

PITFALLS FOR AN HOA TO AVOID IN A MANAGEMENT COMPANY CONTRACT

Michael Rome, Esq.

I recently represented an HOA wanting to terminate their contract with a management company, based upon a list of complaints eight pages long. Unfortunately, the management company ended up holding the association as a financial hostage. The problems were rooted in the contract provisions, combined with a bank not allowing the association to control its own funds.

Problems with the Contract.

- (i) It was a 3 year agreement with no real way out. The lesson here is that an association should only sign a contract, which allows for a 30 day termination notice...with or without cause.
- (ii) If the association wanted to terminate prior to the expiration of the contract, it would still owe all the remaining fees on the 3 year term. The association had 2 years remaining on the agreement. The management fees were \$1,100 a month, which meant 2 years of unearned fees totaled \$26,400.
- (iii) The contract could only be terminated without penalty by providing the management company with written notice of the breach. The company then had 30 days to “correct” the issue. This two bites of the apple clause is detrimental to an association. The breach may not be correctible, or the company may allege the complaints are not a substantial breach of contract. (This happened to the above association.)

Problems with the Bank. A management company is an agent, who holds the association’s funds in trust. In other words, it is still the association’s money, even though the bank account is titled in the management company’s name as acting on the behalf of the association.

In the past, when a management company was holding an association’s funds hostage, I would advise the Board to go directly to the bank and have the funds transferred into the name of association, or the name of a new management company. The bank simply wanted a letter from counsel stating the management company had been terminated as agent, along with proof of the current Board members’ authority to control the Association’s funds .

Regarding the association I recently represented, the bank informed the Board that the money would only be released upon permission from the management company. The bank’s stance was legally questionable, since the funds belong to the association, and the association had not entered into such a prior arrangement with the bank.

Georgia Law.

Illegal Contract Penalty. It is likely a Georgia court would find a termination fee of \$26,400 to constitute an invalid contract penalty. A contract can include a ‘liquidated damages’ clause for terminating prior to the agreement’s expiration, but the amount must be a reasonable estimate of actual damages to the other party. A typical liquidated damages amount would amount to something like one or two months’ worth of fees.

Cure of Breach Provisions. As pointed out above, it could be impossible to cure certain types of breaches. As an extreme example, if a mistake by the management company causes the death of a resident at the pool, how is the management company supposed to correct the breach? The other obstacle can be a bad faith refusal on the part of the management company to admit a breach exists. Although a second bite of the apple clause is not outright illegal, such a provision is totally unworkable.

Georgia 30 Day Turnover Requirement. Pursuant to Georgia statute, a management company must turn over all funds and records within thirty days from the association “terminating a management contract.” Although this is an important law, the trouble is when a management company retains whatever amount of funds it feels entitled to, or alleges a contract has not been properly “terminated.”

Summary. The best way for a Board to avoid all of these pitfalls is by having association counsel review the proposed contract prior to signing. Either way, it should contain the following provisions:
1. Termination with thirty day notice. 2. The date of the notice is the same as the “termination date” for purposes of Georgia statute. 3. Two Board members will be additional signatories on the bank account, with full powers to transfer all of the funds directly to the association or another management company.