

# EchoJournal

A Journal for Community Association Leaders

## CONTRACT CONCEPTS THE BASICS

By Glenn H. Youngling, Esq.

**O**n a regular basis, associations, managers, vendors, contractors and others enter into contracts that they only partially understand. An agreement reduced to writing creates a document that helps the parties understand their mutual expectations. Particularly where there is an ongoing relationship, if all goes as expected, there is little or no need to look back at the written documents. If all does not go as expected, the parties may be surprised to find that the contract contains provisions agreed to that one, the other or both did not understand. There may be serious consequences.

This article addresses common vendor and service provider contracts. (Major repair contracts should be addressed with the assistance of counsel and an architect or engineer.) Directors of associations addressing maintenance and vendor contracts should scrutinize the basic provisions.

At the outset, understand that in this day of computerized agreements, there is no such thing as "The Standard Contract." Frankly, parties routinely proffer proposals and agreements, all of which may be described as "standard" but any of which should be changeable to be sure the contract "tells it like it is" and balances the rights and obligations of the parties. What follows are cate-

gories of information that, at a minimum, should be addressed in every contract.

**Recitals.** At the beginning of many contracts there is a section that permits the parties to include a preamble of agreed facts, circumstances and/or goals that set the stage for the agreement that follows. This is perhaps the most often overlooked opportunity for anyone entering into a contract. By reciting the basic circumstances and most pertinent facts, this section tells an abbreviated story. The recitals not only help a reader to understand the contract itself, but the facts may become admissions in any later dispute.

**Parties.** The identity and legal status of all parties to the agreement must be clearly set forth. This should not only include names but also full contact information. The liaisons or other persons key to the performance should be identified. Don't overlook the significance of stating the legal status of the parties. Are the parties corporations? Have you checked to be sure all corporations are in good standing with the State? Is one of the parties a contractor who is required to be licensed? If so, the license number should be checked with the Contractor's State License Board and the number should be stated on the contract. Be sure the name on the

license is identical to the contractor's name on the contract.

**Specifications and Scope of Services.** This is the part of the contract that should be most important to you. It is what you get in return for the association's money. Sales pitches, advertisements and discussions do not equate to an enforceable scope of work or service. You should always be specific, but the more complicated the job, the more expensive, the longer the time frame and/or the more intrusive it is, the more important it is to be very specific. If you want to avoid proposals or bids that leave you comparing "apples to oranges," draft your scope of work before you solicit vendor proposals or bids. Do your homework. And listen if your manager recommends a consultant or someone else to assist in defining the scope of work.

**Payment.** Directors tend to focus on the bottom line cost and not pay enough attention to the logistics of payment. How much will be paid and when? Is the amount fixed? Is it proportionate to the value delivered? How will extra charges be handled? Is there an up-front charge and if so, how much is too much? Will a portion of payments be retained pending completion of the job? Watch carefully for payment cycles and revise them to fit your pattern of

decision-making. Boards typically meet monthly. Payment cycles shorter than thirty days may trigger late charges or interest. Be sure the timing works for you.

With the exception of banks, the companies an association contracts with should not be in the business of lending money. It's rare that they will extend credit willingly, but if they are put into the position of not receiving timely payment, most parties ask for late charges and/or interest at a high rate. Typically these can easily be revised to be sure you have the economic incentive to make payment but not end up facing exorbitant late charges or high (possibly usurious) interest rates.

**Liens.** The general rule is that those who contribute labor or materials to the improvement of property have the right to assert a lien against that property. Contractors, subcontractors, material providers and even architects and engineers are among those who can use their lien powers "to sue your property" if they are not paid. Statutes in this area of the law are intended to protect those with lien rights and can have harsh consequences to the property owner who does not competently manage risks associated with construction. If an association pays a general contractor in full but the general does not pay a subcontractor, that subcontractor can file a lien for which the association will be responsible—even though it would be a double payment by the association! What are the contractor's obligations to keep the property free of liens by others? Does the association have the right to issue checks jointly to the general and a subcontractor or material supplier? Must the contractor provide partial lien releases from all involved as incremental payments are made? Safeguards should be built into any contract where lien rights exist. (The Contractor's State License Board has an excellent website that includes information about liens and how to protect the property owner.)

**Delay.** What is the consequence of delays? In some instances a brief delay will make no difference, but in others the financial impact could be great.

Who bears what risk and for which types of delay?

**Insurance.** Initially parties will try to avoid a problem before it occurs. However once a problem occurs, insurance is the first line of defense. Has the association confirmed the contractor, vendor or service provider has liability insurance and worker's compensation insurance? Is there insurance to cover other risks inherent in the particular relationship (such as errors and omissions insurance and professional malpractice insurance)? Can the association be added as an additional insured on a contractor's policy? Does the manager fit within the definition of insured on the association's policy? If something goes wrong, whose insurance will be primary? Directors should feel comfortable consulting with the association's insurance agent on these subjects.

**Indemnification.** Frequently "standard" contracts have provisions for the association to "indemnify, defend and hold harmless" the other party to the contract in a variety of broad circumstances. These words are, perhaps more than any others in the agreement, packed with potential risk. Sections related to indemnification and related concepts are often identified by a variety of labels, some of which may appear benign. Make no mistake about it, however; these types of provisions may put the association into the role of insurer to the other party—complete with duty to pay the other party's legal fees and to pay out damages on behalf of the other party even if the association did nothing wrong! It may be that you can transfer such risks to an insurer but you have to be alert to them first. If a contract includes any combination of the concepts of indemnification, holding harmless and defense, you need to consult with counsel and perhaps your insurance agent.

**Disputes.** State whether legal fees and costs will be recoverable and under what circumstances. Remember that this can be a "double-edged sword." With every contract a board signs, thought should be given to the forum and method by which disputes will be resolved if they arise. By default, silence on the subject means that if the parties

cannot resolve their differences directly, they will likely turn to the legal system and inevitably the courts for resolution. In most instances, however, mediation or arbitration will provide a more efficient and cost effective method to resolve differences. Do not wait until a problem arises to attempt to decide mutually who will provide alternative dispute resolution ("ADR") services. You should have a comfort level with the provider, and process you specify. Don't assume that the well-known American Arbitration Association is right for you in any particular circumstance. You may want to specify JAMS, Resolution Remedies or some other provider of ADR services. Most have websites but there is no substitute for asking people around you if they have had a positive experience and will make a recommendation.

**Default/Termination.** Sooner or later all business relationships come to an end. The beginning of the relationship is the best time to describe the procedures to be used to wrap up the "loose ends" at the end. These provisions will vary greatly depending on the nature of the relationship and its duration. What notices are to be given to whom? How will final payments be made? Will records be transferred? Will the association be responsible to pay for the costs associated with closing services? Are there differences between termination "for cause" and "without cause?" What constitutes a default? Will "lost profits" become an issue? Think through these concepts at the same time as you consider Alternative Dispute Resolution.

**Miscellaneous.** Most contracts end up with a number of provisions that are important enough to include but do not get much attention. For example, clarification of the other party as an independent contractor or the agent of the association may be a simple sentence but can have significant consequences if there are third party liability claims. Will the term of a contract automatically renew? Is the entire agreement contained within the four corners of the written agreement? If a lawsuit is filed, which county will it be filed in? Can the contract be assigned? If one section of the contract is found to be

unenforceable, is the balance of the contract still in effect? These types of provisions are often characterized as "boilerplate," but depending on the type of problem that may arise, can become very significant.

**Signature and Date.** Be sure the signature block identifies the capacity in which the individual is signing. It is wise to be sure related Board minutes clearly confirm that it is the Board that has authorized entering into the contract. Individuals signing on behalf of

the Association should specify their capacity. President? Secretary? Managing Agent? Two signatures on behalf of a corporation provide the presumption that it is a valid corporate act and are preferable to one.

There is no substitute for planning ahead and using counsel to assist with contracts. The concepts listed above are but a few of the considerations that should go into even the most basic contracts. Ideally every association has a relationship with an attorney who

can efficiently review proposed contracts and make recommendations. Legal counsel alone, however, is not substitute for a well-informed board that actively participates in the formation of contracts.

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