



The Soto Law Group, P.A.

CONSTRUCTION PRACTICE GROUP

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TOP TEN CONSTRUCTION CLAUSES PART VIII—INCORPORATION BY REFERENCE

This is the eighth installment in a ten-part series analyzing critical construction clauses. This installment analyzes the “Incorporation by Reference” provision. The first seven articles can be found on our blog at <http://sotolawgroup.blogspot.com/>.

The incorporation by reference clause, sometimes called a flow-down or pour-over clause is the basis by which parties to a contract include upstream contract requirements without specifically attaching them. Typically, this occurs between the contractor and subcontractors. Below is the pertinent section of the incorporation clause taken from AIA form A401.

AIA "Standard Form of Contract Between Contractor and Subcontractor" (A401)

Article 1

The Subcontract Documents

1. The Subcontract Documents consist of (1) this Agreement; (2) the Prime Contract, consisting of the Agreement between the Owner and Contractor and the other Contract Documents enumerated therein, including Conditions of the Contract (General, Supplementary and other Conditions), Drawings, Specifications, Addenda issued prior to the execution of the Agreement between the Owner and Contractor and Modifications issued subsequent to the execution of the Agreement between the Owner and Contractor, whether before or after the execution of this Agreement, and other Contract Documents, if any, listed in the Owner-Contractor Agreement;... These form the Subcontract, and are as fully a part of the Subcontract as if attached to this Agreement or repeated herein

Careless treatment of these clauses can be detrimental to a contractor, subcontractor or supplier's expectations and understandings of what exactly is being agreed to in a contract. From a project Owner or developer's standpoint, incorporation clauses can create unintended conflicts and ambiguities which negatively impact the rights, obligations and liabilities of the parties.

The case of *Katner v. Boutin*, 624 So. 2d 779 (Fla. 4th DCA 1993) deals with a settlement agreement between two parties, where one party believed that they were receiving a piece of property free of encumbrances. The settlement agreement referenced a lease agreement and a purchase agreement that were executed simultaneously without knowledge of one of the parties. The purchase agreement that was referenced by the lease gave the purchaser the continuing right of first refusal on the sale of the piece of property and created an encumbrance on the property. The court found that there was no intent to be bound by what was in the collateral documents (ie the lease agreement and purchase agreement) because it was not referenced to in the settlement agreement.

So what is required to incorporate a document correctly? The document pretending to incorporate an extrinsic document must state specifically that it is subject to the document to be incorporated and the document incorporated must be specifically described and or referred to in the incorporating document in such a way to make clear that the parties intended to incorporate it.

In the case of *Temple Emanu-El of Greater Fort Lauderdale v. Tremarco Indus., Inc.*, 705 So. 2d 983 (Fla. 4th DCA 1998) there was a contract between the owner and the contractor to install a roof system. One of the provisions of the contract provided that contractor would provide a performance warranty on the roof. The owner later sued the contractor and the contractor tried to use a warranty that was referenced in the document to govern the whole contract. The court found that the contract and warranty were not incorporated merely because the warranty was merely referenced. There was no intent found by the court for the parties to be bound by the warranty.

Incorporating extrinsic documents can create unintended consequences. A recent example of this comes from *Int'l Eng'g Servs. v. Scherer Constr. & Eng'g of Cent. Fla., LLC*, 74 So. 3d 531, 532-34 (Fla. 4th DCA 2011). IES, a subcontractor appealed the entry of a final summary judgment in favor of its general contractor, Scherer, on a breach of contract claim.

According to the subcontract, IES agreed to perform certain structural steel work on a project in Maitland, Florida. IES performed its work under the contract but was not paid by Scherer. When IES then brought suit against Scherer, Scherer raised the affirmative defense that the subcontract contained a pay-when-paid clause, which provided that payment by the project owner to Scherer was an express condition precedent to paying IES. Scherer argued that because it had not been paid by the project owner, it did not have to pay IES. The lower court entered the summary judgment in favor of Scherer based on the pay-when-paid clause in the subcontract.

The appellate court held that an ambiguity in the contract was created when the subcontract incorporated the prime contract between Scherer and the owner. Article 2 in the subcontract states:

The "Contract Documents" for this Subcontract consist of this Agreement, the terms, conditions or instructions contained in the transmittal letter from the Contractor to the Subcontractor delivering this subcontract for execution by the Subcontractor, any exhibits attached hereto, the Agreement between the Owner and Contractor dated (prime contract), the conditions of the Architect, all approved drawings and architectural plans and specifications, all modifications issued prior to execution of the Agreement between the Owner and Contractor, and all modifications issued subsequent thereto.

The appellate court found that the prime contract, which was incorporated by reference, provided that the owner was not required to pay the contractor until it had paid its subcontractors. The court explained that this created an ambiguity which had to be resolved against the contractor and further interpreted to require the contractor to pay IES within a reasonable time, not when actual payment was received by the owner. *Int'l Eng'g Servs. v. Scherer Constr. & Eng'g of Cent. Fla., LLC*, 74 So. 3d at 532-34.

Practice Points:

Key contracts clauses typically incorporated by reference:

Venue of dispute

Arbitration or Litigation Option

Waiver of certain damages including consequential damages
Liquidated damages
Pay when paid

Affected party needs to specifically review the upstream incorporated documents and establish at inception the carved out flow down items, which are not accepted!



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