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Vendor Contracts: “Crossing the T’s and Dotting the I’s”

By: Kathleen N. Machado
Winta Mengisteab

Vendor contracts are a part of association governance. One of the most important roles that a board of directors plays for an association is to make sure that the necessary contracts are in place for the association’s daily operations. While this topic has many angles, to avoid going off on any number of tangents, this article focuses on how boards and managers can protect their associations from “bad contracts”.

How many of us have heard the “bad contract” horror stories, or perhaps even experienced one first-hand? It doesn’t require a significant amount of time in the community association industry, as a board member, manager or other related professional, to hear the tale of the association that hastily entered into a contract only to find itself bound to a relationship with a vendor that provides subpar service, or even worse, the story of the association that incurred significant monetary damages to replace an incompetent or unsavory contractor. The common thread throughout all of these horror stories is that nine times out of ten, the damage could have been prevented by implementing relatively painless due diligence measures related to the evaluation and negotiation of the contract at issue. And, because board members and community managers owe fiduciary duties to their associations, they must be diligent in reviewing contracts.

Working towards avoiding a bad contract and entering into a good, meaningful and effective contract begins at the first stage; the solicitation. Of course, not every contract will be subject to a rigorous and highly detailed solicitation. However, when soliciting a proposed contract from a prospective contractor, it is always best to clearly define the scope of the contract (no matter how small) and to set out any required terms and conditions. Much can be gleaned from a contractor’s response to the solicitation. For example, if a contractor seems to ignore and/or overlook the requests made in the solicitation, this may be an indication of the level of attention one will receive once a contract is executed. Interviewing or meeting potential contractors may also be useful in some cases.

We also generally recommend a review of the association’s governing documents before sending requests for proposals, since such documents may contain restrictions related to the board’s ability to enter into certain contracts. Common examples of such restrictions include the dollar amount that may be expended by the association’s board of directors without membership approval and/or the duration of a management contract (either a minimum or a maximum term).

Also, as many managers and boards already do, it is always good practice to obtain at least three bids for the board to review. While we understand that it is tempting to go with the least expensive contractor or the most recognizable contractor, comparing multiple bids is the only way to really determine which contractor is most suitable for the association's needs.

Prior to selecting the contractor (not just before commencement of the contract), we strongly recommend boards and managers to require the contractor to provide copies or proof of the proper permits and licenses, which will vary depending on the industry and/or jurisdiction, and to confirm their adequacy. For example, in Virginia, the Department of Professional and Occupational Regulation contains a listing of registered/permitted contractors in a number of industries and also contains information related to complaints/claims filed against a registered contractor. In Maryland the equivalent agency is called the Department of Labor, Licensing, and Regulation, and in DC it is the Department of Consumer and Regulatory Affairs. Associations can also perform simple Internet searches (like reviewing a contractor's BBB rating or reading about the contractor in consumer forums) to uncover a wealth of information on a prospective contractor.

Once a particular contractor has been selected, the board can either present its own contract or review the one proposed by the contractor. In either case, a thorough review of the contract should be conducted to avoid unnecessary, inapplicable, inadequate or one-sided provisions. While you may expect us to say that you should always have your legal counsel review a

contract, practically, we understand that the financial realities of operating a community association do not necessarily permit incurring such fees for every contract. As such, we suggest considering the nature and dollar amount of the contract when deciding whether to provide it to legal counsel for review. Nevertheless, we urge associations to have their legal counsel review all long term and/or high dollar contracts.

That being said, if a board decides not to refer a contract to the association's legal counsel for review, it should be prepared to review each and every provision to ensure that what the association is agreeing to is reasonable, meets the association's needs, and adequately protects the association. And, although there are general provisions that should be included in every contract, a few of which we review below, we caution boards against using a boilerplate or template agreement.

Three of the most fundamental provisions in a contract, and the ones that we find are the most contentious, are termination provisions, indemnification clauses, and insurance terms.

1. Termination provisions are important because they can be drafted to make it very difficult for an association to get out of a contract. Some clauses to watch out for are "with" or "without cause" distinctions, penalties for early terminations, and notice requirements.

2. Indemnification provisions are imperative because they are often drafted to limit the contractor's liability and increase the association's. Therefore, these provisions must

be negotiated to fairly account for each party's liability.

3. Insurance requirements are necessary, and may even be required (by law or by the associations documents) in some circumstances. Where required, we recommend that associations be named as insureds. At a minimum, boards should review insurance provisions to make sure that they are for sufficient amounts, and should retain copies of insurance policies.

We hope that these tips help your association avoid some common pitfalls; however, if your association currently needs assistance reviewing a contract feel free to contact our office.