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A Prenup for Boards Hiring a Managing Agent

By Bruce A. Cholst

Habitat magazine's January 2018 issue, "The Business of Management in 2018," highlights the need for condo/co-op board of directors to clearly define the terms of their relationship with their management company at the time the contract is negotiated, not after the agreement is signed and the engagement is under way. The reasoning is that after the parties' honeymoon phase has run its course, managing agents tend to become more cost-conscious and therefore less willing to accommodate board requests that add to their overhead.

Agents often justify their refusal to provide a greater level of performance by citing ambiguously worded contract language as a basis for limiting the scope of their obligations. With precise language clearly defining the nature and scope of the agent's performance obligations in place before the contract is executed, the agent has less wriggle room to say no to a board request for adjustments in operating procedure.

This article is not intended to serve as an exhaustive primer as to which provisions to include in a management contract. Rather, its purpose is to highlight various issues that a board should broach during contract negotiations to more precisely define the scope of the agent's performance obligations.

Management Dealings with Building Staff

In a typical contract, agents undertake to "cause to be hired and supervised all persons necessary to be employed in order to properly maintain and operate the property." However, there is no obligation on the agent's part to discipline poorly performing employees — i.e., write-up, reprimand or document a case for dismissal. This is not only time consuming, but from a liability perspective ought to be performed by the board or building owner. However, if the requirement is not included in the contract language it is a duty the agent can legally avoid. Moreover, inclusion of contract language requiring the agent to use their "best efforts in screening all prospective employees" imposes a legal duty to perform background checks on prospective employees with a greater degree of diligence. If this standard is not imposed up front, an agent might well be loath to agree to the process after the contract is signed.

Defining the Scope of Services to Be Included in the Basic Fee

All too often boards request services from their agent after the contract is signed, only to be told that those "extras" are not included within the basic fee. An effort should be made

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at the time contract terms are being hammered out to define what the basic fee comprises and which "extra" services (e.g., insurance brokerage, transfer agency, commercial and mortgage brokerage, project management) are to be provided and at what additional cost. Obviously an agent will be less inclined to throw in freebies or negotiate reduced "extra" fees after the contract is signed and the engagement is under way.

Setting the Time to Be Spent by an Agent Onsite

The management contract typically requires the agent to "visit" the site once weekly. However, boards often discover to their chagrin that the agent defines a "visit" as a 10-minute appearance in the building's lobby and a five-minute chat with the super. Post-contract complaints about the length of the weekly visit often do not elicit a substantive change in the agent's time commitment to the building. The problem is better addressed prior to contract execution, with the agreement stating something like "Agent shall ***tour*** the premises from basement to roof at least once weekly."

Timing of Issuance of Management Report

Most management contracts provide for delivery of the monthly financial report by the 25th day of every month, and delivery is rarely if ever early. By then, the information being reported is 30 to 55 days old and therefore stale. Boards are better served by inserting a contractual requirement mandating delivery by the 10th day of every month.

Indemnification

Every management contract contains a provision requiring the board to reimburse the agent for legal fees incurred in the defense of a suit brought by a third party arising from the agent's performance of duties under the contract or entry of a judgment thereon. This is not an unfair provision. However, the language of an indemnification provision can make a big difference in determining whether in any given suit the board is obligated to make reimbursement to the agent. To the extent that the board's obligation to indemnify the agent contains few conditions or exemptions, the board is more likely to be obligated thereunder. To the extent that the board's indemnity obligation is diluted with exceptions and conditions, it is less likely to have to pay the agent's defense costs or judgment. Since agents are not likely to voluntarily water down the indemnification provision after the contract is signed, the scope of the indemnification should be a top focus of contract negotiations. From the board's perspective, the following areas should be carved out as exceptions to any provision indemnifying the agent against damages resulting from a suit initiated or judgment obtained against it:

- Breach of the management contract.
- Ordinary negligence.
- Misconduct.
- Violation of law.

The Term of the Contract

Since agents are unlikely to consent to premature termination of a contract, boards should pay close attention to the verbiage describing when and how the agreement is terminated *before* consummating the deal.

They should resist signing multi-year deals unless the agreement permits early termination at any time without cause and upon minimal advance notice. They should also avoid automatically self-renewing contracts.

With increasing frequency, agents are seeking to impose a "breakup fee" in the event of early termination of a multi-year deal. They will justify such a breakup fee on the ground that they have invested substantial money in setting up the account and need to recoup their investment. The concept is not necessarily unfair but the fee should be determined on a sliding scale basis, with a declining amount as the relationship progresses (i.e., $15,000 if the break up occurs less than six months after the contract is signed, $10,000 if after 9 months, etc.).

Prior to commencing a service relationship, it's human nature to avoid close consideration of what might go wrong or to specify step-by-step how the party providing service must fulfill its obligations. The more precisely those obligations are spelled out, however, the more likely the relationship will be a long-lasting and mutually satisfying one.

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