



SHAW & LINES, LLC
COUNSELORS TO COMMUNITY ASSOCIATIONS

THE COMMUNITY ASSOCIATION LAW
LUNCH & LEARN LECTURE SERIES
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**Help!!!- How to Properly Choose Association
Vendors and How to Protect the Association
Concerning Vendor Transaction**

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I. INTRODUCTION

All Homeowner Associations (“HOAs”) have one thing in common, they all, at one time or another, must hire a vendor to perform tasks on behalf of the HOA. Because of this fact, it is important that HOAs know how to properly protect themselves when it comes to hiring a vendor.

This Guide is meant to discuss issues concerning the hiring of vendors and to provide guidance concerning how a HOA may effectively hire a vendor and protect its interests.

II. CHOOSING A HOA VENDOR: INDEPENDENT CONTRACTOR VS. EMPLOYEE

There are several issues a HOA must evaluate when it seeks to hire a vendor. One major issue is the employment status of vendor, i.e. whether the vendor is an “employee” of the HOA or an “independent contractor” of the HOA. It is critical that the HOA determine whether it wishes the vendor to be an employee or an independent contractor, as this determination will require the HOA to perform certain tasks and responsibilities.

a. Employee vs. Independent Contractor

According to Publication 15-A of the U.S. Internal Revenue Service, a vendor will be considered an employee of the HOA if the HOA “can control what will be done and how it will be done.” Thus, if the HOA plays an active role

concerning the work the vendor will perform, the vendor may be considered an employee. Some determining factors as to whether the Association is playing an active role include:

1. Whether the HOA closely supervises the work of the vendor;
2. Whether the HOA requires the vendor to obtain the approval of the HOA concerning work assignments;
3. Whether the HOA trains the vendor to do the work required by the HOA; and
4. Whether the HOA provides a set schedule of working hours for the vendor.

Some common examples of employees of HOAs are the executive director or manager of a self- managed HOA, a full time handyman or any other person directly hired, as an individual, by the HOA.

If a vendor is considered an employee of the Association, the Association must engage in a number of tasks concerning said employee. Generally, if a vendor is an employee of the HOA, the HOA must:

1. Withhold income taxes;
2. Withhold and pay Social Security and Medicare taxes;
3. Pay Unemployment Tax on wages paid to an employee; and
4. Verify the legal residency status of the employee.

In regards to independent contractors, Publication 15-A of the U.S. Internal Revenue Service states that a vendor will be deemed an independent contractor of the HOA if the HOA controls or directs “the result of the work done by an independent contractor and not the means and methods of accomplishing the work.” What this means is that the HOA may determine the outcome of the work but may not determine how the work is performed. Some examples of this are:

1. The HOA instructs the landscaper to mow the grass but does not tell the landscaper how to mow the grass;
2. The HOA instructs the painter to paint the clubhouse but does not actively supervise the painter while he paints;
3. The HOA hires an attorney to prosecute a lawsuit but does not tell the attorney how to prosecute the lawsuit or what legal theories to advance.

Some examples of independent contractors are landscape companies, painters, management companies or other incorporated entities that provide services to the Association.

If a vendor is an independent contractor of the HOA, the HOA only has to file and provide the independent contractor a 1099 Payment Evidence Form. A HOA does not generally have to withhold or pay any taxes on payments to independent contractors.

b. Most Association Vendors should be Independent Contractors.

As can be seen above, it is advantageous for HOAs that their vendors be considered independent contractors and not employees of the HOA. Independent contractor relationships do not require as much reporting to the IRS and other Governmental Agencies and thus benefit the HOA. Additionally, independent contractors bring less liability to an HOA. As such, HOAs should seek to engage in independent contractor relationships as much as possible.

III. THE NECESSITY OF A VENDOR AGREEMENT

Regardless of whether a vendor is an employee or independent contractor, any relationship between the vendor and the HOA should be reduced to writing. This is important because a written vendor agreement provides a number of protections to the HOA.

For example, one of the ways to insure that a vendor is an independent contractor or an employee of the HOA is to execute a vendor agreement. The vendor agreement should contain a provision that clearly states that the relationship being entered into between the vendor and the HOA is an independent contractor or employee relationship.

Additionally, vendor agreements help to memorialize the important terms between the vendor and the HOA. Some examples of said terms include:

1. The work to be performed by the vendor;
2. When the work shall commence and be completed;
3. The price the HOA will pay for the work;

4. How the contract may be terminated;
5. Methods of payment concerning the work;
6. How to address a failure by the vendor to perform the work;
7. Any warranties concerning the work performed; and
8. Indemnification of the HOA for any damages caused by the vendor during the scope of their work.

Attached as **Exhibit A** is a **SAMPLE** Vendor Agreement. The **SAMPLE** Agreement is the basis of a good vendor agreement. It is always advisable that prior to a HOA entering into a vendor agreement, the HOA request that their attorney review the agreement for legal appropriateness.

IV. CHOOSING A VENDOR: OTHER IMORTANT CONSIDERATIONS

HOA Boards have specific fiduciary duties as officers and directors of the HOA. Board members have duties and responsibilities to manage and direct the interests of the corporation in a sound and reasonable manner in accordance with all applicable laws and pursuant to the mandatory provisions of the HOA's governing documents. These duties include insuring that any vendor hired by the HOA has gone through a set process of evaluation and that said vendor is qualified to perform the work.

One of the ways a HOA can insure that the HOA is meeting its duties is to obtain competitive bids concerning work to be performed at the HOA. Competitive bids will insure that the HOA not only obtains the best deal, but will also expose the HOA to possible alternative methods of performing the work.

Additionally, it is important that whatever vendor the Association chooses, the vendor be licensed, bonded and insured. This will insure that not only the vendor is qualified to perform the specific work, but should something occur, the vendor is insured and has the means to address any issues that should arise.

Many commentators have opined that should a HOA fail to obtain competitive bids or fail to hire licensed, bonded and insured vendors, the Board of Directors of said HOA may be found to have breached their fiduciary duty to the HOA. This underscores the importance of HOA obtaining competitive bids and hire licensed, bonded and insured vendors.

V. CONCLUSION

Choosing a HOA vendor on its face may seem simple; and for the most part it is. HOAs, however, must keep in mind that there are issues that arise when a HOA decides to hire a vendor. This Guide is meant to assist HOAs in identifying issues concerning vendor transactions and help HOAs navigate the potentially difficult area of HOA vendor transactions.

EXHIBIT A

CONTRACT FOR SERVICES

CONTRACTOR

(Name, Address, Zip Code & Phone)

Contractor Registrar of Contractor License # _____

PROJECT DESCRIPTION: _____

WORK TO BE PERFORMED (Hereafter, the "Work"): _____

COMMENCEMENT OF WORK: _____

COMPLETION OF WORK: _____

CONTRACT AMOUNT OR AMOUNT TO BE PAID TO CONTRACTOR: _____

Proposal by Contractor

Signature Title Date

Acceptance by Association

Signature Title Date

Signature Title Date

STANDARD PROVISIONS

1. Contractor hereby asserts that it is not an employee of the Association but is an independent contractor of the Association.
2. Subcontractors. Contractor may not delegate any portion of the work to a Subcontractor without the express written approval of the Association.
3. Work involved. All work will be performed in a professional, workmanlike fashion according to the plans and specifications identified above.
4. Time of Commencement and Substantial Completion. The work shall be convened and, subject to adjustments, substantially completed within the time limits given. Contractor shall not be penalized for Acts of God, strikes, shortages of critical materials and other delays beyond his control. Upon notice by the Contractor of substantial completion of the Project, the Association's representative shall tour the project with the contractor and provide contractor with a "Final Punch List" by which the contractor can fully complete his work. Items not included in the Punch List shall be treated as Warranty Work, more fully discussed below
5. Warranty Work. Contractor warrants to Association that all materials and equipment incorporated into the project will be new. All materials and workmanship for the warranty work, which is not part of the subsidiary warranty, will be warranted by the contractor.

6. Initial Payment. The initial payment shall be paid by Association to Contractor prior to commencement or work that shall be used for payment of materials and site setup, labor, etc. The Initial Payment shall be Fifty percent (50%) of the Contract Amount. The remainder of the Contract Amount shall be paid upon satisfactory completion of the Work. Association is under no obligation to pay the remainder of the Contract Amount until it is fully satisfied with the Work.
7. Effect of Final Payment. The making or the final payment shall complete this transaction with the Contractor except those arising from unsettled liens, from failure of work, to comply with requirements of Contract documents, or from faulty defective work that could be stated as completion or identified in the final punch list.
8. Surveys. Legal Descriptions Association should furnish all surveys and legal descriptions of the project, and shall secure and pay for all necessary approvals, easements and charges requirements of the project.
9. Supervision, Safety and Insurance. Contractor shall be responsible for all supervision and coordination of the work and for all responsible precautions needed to carry out such work in a manner safe for both the project and all person involved therein. Contractor shall secure and maintain all liability and Workmen's Compensation Insurance necessary for the work.
10. Administrative and Job Overhead Items. The following administrative and job overhead items are to be absorbed by the Contractor in a fixed fee contract and to be treated as job costs in a cost-plus contract: Office overhead directly related to the project, construction schedules and project record documents, job storage and protection of job materials as well as maintenance, replacement and rental or tools and equipment.
11. Construction Permits and Sale Taxes. Contractor shall comply with all laws, ordinances and regulations effecting construction of the project, and shall secure and pay for all necessary building and construction permits, and shall pay all sales taxes arising from the construction of the project. If this Contract is performed as "cost plus" contract in lieu of a fixed fee contract all such taxes and fees shall be treated as part of the job costs.
12. Legal Remedies. This Contract shall be governed by the laws of the State of Arizona and all applicable Arizona case law. All of the remedies available under those laws shall be available to the parties of the Contract. The prevailing party in any dispute arising will be awarded attorney's fees, arbitration and court costs as the court deems fair.

