

Contracting for Community Associations

Why do we need written contracts?

Contracts set forth the rights and duties of the parties to the contract, and help to reduce or eliminate misunderstandings regarding the work to be completed and the money to be paid. In resolving any dispute or problem under the contract, such as whether a payment is due, a reviewing court will look to the language of the contract to determine which party will prevail. Thus, the contract provisions should be carefully considered in every contracting situation.

Should we sign the contract prepared by our contractor?

Most "standard form" contracts are written to favor the party who wrote it. Thus, most pre-printed contractual forms will provide little or no protection to the association if a contractual problem develops. Whereas any contract may be acceptable if there are no problems with the contractor's performance, only an association-prepared or reviewed contract offers the protections necessary in case of serious disputes.

What are the most important issues to address in a contract?

There are many, many important issues to be considered in every contract. Those that most frequently lead to problems or disputes include: an inadequate description of the work the contractor is to perform, poorly drafted payment provisions (when payments are due, when they can be withheld, and retentions), how change orders are approved, indemnification and mechanic's lien issues.

What types of insurance should the contractor have?

This can vary depending upon the type of job, but all contractors should have at least a comprehensive general liability policy, an owned, non-owned and hired automobile policy and workers' compensation coverage. The amount of insurance may vary, but should never be less than \$1 million in comprehensive general liability and \$500,000 in automobile coverage. The association should be named as an "additional insured" on the contractor's insurance policies. Some contractor's insurance policies contain an exclusion for all work performed on a community association. Contractors who are not insured to work on community associations should not be hired.

How should payment provisions be written?

The Association's best protection against financial loss resulting from a contract problem is to not allow the contractor to receive more money than the percentage of work that has been completed. In regular maintenance contracts such as landscaping and pool service, payment should be made after the service has been provided. In construction projects, the contract should provide that progress payments can be submitted only for work actually completed, and should also provide for the association to retain a percentage of each progress payment until the job is completed. Avoid provisions that require payment "upon delivery" or "upon completion," as few associations are set up to have a check waiting for the contractor immediately after the job is completed.

What are "indemnification" clauses?

Indemnification is the contractual obligation of a party to a contract that requires the party to pay the expenses of the other party under certain conditions, such as when the party being indemnified is named in a dispute or lawsuit. The indemnification clause defines when this obligation arises. Most often, the obligation arises when the party being indemnified is not legally liable for the alleged damage, loss or injury, while the party providing the indemnification is legally liable. Many "standard form" contracts contain clauses that require the owner/association to indemnify the contractor unless the contractor is negligent. Boards of directors should be aware that most association insurance policies contain an exclusion for "contractual obligations" such as indemnification. As a result, whenever possible, provisions requiring the association to indemnify the contractor should be stricken from the contract before it is signed.

Are provisions requiring mediation or arbitration a good idea?

Provisions requiring mediation or arbitration to resolve disputes can save the association significant time and money, especially if these forms of "Alternative Dispute Resolution" succeed in avoiding litigation. Mediation is the voluntary attempt by the parties to discuss and negotiate the dispute with the help of a neutral third party in an effort to reach an agreement or settlement. Arbitration is similar to litigation in that the facts of the dispute are presented to an arbitrator who will decide which party is right. Arbitration can be binding or non-binding. If non-binding, the losing party still has the option of filing a lawsuit. In binding arbitration, the parties agree to waive their rights to a jury trial and appeal. The arbitrator's decision is final.

What is a mechanic's lien?

A mechanic's lien is a constitutionally-established procedure that helps ensure that a contractor gets paid for the work that has been completed. If the contractor is not paid, he or she can record a lien against the property where the work was performed. If

payment is not timely made, the property can be foreclosed by the contractor to satisfy the debt. If the association is not vigilant, a lien can be recorded by a design professional, subcontractor, material supplier or wage earner even if the general contractor has been paid!

How does the Association protect itself against the contractor recording a mechanic's lien?

Except for a party with a direct contractual relationship with the association (such as a general contractor or design professional), a "lien claimant" (party desiring to record a mechanic's lien) must provide the association with a Preliminary Notice (which is sent by registered or certified mail, return receipt requested). Before payment is made to the general contractor, the association has the right to insist that every company or individual who has filed a Preliminary Notice submit a lien release with every request for payment. If the lien claimant has not been paid, the association can then write joint checks to the general contractor and the potential lien claimant.

What are liquidated damages?

Liquidated damages are the amount of money that the contractor and the association agree in advance is a reasonable sum that the contractor will be charged if the work is not completed on time. The amount is usually charged on a daily basis until the work has been completed, and is intended to eliminate the need to prove the actual damages suffered by the association because the work was not completed on time.