

**STATE OF NEW JERSEY
OFFICE OF THE STATE COMPTROLLER**

PROCUREMENT REPORT

TOWNSHIP OF PARSIPPANY - TROY HILLS

MUNICIPAL INSURANCE CONTRACT

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INTRODUCTION

The Office of the State Comptroller (OSC) sets forth this written guidance to address the use by the Township of Parsippany-Troy Hills (Township) of a flawed contracting process that ultimately resulted in higher costs to taxpayers. This public report provides guidance pursuant to N.J.S.A. 52:15C-1 et seq. specifically regarding the process used for the procurement of municipal insurance.

On December 29, 2008, the Parsippany-Troy Hills Township Council (Council) voted to contract with the Morris County Joint Insurance Fund to provide insurance services for the Township at a cost of approximately \$3.7 million over a three-year period. Although government units that enter into contracts valued at greater than \$2 million are required by statute to provide notice of such procurements to OSC, the Township did not provide such notice in this instance. Instead, OSC learned of the procurement from newspaper reports and a complaint filed with this office by a member of the public. The press reports and citizen's complaint both raised questions as to why the Township opted to retain the Morris County Joint Insurance Fund when the two other proposals presented to the Township were less expensive.

The ensuing investigation by this office¹ revealed that this procurement process was not performed in accordance with legal requirements. For example, the Council selected a higher-cost vendor and usurped authority not granted to it under state law when it selected that vendor contrary to the recommendation made by the mayor. As described below, circumstances

¹ OSC's investigation was conducted in accordance with the standards set forth in Quality Standards for Investigations, issued by the President's Council on Integrity and Efficiency. A draft copy of this report was provided to the Township's mayor and Council president to provide an opportunity to offer comments or corrections in advance of the issuance of the final report. We received comments from the mayor's administration, which were incorporated herein where appropriate.

surrounding this procurement process raise questions as to whether considerations other than quality and cost of services were the primary driver behind the selection of this vendor.

BACKGROUND

Parsippany-Troy Hills is the largest municipality in Morris County, with a population of approximately 52,900 people. In accordance with the state's Faulkner Act, N.J.S.A. 40:69A-1 et seq., the Township has adopted the "mayor-council" form of municipal government. The Township has a full-time mayor and five Council members. Both the mayor and Council are directly elected by popular vote.

Under the mayor-council form of government, the mayor acts as the municipality's chief executive and is provided with substantial authority, including the power to enforce all municipal ordinances, prepare and submit operating and capital budgets for the council's consideration, appoint and supervise department heads, and negotiate contracts for the municipality subject to council approval. The council acts as a type of local legislative body, with powers that include the authority to approve contracts presented by the mayor, adopt local ordinances, and schedule the time and place of council meetings. N.J.S.A. 40:69A-36, 40.

In late 2008, the Township took steps to procure liability and related insurance, as its then-current arrangement for insurance was scheduled to terminate at the end of that year. Local government units in New Jersey obtain such insurance to ensure they are financially protected against potential risks. Areas covered under such municipal insurance policies typically include damage to public property and harm caused by acts of public employees.

Historically, local government units in New Jersey had two primary options regarding such insurance: a policy could be purchased from a commercial insurance company or a public

entity could choose to self-insure. A third option became available in 1983 when the State Legislature permitted local government units to form Joint Insurance Funds. N.J.S.A. 40A:10-36 et seq. A Joint Insurance Fund (JIF) is simply a group organized by two or more units of local government to establish an insurance fund for the purpose of jointly insuring or self-insuring against certain risks. JIFs are formed for the purpose of achieving cost savings for local government units in the area of insurance. N.J.S.A. 40A:10-36, L. 1990, c. 120, Assembly Insurance Committee Statement.

In terms of JIF operation and administration, each local government unit participating in a JIF appoints one employee of the local unit or a member of that unit's governing body to serve as a JIF "commissioner." N.J.S.A. 40A:10-37. The JIF's commissioners, in turn, typically select a sub-set of commissioners to serve as the JIF's executive committee, which acts on behalf of the fund. The commissioners also elect a JIF chair and secretary from among their membership. The commissioners retain professionals to provide administrative, actuarial, legal, and other services for the fund.

Through the 1980s and much of the 1990s, the Township was insured through a private insurance company. In 1998, the Township changed course and used the insurance services of a JIF named the Statewide Insurance Fund (Statewide), which currently has over 65 public entities as members. At issue in this report are the actions that the Township took in procuring insurance coverage for 2009 as its contract with Statewide came to an end.

SUMMARY OF GUIDANCE

- 1) Government units operating under the mayor-council form of government must adhere to the division of responsibilities set forth in the Faulkner Act so that the separation of powers requirements of state law are not violated. Specifically, the council may approve or reject a contract award proposed by the mayor, but the council may not award a contract to a vendor or other agency that the mayor has not recommended.
- 2) Government units should ensure adherence to high ethical standards in managing contracts. Steps should be taken to eliminate or mitigate potential or actual conflicts of interest to ensure public confidence in the government contracting process.
- 3) Local government units must follow legally prescribed procedures concerning certification of funds to ensure that necessary funds are available for contracts and to ensure transparency to the public regarding budgetary appropriations.
- 4) A municipality's entering into a trust and indemnity agreement with a Joint Insurance Fund under the circumstances described in this report is a contract subject to OSC's procurement oversight and related statutory notification requirements.
- 5) State law requires that absent a formal public bidding process, insurance must be procured by municipalities and school districts according to the requirements for contracts awarded as extraordinary unspecifiable services. Such requirements include making an effort to secure competitive price quotations where possible and making disclosures to the public to ensure transparency of these contracts that are not subject to formal bidding procedures.

THE TOWNSHIP'S DECEMBER 2008 PROCUREMENT OF INSURANCE SERVICES

In evaluating the procurement process used for this contract, OSC reviewed the documents related to the procurement, listened to the recording of the relevant Council meeting, and interviewed a number of Township officials. That analysis revealed that the Council overstepped its lawful authority in awarding this insurance contract to a higher-cost vendor that the mayor had not recommended. Specifically, OSC's analysis revealed as follows.

Beginning in early 2008, a Township councilman began calling for the Township to switch its insurance coverage to a JIF known as the Morris County Joint Insurance Fund (the

MCJIF). The MCJIF provides insurance coverage to 40 member municipalities, mainly in Morris County.

In the summer of 2008, the MCJIF chairwoman contacted the Township's mayor (Mayor) to discuss the possibility of the Township joining the MCJIF to secure insurance services. In response to the MCJIF's inquiries, the Township provided the MCJIF chairwoman with information regarding the Township's liability and related insurance coverage, including premiums paid. According to the Council president, around that same time the MCJIF chairwoman also approached individual Council members, suggesting that they review the Township's insurance contract because they might not be getting the best deal on insurance. In October 2008, the Township sought a formal determination from the MCJIF regarding whether the MCJIF would accept the Township as a member.

While awaiting the MCJIF's response, in November 2008, the Mayor instructed the Township's risk management consultant to solicit proposals from potential insurance providers to include both JIF and non-JIF options. A risk management consultant is a vendor retained by the client, here, the Township, to provide advice and assistance on insurance-related issues. In an interview with OSC staff, the Mayor explained that he believed by this time that the Council would not agree to renew the Township's contract with Statewide. The same councilman who had been publicly advocating for the MCJIF had begun to express concern about a conflict-of-interest issue regarding Statewide. Specifically, the Township's risk management consultant was also the executive director of Statewide, the Township's current insurer.

The minutes from the Council's agenda-setting meeting on December 9, 2008, state that the same councilman suggested at that meeting that the MCJIF be invited to make a presentation

to explain “what it can do for the Township.” The Council president directed that such a presentation be added to the agenda for the December 16 Council meeting, with a member of the Council to notify the MCJIF. However, at the December 16 meeting, the Council president announced that the presentation would not take place as scheduled. Neither the Council president nor others we interviewed definitively recalled why, although the Township business administrator believes that it may have been because the MCJIF still had not submitted its formal insurance proposal to the Township as of that date. A special Council meeting was scheduled for December 29 to consider and take action on the insurance issue.

The Township ultimately received three proposals in response to its insurance solicitations: one from the MCJIF, one from Statewide, and one from the Travelers Companies, Inc. (Travelers). Travelers is a private insurance company on the Fortune 500 list, with total assets of approximately \$110 billion. Of the three potential insurance vendors, Travelers offered the lowest premium. The MCJIF offered the highest. Specifically, the annual premiums for the three vendors were as follows:

Vendor	Annual Premium
Travelers	\$ 970,988
Statewide	\$ 1,183,000
MCJIF	\$ 1,221,262

Thus, Travelers’ annual premium was over \$200,000 less than that of Statewide and over \$250,000 less than that of the MCJIF. The term for the MCJIF and Statewide proposals was 3 years, while the Travelers proposal was for 1 year.

According to the Township's business administrator, the Travelers' coverage, aside from cost considerations, was overall the best of the three options. For example, Travelers offered greater property coverage and public officials liability coverage, although there were other areas where the coverage of Statewide or the MCJIF was marginally stronger. The following table summarizes the three proposals:

	Travelers	Statewide	MCJIF
Premium	\$970,988	\$1,183,000	\$1,221,262
Property Coverage	\$180,630,396 /\$1,000 deductible	\$150,000,000 /\$1,000 deductible	\$100,000,000 /\$5,000 deductible
Liability Coverage	\$16,000,000 occurrence /\$17,000,000 aggregate	\$15,000,000 occurrence	\$20,000,000 occurrence /\$20,000,000 aggregate
Automobile	\$16,000,000 /\$1,000 physical damage deductible	\$15,000,000 /\$1,000 physical damage deductible	\$20,000,000 /\$2,500 physical damage deductible
Public Officials Liability Coverage	\$16,000,000 /\$25,000 deductible	\$10,000,000 /\$25,000 deductible	\$10,000,000 /\$10,000 deductible plus 20% of the first \$100,000 of each loss
Employment Practices Liability Coverage	\$10,000,000 /\$25,000 deductible	\$10,000,000 /\$25,000 deductible	Included in Public Officials Coverage. No separate limit.
Law Enforcement Liability Coverage	\$16,000,000 /\$50,000 deductible	\$6,000,000 /\$100,000 deductible	Included in Liability Coverage of \$20,000,000 /\$100,000 deductible. No separate limit.
Crime Coverage	\$250,000	\$250,000	\$1,000,000
Environmental Coverage	\$1,000,000 occurrence /\$1,000,000 aggregate (through ACE American Ins. Co.)	\$1,000,000 occurrence /\$3,000,000 aggregate	\$1,000,000 occurrence /\$1,000,000 aggregate

On December 29, 2008, the Council held a special meeting for the primary purpose of acting on liability and related municipal insurance for 2009. A recording of the meeting was subsequently provided to OSC as part of this review. At the meeting, the Mayor's administration recommended to the Council that the insurance contract be awarded to Travelers. Specifically, the Township business administrator stated in recommending Travelers that "the Travelers proposal was acceptable and somewhat equal to the other two but there is a cost savings for 2009 of over \$200,000 so it's the administration's recommendation to the Township for 2009 to go with Travelers." Several days earlier, the business administrator had provided to all Council members a comparison of the three options, which had been prepared by the Township's risk management consultant referred to above. In addition to comparing coverages and cost, that comparison also detailed the three companies' training and risk-avoidance programs, with emphasis on the training sessions, web-based materials, and telephone answer line offered by Travelers to its public-sector clients. The risk management consultant reiterated the comparative rates and coverages at the December 29 meeting.

Much of the discussion portion of the meeting focused on the MCJIF, which had eleven representatives at the meeting, including the Roxbury Township clerk (who is the MCJIF chairwoman), the Boonton Township chief of police, the Rockaway Township business administrator, the Borough of Wharton business administrator, the East Hanover township administrator, the chief financial officer for Millburn Township, and a former state senator acting as the MCJIF's legal counsel. The MCJIF's counsel provided a formal presentation to the Council, beginning with noting that "it's good to see some old friends," then providing detailed information on the MCJIF's operations. The MCJIF's administrator provided additional details

and noted that if the Township were to retain the MCJIF, it could “recommend an attorney” to join the MCJIF’s panel of attorneys.

A representative of the Township’s then-current insurer, Statewide, gave a brief presentation lasting a few minutes in which she noted that Statewide operates in much the same manner as the MCJIF. She also described some of the training programs offered by Statewide. No one appeared on behalf of Travelers. The responsible regional sales executive from Travelers informed OSC that Travelers had not been asked to be at the meeting. It was the sales executive’s understanding that Travelers’ proposal was to be presented by the Township’s risk management consultant. When informed that the two other proposers made in-person presentations at the meeting, the sales executive noted that she would have attended the meeting had she been aware of these circumstances, as the Township would have been a significant client for Travelers.

Statements by members of the Council at the meeting indicate that the members were taken aback by the Mayor’s recommendation to award the contract to Travelers. One Council member questioned, “I’d like to know why [the mayor’s administration] went and looked for another insurance company now,” also stating that “we didn’t know there was going to be another insurance company that you were going to come up with.” The Council member further noted that “this Council was unaware that you were looking for numbers from anything other than Statewide and the [Morris County] JIF that we wanted to come in, so Travelers seems to me to be a snowball now here in the process.” Another Council member added, “I thought all was just between Statewide and the Morris County JIF . . . I’m very suspicious about why this came up at this particular point in time because all of the sudden there’s competition.” A third member

noted, “It’s a concern, I mean, you know all of the sudden Travelers comes up because now there’s competition.”

Council members expressed concern at the meeting about retaining a private, for-profit insurance company. They also expressed preference for the three-year term of the JIFs as opposed to the one-year term that Travelers had offered, although it was acknowledged that rates charged by the JIFs could increase during that three-year period. At the conclusion of the presentations, one of the Council members summarized his views: “I’d like to just mention that I’m very impressed with the Morris JIF, with their proactive approach to especially the losses and the seminars and training programs that go on. And I think what draws me to the Morris JIF more than anything is I know each of these individuals sitting out here either personally or by reputation; that they’re either elected or appointed officials in our county for the most part. I know and I trust them. They, as far as I’m concerned, are part of our family. They are us and I would like to make a motion that we accept the Morris County JIF.”

The Council did not vote specifically on the Mayor’s proposed resolution to award the contract to Travelers. Instead, as the Township’s business administrator noted at the meeting, the resolution ultimately voted on “was prepared by the fund attorney for the Morris County JIF and tweaked a little bit by [the] Township Attorney.” A Council member asked in response, “Have they [the MCJIF] reviewed the tweaking?” The business administrator replied that the tweaking was minor, but that counsel for the MCJIF had reviewed it and said it was not a problem.

The resolution accepted the MCJIF’s insurance proposal and authorized execution of the indemnity and trust agreement that would govern the MCJIF’s coverage of the Township for a

three-year period. The resolution, as drafted by the MCJIF and adopted by the Council, states as justification that the Council was “impressed with the training the [MCJIF] offers,” “impressed with the team approach,” and “impressed with the [MCJIF’s] financial stability.” The Council unanimously adopted the resolution, awarding the insurance contract to the MCJIF.

* * *

It is not entirely clear what motivations drove the respective actions of the Council and the Mayor in the process that led to the Township’s retention of the MCJIF. What is clear is that the Township’s procurement process in this instance violated legal requirements, was conducted in a rushed manner, and resulted in taxpayer expense associated with selection of the highest of three quotes submitted. We provide the following guidance.

1. The Township violated the Faulkner Act

As noted earlier, the Township has adopted the mayor-council form of municipal government under the Faulkner Act. Under this form of government, the mayor is granted substantial powers, including the power to “negotiate contracts for the municipality, subject to council approval.” N.J.S.A. 40:69A-40(j). In contrast, the council may act only “by ordinance, except for the exercise of those powers that, under this plan of government or general law, do not require action by the mayor.” N.J.S.A. 40:69A-36. In the area of procurement specifically, the council’s authority is limited to the “approval of contracts presented by the mayor.” N.J.S.A. 40:69A-36(l).

Thus, the procedure for awarding contracts under this “strong mayor” form of government is for the mayor to recommend a contract to the council and for the council to either approve or reject the mayor’s recommendation. The council is not permitted to authorize a

contract unless the mayor has first presented a formal recommendation of that particular contract (i.e., vendor) to the council. In other words, the council may reject the mayor's recommendation, but it may not award its own preferred contract that the mayor has not recommended. Municipal Council of the City of Newark v. James, 183 N.J. 361, 363 (2005) (holding that the Faulkner Act "allocates the responsibility for initiating, negotiating, and signing contracts to the mayor of the municipality, while the city council is charged with approving or rejecting the contracts presented to it by the mayor").

In this instance, the Council usurped contracting authority it did not lawfully possess. The Mayor recommended that the indemnity contract be awarded to Travelers. The Council was not required to endorse that recommendation. It was not, however, empowered to substitute its own preferred service provider and then proceed to award the indemnity agreement to that entity. Other than endorsing the Mayor's recommendation, the Council's only lawful option was to reject that recommendation and thereby send the matter back to the Mayor for further consideration and, possibly, mayoral recommendation of an alternate vendor. In this regard our Supreme Court has observed, "[T]he Faulkner Act places a heavy burden on both the Mayor and City Council: they must work cooperatively for the ultimate benefit of all the citizens of [the municipality]." James, 183 N.J. at 375. In dealing with this insurance contract, the Council overstepped its legally prescribed role in the municipal procurement process.

2. This procurement process was tainted by perception of a conflict of interest

As referenced above, the executive director of one of the competing vendors here, i.e., Statewide, was simultaneously acting in an official capacity advising the Township which vendor to select. Specifically, Statewide's executive director was acting as the Township's risk management consultant. In fact, she had prepared the analysis of the three proposals that was

presented to the Council, despite her principal role in the entity that was the Township's current insurance provider and was again competing for the contract. A member of the Council had noted and expressed concern about this issue.

The process used by the Township to procure municipal insurance for 2009 was late in getting started, then conducted in a rushed manner. Proposals were received for varying numbers of years and there was a misunderstanding on the part of one vendor about making an in-person presentation to the Council. While the conflict referenced above was not necessarily the cause of these circumstances, that conflict ultimately resulted in the proposal for the low-cost vendor being presented to the Council by the executive director of a competing vendor.

Taken in tandem, these circumstances do not promote public confidence in the appropriateness of the vendor-selection process. In addition, they potentially constitute a violation of the Local Government Ethics Law, N.J.S.A. 40A:9-22.5. We are referring this matter to the Local Finance Board for further consideration.

3. The Township did not take steps to document the availability of funds

The Township did not follow legal requirements designed to ensure that a government unit has sufficient funds to pay for the contractual obligation being considered. Specifically, the chief financial officer for the Township was required to certify in writing to the Council that adequate funds were available for the insurance contract, and to set forth the specific line item appropriation of the Township budget to which the contract would be charged. N.J.A.C. 5:30-5.4(a)(1). She did not do so. Regulatory law precludes the governing body of a municipality from entering into a contract without such a certification, which is to be attached to the resolution at issue. N.J.A.C. 5:30-5.4(a)(3), (5). Where, as in this instance, lower-cost contract

partners were not awarded the contract, it is particularly important to adhere to these requirements designed to ensure that adequate contract funding will be available.

4. The Township did not provide required notice to OSC

Government entities in New Jersey that enter into a contract valued at greater than \$2 million are required by statute to provide notice of that procurement to OSC. N.J.S.A. 52:15C-10. As noted above, the Township did not send the required notice to OSC in this instance. Township representatives have explained that they did not view the MCJIF as a contract partner, but rather as an association to be joined. While we do not have a basis to dispute the genuineness of that belief, the executed indemnity agreement between the Township and the MCJIF demonstrates that a contract was awarded in this instance. Following a solicitation process, the Township and the MCJIF reached agreement, memorialized in writing, for the MCJIF to provide a service for a fee. In such circumstances, where the value of such an arrangement exceeds \$2 million, N.J.S.A. 52:15C-10 requires notification to OSC to ensure transparency and compliance with contracting requirements.

5. Other guidance concerning procurement of municipal insurance

State law exempts the procurement of insurance from formal bidding and advertising requirements. N.J.S.A. 40A:11-5(1)(m). State law requires, however, that such insurance contracts be awarded “in accordance with the requirements for extraordinary unspecifiable services.” Id. Those “EUS” requirements include, among others, securing competitive price quotations when possible; filing a certification describing the nature of the service to be provided, the informal solicitation of quotations, and how the contract meets applicable legal requirements; and publishing a notice after the award stating the nature, duration, and amount of the contract. N.J.S.A. 40A:11-5(1)(a)(i); N.J.S.A. 40A:11-6.1(b); N.J.A.C. 5:34-2.3; New Jersey

Department of Community Affairs, Local Finance Notice AU-2002-2. The New Jersey Department of Community Affairs, Division of Local Government Services, has discussed in a Local Finance Notice application of EUS requirements to participation in a JIF and similar insurance arrangements. See Local Finance Notice AU-2002-2.

In view of the public interests involved, “when an award of an insurance contract is to be made in reliance upon the exemption from public bidding, governing bodies must scrupulously observe” these requirements. McCay Corp. v. Mt. Laurel Township Council, 203 N.J. Super. 550, 562 (Law Div. 1984). Contracting units are further reminded that in view of the heightened risks associated with informal solicitation procedures, it is important that public officials conduct such procurements based on factual evidence, pursuant to required procedures, and in a transparent manner.