



## **Incorporation by reference provisions in subcontracts may not fully protect GCs, owners - by Andrew Richards**

February 04, 2020 - Long Island

Incorporation by reference provisions in subcontracts may not fully protect general contractors and owners from claims by subcontractors.

A common, yet frequently overlooked, cause of increased project and construction costs occurs when the terms of the agreement between the owner and the contractor (the “general contract,”) and the agreement between the contractor and a subcontractor (the “subcontract,”) conflict. Such conflicts often result in costly project delays and litigation involving the owner, general contractor and subcontractor.

In an effort to avoid conflicting contractual terms, general contractors often attempt to bind its subcontractors to certain key terms set forth in the general contract, such as terms concerning payment, the procedure for seeking payment for extra work, damages and dispute resolution. A typical method used by general contractors to protect them is the use of “incorporation by reference” provisions. Such provisions in the subcontract will contain language stating that certain terms of the general contract are incorporated into the subcontract as if they had been fully set forth in the document itself.

If utilized correctly, an incorporation by reference provision is an extremely effective way to streamline project documents and eliminate costs, claims and delays arising out of conflicting contract terms. However, if improperly utilized, incorporation by reference provisions could have costly consequences to both the owner and the general contractor.

The law in New York always has been that general incorporation clauses (i.e. “[a]ll of the terms of the general contract are hereby incorporated by reference in this subcontract”) which incorporate by reference clauses of a general contract into a subcontract, bind the subcontractor only to the general contract provisions relating to the:

- Scope;
- Quality;
- Character; and
- Manner of the work to be performed by the subcontractor.

Importantly, New York law provides that a general contract's payment limitation and dispute resolution clauses cannot be incorporated into the subcontract by a general incorporation by reference provision and, therefore, the subcontractor cannot be bound to such clauses unless they are specifically incorporated by reference into the subcontract.

For example, many general contracts contain arbitration provisions. New York courts, however, will not bind subcontractors to such arbitration provisions unless the provision is specifically and expressly incorporated into the subcontract. Thus, certain disputes, such as a subcontractor's claim for extra work, which involve the owner, general contractor and subcontractor, may result in contemporaneous arbitrations and lawsuits which could lead to inconsistent determinations, as well as increased costs for the owner and general contractor.

In addition, prime contracts between government agencies and prime contractors often contain dispute resolution provisions whereby the prime contractor, among other things, forfeits its right to commence a lawsuit against the agency seeking payment for extra work performed and, instead, must comply with the agency's onerous and often one-sided internal rules and procedures. Obviously, in such cases, it would be in the prime contractor's best interests to have its subcontractors also prosecute its claims for extra work in accordance with the agency's rules and procedures. However, many New York courts have held that subcontractors are not bound by such dispute resolution provisions unless the subcontract specifically and expressly incorporates such terms, and that a general incorporation by reference of the terms of the general contract will not suffice. Thus, the agency's more onerous rules and procedures may result in a prime contractor, facing a lawsuit by its subcontractor seeking payment for extra work, from passing the subcontractor's claim through to the agency even if the work was outside of the scope of the prime contract. Thus, the general contractor may have to litigate the subcontractor's extra work claims in a traditional lawsuit while prosecuting those claims against the governmental agency pursuant to the agency's more onerous procedures. By doing so, the general contractor risks having to pay the subcontractor, but not be reimbursed by the agency.

Accordingly, it is in the interest of both owners and general contractors to incorporate into the subcontract certain provisions regarding payment procedures and dispute resolution procedures by specific reference to the actual provision in the general contract in order to reduce the risk of prolonged litigation, increased project costs and inconsistent claim resolutions.

Andrew Richards is a co-managing partner – Long Island office, chairman of construction practice group at Kaufman Dolowich & Voluck, LLP, Woodbury, N.Y.

New York Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540