

MAHC Messenger

“The Devil is in the Details” - Dealing with Coop Vendors

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Cooperative Boards, in discharging their fiduciary duties, usually award contracts to low bids. They also try to cut corners in entering into contracts with bidders. Obviously, the motivation is to keep costs down for the benefit of their members. That is what they perceive as their job, and they are correct - in part.

But the rest of the story needs to be told. Sometimes the low bidder is not an established, reputable businessperson. Sometimes, the low bid means cutting corners. Sometimes, it spells disaster for the Cooperative.

The point of this article is to encourage Boards to be circumspect and knowledgeable in making decisions on bids. It is not to dissuade Boards from taking advantage of good deals and awarding contracts to the low bidder. Quite to contrary: the goal here is to equip Boards to do their due diligence and take steps to protect themselves.

While it is impossible to provide a comprehensive list of rules, the following is an attempt to identify some common concerns that Boards should consider with each contract. It is not a replacement for involving the Cooperative's professionals - management and legal.

Rule #1: Require the Vendor to have and produce Workers' Compensation coverage. If someone working for the vendor is injured while working on your Cooperative's project and your vendor does not have worker's compensation, that injured person will be able to recover from the Cooperative. Therefore, it is a simple preventative matter to require evidence of the coverage.

One nonprofit learned this lesson the hard way. It was a simple job, involving repairing a stairwell. It seemed like a small matter and so a friendly local vendor was summoned, and a very reasonable price was agreed upon. The vendor, who happened to be a one-man shop, came with a friend who was to help. Unfortunately, this friend was not very adept with power tools and was injured by a saw. Much to the surprise of this nonprofit, the friendly vendor did not have any workers' compensation and, under Michigan law, the injured assistant was able to recover from the nonprofit. Of course, the result would have been different if Rule #1 had been followed.

Rule #2: Get guarantees in writing. Being precise and having the legal ability to force a vendor to keep its word depends on having a written deal. Here, there are

actually two rules in one - first, get it down in writing; second, make sure the deal is clear.

As to the first point, Cooperatives are reluctant to spend money on legal fees to prepare a contract for every single transaction. That makes sense and for that reason, we have standard “wrap around” agreements for Cooperatives, that contain the essential elements of typical deals yet allows a vendor and Board to tailor the performance aspects. This provides a handy tool for the Board and Manager to quickly and inexpensively provide a written contract that, in turn, incorporates an attached performance bid specification and the vendor’s proposal. If the vendor’s form has fine print that conflicts with the standard “wrap around” agreement, it is resolved in favor of the standard “wrap around” contract by that instrument’s terms.

This tool is good for many smaller transactions. Larger ones, where more is at risk, should involve the Cooperative Attorney. The Manager should be involved in deciding whether the size and complexity of the deal requires legal assistance. Failing to get legal help is penny wise and pound foolish, and eventually catches up to those cutting corners.

Related to this point is the need to spell things out. Ambiguity is as fatal to a claim that the vendor failed to do the agreed upon job as is not having it defined at all. More detail here is better than brevity. Use layperson’s language and insist on being able to understand it. You need to play “devil’s advocate” and think of the various scenarios possible. If the Board is hiring someone to replace gutters, think about what should happen if the underlying wood is rotted out. Managers should be helpful in this regard. Of course, no one has experience in all matters so do not hesitate to seek other experienced help.

Rule #3: Make sure there is liability & automobile insurance. Requiring insurances of the vendor is a simple enough requirement and if you are dealing with a reputable company, it will not be a problem. In fact, it is expected as a customary element of doing business. Should you meet resistance to imposing insurance on the vendor, that is a red flag that you should run away from that deal.

Among the insurance requirements you should seek are insurers that are licensed and registered in your State. The amount required should be abundant and if it involves high risk activity, ask for more. Make sure the insurer has the financial means to pay any claims, and that if it cancels the vendor, that you get advance notification. Also, it is easy enough to check on the insurer’s history of complaints against it. You do not want to have an insurance company that fights with the vendor and the Cooperative when a third party files a lawsuit. You want an insurer to take up the defense immediately and handle it all the way through final disposition.

Associated with this is identifying the scope of coverage. This requires professional advice to make sure that all possible claims are covered in the policy. These need to be spelled out in the bid specifications.

Rule #4: Require a start and finish date. As simple as it sounds, many times the parties do not set a start and finish date. This can be very frustrating when the vendor uses that omission to excuse slow performance.

Using a penalty for untimely performance is a powerful stick to prod a vendor into action. Of course, that needs to be in the contract. Similarly, the Board may consider a reward to give an incentive to early performance. These are reasons why rule #2 is so important.

Rule #5: Make sure the vendor gets the permits and pays the fees. The local government may have codes and ordinances that mandate inspections, permits and fees. For example, installing furnaces and hot water heaters may trigger such requirements. The vendor ought to bear the responsibility of interfacing with the municipality. After all, it is the vendor's work that is being inspected. Knowing these requirements at the commencement of the job and shifting them to the vendor is much preferred to chasing the vendor after the fact.

Rule #6: If the project involves construction of any kind, beware of the construction lien act and require evidence of payment to subcontractors and suppliers before you pay the general contractor. Most states give subcontractors and material suppliers the legal right to place a lien on the property of a customer if they do not get paid. Therefore, it is imperative to follow the strict requirements of your State's construction lien laws. Among the most important requirement is to withhold payment to the general contractor until and unless you obtain sworn statements from the subcontractors and suppliers that they have, in fact, been paid.

One Cooperative learned this lesson the hard way. Assuming that the Manager knew this law and would follow it proved to be a disaster. He did not know the requirements and went ahead and paid the contractor in full. Sure enough, the subcontractors were never paid and so they placed a lien on the Cooperative's property and began to foreclose. The general contractor happened to file bankruptcy, so the Cooperative ended up paying for the work twice - once to the general contractor and a second time to the subcontractors and suppliers. Litigation to recover from the general contractor has proven unfruitful to date, and the Manager is presently being sued by the Board in an attempt to recover from him.

This is a complex area of law and the Cooperative Attorney must be involved. In the case cited above, the Attorney was not involved and the results have been disastrous.

Rule #7: Read the fine print of the vendor's form contract. If you are not preparing the contract but instead signing the vendor's form, take the time to have it reviewed. You may find that it is extremely unsatisfactory. For instance, if there is a dispute, you may find yourself in an out of state court. You may find an attempt to alter the statute of limitations, curtailing your rights to bring suit. Performance guarantees may be limited or essentially eliminated.

Knowing this going into the deal is important. You may wish to attempt to negotiate these and other onerous or one-sided terms out of the contract. Alternatively, you may want to use the standard “wrap around” agreement form discussed in Rule #2, or draft your own contract. In any event; as obvious as it sounds, reading the fine print is essential before you sign on with a vendor.

Many experienced attorneys can help the Board evaluate whether it should engage a vendor who presents such a contract form. For example, the Cooperative Attorney may have dealt with the vendor in other deals and can advise you of whether the pricing is reasonable. Similarly, the Cooperative Attorney may be able to check litigation histories.

As noted above, this list is just a beginning. Professionals should guide the Board to minimize risk to the Cooperative. The stakes can be rather high in even the smallest and apparently routine matters. We have seen major lawsuits over mistakes in contracting with vendors, costing literally hundreds of thousands of dollars in legal fees to fight it out in court. So the wise Board will not play Russian Roulette with the Cooperative bank account. When in doubt, err on the side of spending a little extra time, energy and money to do things right.

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