negotiating those terms. This can put subcontractors in a weak bargaining position, as they may be forced to accept terms that were negotiated between the main contractor and employer but not tailored to their specific circumstances. Lack of direct negotiation can result in subcontractors being bound by unfair or unreasonable obligations, which can lead to increased costs, delays, and disputes. It can also discourage smaller subcontractors from bidding on projects where flow-down clauses are heavily used.

Enforcing flow-down clauses can sometimes be challenging, particularly if there is a disconnect between the main contract and the subcontract. Courts may scrutinize flow-down clauses closely, especially if they are unclear or too general, and they might not enforce them as intended.

### **Conclusion**

Flow-down clauses offer significant benefits for aligning risk and responsibility across contracts. However, if they are not worded carefully, they can create confusion, unfairness, and legal disputes, potentially undermining the project's success. Effective drafting, clear communication, and fair risk allocation are essential to mitigating these downsides. Both contractors and subcontractors alike would benefit from appointing a contract expert to ensure the proper integration of flow-down clauses, helping to avoid the pitfalls mentioned and ensuring that all parties fully understand their obligations. This expert

guidance can contribute to smoother project execution and a more balanced distribution of risk, ultimately leading to a more successful outcome for everyone involved.