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WHEN YOUR CONTRACTOR SHUTS ITS DOORS

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Every year, the community association industry is rocked by the failure of a major service provider. Fortunately, not all communities get hit by such failures, but, when it happens, the board is often left with the difficult task of picking up the pieces.

No business failures are identical; so, the issues that occur in the aftermath of a failed business will always be different. However, this memo will briefly outline how a board can respond to a contractor that files for bankruptcy relief.

There are some fundamental points that a board needs to keep in mind when its association finds that a service provider has filed for bankruptcy protection, the first of which is to always review the contract. In general, contracts will define what constitutes a "default" by the contractor. Oftentimes, a contractor protects itself by requiring the association to provide it with a notice and cure period before the board can exercise any right to terminate the contract. Other contracts may have a clause that allows the board to terminate the contract automatically if the contractor files for bankruptcy protection.

While these clauses seem protective of the rights of the association, the reality is more complicated, and, in some cases, counter-intuitive. Consultation with counsel in these cases is absolutely necessary primarily because the laws of bankruptcy protect the debtors, not the creditors. Once the debtor files for bankruptcy relief, all creditors are subject to an injunctive stay that prohibits the creditors from taking certain legal action against the debtor, which, in some cases, can include the action of terminating pending contracts.

This scenario often unfolds when the bankruptcy trustee assigned to the case believes that the contract is an asset of the business that the trustee can sell to another vendor in order to obtain funds for the bankrupt business's estate, which then can be distributed to the creditors.

Such events are not rare. Some community associations have been required by order of the bankruptcy court to accept these assignments of contract – even though the board does not know anything about the new service provider.

Even worse, it is not uncommon for boards to rush into new contracts with new service providers based upon the thought that the prior contract is void as a result of the prior contractor's cessation of service and filing for bankruptcy relief. These scenarios can turn out to be a board's nightmare because the association can find itself obligated under two contracts for the same service when the trustee decides to sell the original contract.

So, if one of your contractors files for bankruptcy relief, we caution you against taking action before consulting with the association's legal counsel. The association's attorney can research the bankruptcy filing and provide advice regarding the appropriate steps to take in order to best protect the association's interest.

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