



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

PROCUREMENT REPORT

BOROUGH OF EDGEWATER

PROFESSIONAL SERVICES CONTRACTS

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COMPTROLLER**

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INTRODUCTION

As part of our statutory responsibility to audit and monitor government contracting, the Office of the State Comptroller (OSC) undertook a review of professional service contracting in the Borough of Edgewater (the Borough). OSC began the review after receiving a complaint regarding the Borough's professional services contracts, which included allegations of overbilling.

During the course of the review, OSC identified multiple deficiencies in the way in which the Borough has awarded and administered its professional services contracts. For example:

- The Borough did not properly use the “fair and open” process set forth by the state’s “Pay-to-Play” statute. Nor did the Borough disclose in its resolutions awarding such contracts the reasons for its award decisions, as required by state law;
- The Borough did not address cost-related factors in awarding its professional service contracts, or impose a cap on billings submitted pursuant to those contracts;
- Apparently without the awareness of key Borough officials, language in the Borough Attorney’s contract repeatedly was changed over a four-year period to permit additional billings by the attorney; and
- Without detection by the Borough, the Borough Attorney’s firm billed the Borough additional hourly fees for work that actually was covered under the pre-set retainer amount the attorney separately received from the Borough.

In addition, while engaging in this review OSC determined that the Borough Attorney had received pension credit to which he was not entitled in connection with legal work he performed on behalf of a second municipality.

In issuing this report, OSC sets forth guidance for the Borough and other government units concerning professional services contracting and fiscal management practices. OSC is also referring this report to the state's Division of Pensions and Benefits to ensure appropriate resolution of the pension-related issues that we identified.

METHODOLOGY

OSC examined the Borough's contracts with the following six professionals over a four-year time period (2006 through 2009): Bond Counsel, Borough Attorney, Borough Auditor, Borough Engineer, Borough Planner and Risk Manager. Specifically, OSC examined, among other documents, the Borough's Requests for Qualifications (RFQs) for these professionals as provided to us by the Borough, all vendor submissions in response to the RFQs, the executed contracts, and the Borough's resolutions awarding the contracts. In addition, OSC reviewed the Borough's disbursement ledgers and bills submitted by the professionals. The review also included interviews with Borough officials including the Business Administrator, Mayor, Council President, Chief Financial Officer and Borough Attorney.

We provided a draft of this report to the Business Administrator, Mayor, Council President and Borough Attorney for their review and comment. We received comments from the Borough Attorney and from the Business Administrator, who responded on behalf of the Mayor and Council. Their comments were considered in preparing the final report and were incorporated herein where appropriate.

BACKGROUND

The Borough of Edgewater is located along the Hudson River in Bergen County. The Borough's estimated population in 2009 was 9,624 and its 2009 budget was \$21.7 million. In terms of its municipal governance, the Borough operates under the Borough Act, N.J.S.A. 40A:60-1 et seq. Its government includes a Mayor, who is elected to a four-year term, and six Council members who are elected to staggered, three-year terms.

With the Borough having adopted this "weak Mayor-strong Council" form of government, the Mayor's duties are limited to ensuring that the ordinances of the Borough are faithfully executed, presiding over Council meetings and voting at those meetings in the event of a tie. The Council serves as the Borough's legislative body, introducing, adopting and amending ordinances and resolutions and voting to approve municipal contracts.

In this form of government, the Council may further appoint an Administrator to whom it may delegate executive responsibilities. According to the Borough's Administrative Code, its Borough Administrator serves as chief administrative officer and is responsible for, among other duties, supervising the execution and performance of Borough contracts.

With regard to contracting for professional services, the Borough generally appoints its professional service providers once a year at its annual Council Reorganization Meeting, which is held in January.

RESULTS OF THE PROCUREMENT REVIEW

A. Deficiencies in the Borough's Process for Awarding Professional Service Contracts

1. The Borough failed to use an appropriate evaluation process in awarding its professional services contracts

New Jersey's local government "Pay-to-Play" law, N.J.S.A. 19:44A-20.4 et seq., sets forth contracting procedures designed to address the influence of campaign contributions in the public contracting process. In awarding its professional services contracts from 2006 through 2009, the Borough sought to use the Pay-to-Play law's "fair and open" award process. This procurement process is required to be used unless the contract in question is being awarded to a vendor that has not made disqualifying campaign contributions. Among other mandates, the "fair and open" process requires that the contract be "awarded under a process that provides for public solicitation of proposals or qualifications and awarded and disclosed under criteria established in writing by the public entity." N.J.S.A. 19:44A-20.7. We reviewed whether this requirement was satisfied by the Borough.

In seeking professional services vendors, the Borough publicly advertised RFQs. Those RFQs stated that responses would be judged according to the following four criteria:

- a. Experience and reputation in the field;
- b. Knowledge of the Borough and the subject matter addressed under the contract;
- c. Availability to accommodate the required meetings of the Borough; and
- d. Other factors demonstrated to be in the best interest of the Borough.

OSC sought from the Borough documents evidencing the process through which competing vendors were actually evaluated. We were informed that no such documents exist or previously existed. There are no scoring sheets, no written records of what transpired during any negotiations between vendors and local procurement officials, no comparative analyses of

competing proposals and no written award recommendations. As OSC has noted in a previous report, the less documentary evidence there is to explain each step of the contract award process, the more susceptible the process is to claims that the contract was awarded without meaningful or appropriate deliberation. *See* Office of the State Comptroller, *Best Practices for Awarding Service Contracts* (March 2010).

Similarly, the Borough Council resolutions awarding these contracts do not provide any justification or rationale underlying the Borough's award decisions. None of the 23 resolutions OSC reviewed explain the reasons for hiring the vendor in question, at most stating "there exists a need" for the Borough to hire a vendor to provide the service at issue. This violates the requirement in the Local Public Contracts Law that a governing body "state supporting reasons for its action in the resolution awarding each contract." N.J.S.A. 40A:11-5(1)(a)(i).

OSC's interviews with Borough officials confirmed that the vendor submissions were not evaluated in any meaningful way. For example, the Borough Administrator and the then-Council President both acknowledged the absence of any formal, criteria-driven process in awarding these contracts. The Borough Administrator noted his view that "politics" played a role in the awards.

Thus, there is no evidence these contracts were "awarded . . . under criteria established in writing by the public entity." N.J.S.A. 19:44A-20.7. Although criteria were established, there is no basis on which to conclude that award decisions were made pursuant to those criteria. As a result, the procurement process used by the Borough could not be said to constitute a "fair and open" process in accordance with the Pay-to-Play law.

2. *The Borough failed to address cost in awarding its professional services contracts*

The Borough's stated evaluation criteria, as set forth above, mirrored four out of the five suggested award criteria set forth in the state Department of Community Affairs' *Guide to the New Jersey Local Unit Pay-to-Play Law*. Of note, the fifth suggested criterion, which the Borough did not incorporate, was "compensation proposal." Although, as noted previously, none of these evaluation criteria appear to have been actually used by the Borough, the absence of cost as a stated criterion is an additional cause for concern. While service contracts, unlike contracts for goods, are oftentimes awarded on bases other than exclusively price, to exclude price entirely as an award criterion frequently is inconsistent with the interests of taxpayers.

In addition, the Borough may have failed to account for the cost of these contracts as required by state regulatory law. Specifically, state regulations prohibit a municipality from entering into a contract unless the municipality's chief financial officer first certifies in writing to the governing municipal body that adequate funds are available for the contract. N.J.A.C. 5:30-5.4(a)(1). In the certification, the financial officer must indicate the line item appropriation of the municipal budget to which the contract will be charged. This certification is to be attached to the resolution awarding the contract. N.J.A.C. 5:30-5.4(a)(3),(5). None of the resolutions for the Borough contracts OSC reviewed included the required certification of funds, and the Borough was unable to provide any such certifications to us. Borough staff initially indicated that the Borough had not been completing such certifications for professional services contracts, but later attested that such certifications generally are completed but had been archived and could not be located. In any event, the Borough should ensure and document that the Borough's budget includes available funds for each professional service contract it seeks to award.

Nor did the Borough's resolutions set forth the anticipated value of these contracts. Resolutions concerning only two professionals -- Bond Counsel and Risk Manager -- referenced the existence of a fee agreement. The remaining resolutions simply stated that the professional would be paid "at a fee commensurate with the services rendered." The failure to include fee information in these resolutions deprives taxpayers of information regarding how much money the Borough plans to spend on these services.

To certify funds for "open ended" contracts that do not have a pre-set contract amount, state regulations set forth a process of certifying the "maximum amount covered by the contract." N.J.A.C. 5:30-5.5(b)(1). These Borough resolutions, however, did not contain any "not to exceed" cost language. With one exception, neither did the contracts themselves. Without such language, no cap existed on the amount these vendors could bill the Borough for their services.

B. Deficiencies in the Terms of the Borough's Professional Service Contracts, Particularly with Regard to the Borough Attorney Contract

In addition to reviewing the process used to select professionals, OSC reviewed the Borough's contracts themselves to determine whether they incorporated best contracting practices. OSC found shortcomings in this regard. For example, of 23 professional service contracts executed by the Borough for the years 2006 through 2009, only the Bond Counsel and Risk Manager contracts contained a termination provision. Such a provision is significant in preserving the rights of the municipality in the event of subpar vendor performance. Similarly, none of the contracts contained an incorporation clause, which is important in ensuring that all relevant commitments by the vendor are considered part of the contractual agreement between the parties.

Of the contracts OSC reviewed, terms of the contracts with the Borough Attorney caused particular concern, which led us to undertake a more detailed review of those contracts and the bills the attorney submitted to the Borough for payment. According to these contracts, the Borough Attorney was to be paid under a hybrid method of compensation. This method provided the Borough Attorney with a fixed salary -- referred to in the contract documents as a retainer -- for performing certain prescribed duties, such as attending all regularly scheduled Council meetings. In exchange for performing these services, the Borough Attorney received a biweekly paycheck and was paid as an employee of the Borough. In addition, for duties not covered under the retainer (e.g., litigation-related services), the Borough Attorney could bill the Borough at an additional, uncapped hourly rate of \$150. We noted the following:

1. Narrowing of Responsibilities Encompassed by Retainer Payment

Over a four-year period, while the amount of the Borough Attorney's retainer was increased, the operative contract language was changed to narrow the responsibilities covered by that retainer payment. Some of the specific changes to the contracts are illustrated in Table 1 on the following page. The changes are set forth in italics.

Table 1: Retainer Amounts and Scope

Year	2006	2007	2008	2009
Retainer amount	\$72,837	\$75,022	\$77,273	\$78,625
Services covered by the retainer	Preparation of ordinances and resolutions Preparation of ordinary contracts and bid documents	Preparation of <i>routine</i> ordinances and resolutions Preparation of ordinary contracts and bid documents	Preparation of routine ordinances and resolutions Preparation of ordinary contracts and bid documents	Preparation of <i>minor changes to existing</i> ordinances and resolutions [Removed entirely]

As illustrated in Table 1, certain duties that were covered by the Borough Attorney’s retainer in earlier years were carved out in later years, thereby permitting him to bill the Borough an additional \$150 per hour for this work. For example, in 2006 the Borough Attorney was paid a retainer of \$72,837 for, among other things, “preparation of ordinances and resolutions.” However, the 2007 retainer covered only “preparation of *routine* ordinances and resolutions.” Thus, while previously the Borough Attorney was prohibited from billing hourly for the preparation of ordinances and resolutions -- a significant part of any Borough Attorney’s work -- beginning in 2007 he could bill hourly for any ordinance he deemed not “routine.” In 2009, the contract was changed again so that the retainer encompassed only the “preparation of *minor changes to existing* ordinances and resolutions,” thereby permitting the attorney to bill at an hourly rate for any newly drafted ordinances -- whether or not “routine” -- and to bill for any changes to existing ordinances and resolutions that he deemed not minor.

The 2009 contract also removed preparation of “ordinary contracts and bid documents” from the scope of the retainer. This change permitted the Borough Attorney to bill hourly for all

work related to preparation of contracts and bid documents. As a result, for example, in 2009 he billed hourly to review the Borough's recycling contract and certain professional services contracts. Despite the decrease in responsibilities included in the scope of the retainer, there was no corresponding decrease in the set retainer amount paid to the Borough Attorney under his contract. In fact, the retainer amount increased by over \$1,000 to \$78,625 in 2009.

Our review of the Borough Attorney contracts revealed one change that, on its face, increased the coverage of the retainer. Specifically, the 2007 contract added a category of Borough personnel (i.e., Department Heads) to the list of officials with whom telephone conferences were to be included in the retainer. Our review revealed, however, that the Borough Attorney nonetheless continued to bill the Borough hourly for such telephone conferences.

In interviews with OSC, the responsible Borough officials were not able to provide us with justification for this series of contract changes. When asked about the changes, they stated that they were unaware of them. The then-Council President, for example, stated that he was unaware of the changes and that to his knowledge they had not been presented to the Council for review, even though the Council had indeed voted to approve the contracts. Similarly, the Borough Administrator did not recall the changes.

The Borough Attorney told us that he indeed had discussed the changes with Borough officials, including the Borough Administrator, before they were made. In his initial interview with OSC, the Borough Attorney explained that he made the changes to the contract because wording in earlier versions was too vague to permit easy interpretation. He mentioned the contract's use of the word "routine" as an example. In response to a draft of this report, the

Borough Attorney further stated that the narrowing of the retainer language was proper given the nature and extent of the work he was being asked to perform on behalf of the Borough.

In any event, these contract changes, coupled with insufficient cost controls resulting in part from the absence of a ceiling on the amount that could be billed under the contract, contributed to increased legal costs for the Borough. As the Borough Attorney noted to us, the increased costs also resulted from the Borough Attorney's involvement in a number of substantial projects on behalf of the Borough. The current Borough Attorney began in that capacity in January 2007, having replaced an individual who had held that position for a lengthy period. In 2007, the first year of the new Borough Attorney's tenure, hourly legal billings increased by more than \$100,000, from \$78,540 to \$181,740. Similarly, in 2008, in addition to his \$77,273 salary, the Borough Attorney billed the Borough an additional \$180,262 for legal services. In subsequent years the billings decreased, but the decrease was not substantial, relative to the billings of the prior borough attorney.

2. Provision of Legal Services by Individuals Not Included in Contract with Borough

The legal services contract with the Borough was executed by the Borough Attorney in his individual capacity, not on behalf of the law firm by which he was employed. Similarly, operative contract documents did not reveal other members of the Borough Attorney's firm who would be billing the Borough for legal services or the price of such services, such as a fee schedule of other partners or associates. While the Borough's annual RFQ for Borough Attorney services requested that responders submit resumes of key employees, the only resume or other credentials submitted by the Borough Attorney were his own.

Nonetheless, several other employees at the Borough Attorney's law firm billed the Borough for work at various hourly rates. The work performed by these individuals included matters specifically covered by the Borough Attorney's retainer and for which he was paid a salary, including attendance at Council meetings. This issue is addressed more specifically in the next section of this report.

A professional services RFQ is intended to procure a contractor with appropriate technical skill, professional judgment and expertise. Selection is focused on a contractor's qualifications, including experience, training and performance history. The Borough (and the public) was entitled to the services for which it contracted, i.e., the services of a specific attorney with qualifications as presented.

Responses to Borough RFQs for non-legal services provided greater transparency and information regarding personnel who would be providing the services, as well as the cost associated with those individuals' services. The Borough should be obtaining no less information in the Borough Attorney context, and the public is entitled to such information through these publicly available documents.

3. Inadequate Review of Legal Bills

As discussed previously, the contract with the Borough Attorney provided for him to receive a retainer for performing enumerated duties and to receive \$150 per hour for work performed on matters not covered by the retainer. Such hybrid methods of compensation are appropriate so long as the duties set forth in the retainer portion and non-retainer portion of the contract do not overlap. *See Loigman v. Township Committee of the Township of Middletown*, 409 N.J. Super 1, 11 (App. Div. 2009). We found, however, that the Borough Attorney and his

associates billed the Borough, and the Borough paid, hourly for work that should have been covered under the retainer payments.

For example, one of the duties under the Borough Attorney's retainer was "to attend all regularly scheduled meetings of the Mayor and Council." In July 2007, the Borough Attorney's law partner and an associate from his firm attended a regularly scheduled Council meeting. While the firm did not bill for the law partner's attendance at the meeting, it improperly billed the Borough hourly for the associate's attendance at and travel to the meeting. In addition, the law partner billed for office conferences related to the meeting. The Borough Attorney reimbursed these amounts to the Borough after we brought them to his attention.

Another of the Borough Attorney's responsibilities under the retainer was "telephone conferences with the Mayor, Members of Council, Borough Administrator, and Borough Clerk and other Department Heads." Nonetheless, a review of bills submitted by the Borough Attorney and his associates from 2007 to 2009 indicates that the firm improperly billed the Borough 32 times for telephone conferences with the above-mentioned individuals. When we provided a list of these billings to the Borough Attorney, he responded that these calls had been billed inadvertently and that he would credit the Borough these amounts.

In both 2007 and 2008, the Borough Attorney was responsible under his retainer for the "preparation of routine ordinances and resolutions," as well as for the "preparation of ordinary contracts and bid documents." The contract was deficient in that it did not define "routine" or "ordinary," which in practice provided the Borough Attorney with wide latitude to determine what matters he could bill for outside of the retainer. As a result, during these two years the Borough Attorney billed hourly for certain matters that were arguably routine, such as preparing a resolution approving the purchase of a fireboat.

OSC staff questioned the Borough Administrator about the legal services that were billed and paid hourly when they should have been covered under the retainer. He confirmed that he had never disapproved or reduced a bill submitted for payment from one of the Borough's professional service providers, although he acknowledged that he had noticed hourly billings that would appear to be covered under the Borough Attorney's retainer. The language and terms of the Borough Attorney contract, along with a lack of appropriate internal controls at the Borough, resulted in a substantial risk of the Borough essentially paying twice for the same services.

4. Borough Attorney's Pension Status

In view of the issues we identified in connection with the Borough's compensation of the Borough Attorney, we reviewed the Borough Attorney's status in the Public Employees' Retirement System to determine if the Borough had made appropriate classifications in this regard. In 2007, state pension law was amended, effective January 1, 2008, to codify that individuals are not eligible to receive pension credits for performing professional services pursuant to a professional services contract. *See* N.J.S.A. 43:15A-7.2.

We determined that the Borough indeed fulfilled its obligation to remove the Borough Attorney from the pension system upon the new law taking effect. We note, however, that questions remain as to whether the Borough Attorney is entitled to pension credit for his work for the Borough prior to 2008. For instance, although the Borough had contracted with the Borough Attorney personally, he received pension credits (based on his retainer payment) for work that was performed by his law firm associates. The Division of Pensions and Benefits (the Division), which is the state agency charged with administering the state pension system, previously has expressed doubts about whether an individual may receive pension credit where

the individual is not personally performing the work at issue. OSC is referring this matter to the Division for its review and determination.

We further note that although the Borough removed the Borough Attorney from the pension system in 2008, for payroll purposes it continued to treat his retainer payments as salary paid to an “employee,” as opposed to payments made to an independent contractor. This designation has resulted in additional Borough expense, requiring its payment of taxes for which it would not be responsible if the Borough Attorney were to be considered an independent contractor. Such taxes include Social Security employer taxes, Medicare employer taxes and unemployment taxes. *See* Internal Revenue Service (IRS) Publication 1779. The Borough should consult IRS Revenue Ruling 87-41 and determine whether the Borough Attorney is more accurately deemed an independent contractor in view of his partnership in a law firm and his retention through a public contracting process, among other factors. The Borough has contended to this office that this designation is a decision entirely within its discretion. In addition to being legally incorrect, the Borough’s contention raises the question why, if the Borough believed it had unlimited discretion on this issue, it would have chosen the option more costly to local taxpayers.

Lastly, in reviewing the Borough Attorney’s pension status, we noted that he was still receiving pension credit for his legal work for a different municipality, the Borough of Emerson (Emerson), where he also serves as Borough Attorney. In response to our ensuing inquiry, Emerson acknowledged having incorrectly continued to provide the Borough Attorney with pension credit following the January 2008 amendment and wrote OSC to confirm that the credit would cease retroactive to January 1, 2010. However, the effective date should have been

January 2008, when the new amendment took effect. OSC has alerted Emerson and the Division of this issue so that corrective action may be taken.

SUMMARY OF GUIDANCE FOR GOVERNMENT UNITS

- 1) A local government using the “fair and open” process set forth in the Pay-to-Play statute must award the contract “under criteria established in writing by the public entity.” N.J.S.A. 19:44A-20.7.
- 2) Documentary evidence should support each step of the contract award process, including, for example, scoring sheets, analyses of competing proposals, records of any vendor negotiations and written award recommendations.
- 3) The Local Public Contracts Law requires that a governing body awarding a contract “state supporting reasons for its action in the resolution awarding each contract.” N.J.S.A. 40A:11-5(1)(a)(i).
- 4) While service contracts, unlike contracts for goods, are oftentimes awarded on bases other than exclusively price, to exclude price entirely as an award criterion frequently is inconsistent with the interests of taxpayers.
- 5) Municipalities should follow the required procedures concerning certification of funds to ensure that necessary funds are available for municipal contracts. N.J.A.C. 5:30-5.4(a)(1).
- 6) Public contracting officials should consider including a “not to exceed” amount in professional service contracts to provide greater budgeting certainty and to provide a cap on the amount of funds a particular vendor can receive under the contract.
- 7) Public contracts or incorporated RFQ responses should provide sufficient clarity concerning the identity of individuals to provide professional services and the cost of those services.
- 8) Public contracts generally should include language protective of the government unit’s interests such as a termination provision and an incorporation clause.
- 9) Local governments should ensure that the responsibilities of a professional service provider, especially those responsibilities compensated through payment of a retainer, are clearly delineated and are consistent with the public interest.
- 10) Particular care is appropriate in drafting contracts with legal counsel whose responsibilities typically would include preparing such contracts for the government unit.

- 11) Public officials should carefully review vendor bills to avoid improper payments.
- 12) Government units should ensure that only their employees who qualify for participation in PERS are receiving pension credits for their work for the government unit.
- 13) Government units should avoid incurring unnecessary expense by paying a service provider as an employee when an independent contractor designation would be more appropriate.