

**EVALUATION REPORT
AND
RECOMMENDATION OF CONTRACT AWARD
REGARDING
REQUEST FOR PROPOSALS
FOR OPERATION AND MANAGEMENT SERVICES
FOR THE MUNICIPAL WATER, WASTEWATER AND
STORMWATER SYSTEMS FOR THE
CITY OF PERTH AMBOY, NEW JERSEY**

By: Evaluation Committee

Dated: June 21, 2018

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OF THE CONTRACT AWARD
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ATTACHMENT — ATTACHMENTS

- A: Summary and Recommendation Memorandum
- B: Proposed Contract

This Evaluation Report and Recommendation of Contract Award (the "Report") is being provided pursuant to and in accordance with the requirements of the competitive contracting provisions of the Local Public Contracts Law (N.J.S.A. 40A:11-4.1 et seq.) (the "LPCL"). The purpose of this Report is to provide the Council (the "City Council") of the City of Perth Amboy, New Jersey (the "City") with an evaluation of the proposals (the "Proposals") received in response to a Request for Proposals ("RFP") issued by the City, and to provide a recommendation to the City Council of a Respondent for the award of a contract (the "Selected Respondent").

Recommendation

Based on the information and analysis set forth in this Report, particularly the memorandum prepared by ~~Greg~~Gregory Fehrenbach described herein and attached hereto as Attachment A, the Evaluation Committee (defined herein) recommends the City Council award the ten year contract with the City for the provision of operation and management services associated with the City's water, wastewater and stormwater systems to Utility Service Affiliates (Perth Amboy), Inc. (a Middlesex Water Company Affiliate).

I. EXECUTIVE SUMMARY

A. Initial Request for Proposals

On February 9, 2018 the City issued a Request for Proposals ("RFP") through the competitive contracting process of the LPCL, to solicit Proposals from qualified and experienced firms or entities to enter into an operating and management agreement (the "Contract") with the City for a ten (10) year term for the provision of the appropriate and necessary operation and management services associated with the City's water, wastewater and stormwater systems (the "City Systems"), as more particularly described in the RFP (the "Services"). The Office of the State Comptroller (OSC) reviewed the proposed RFP and after several modifications as per their instructions, the OSC approved of the RFP. The City advertised the issuance of the RFP and posted the RFP on the City's website. The City issued eight (8) addenda to the RFP which were emailed to all recipients of the RFP and posted on the City's website. To evaluate the Proposals, the City formed an Evaluation Committee comprised of: Adam Cruz, City Administrator; Gregory Fehrenbach, Principal, Government Management Advisors LLC, Consultant; Acela David, Chief Accountant; Jill Goldy, CFO; and Gary Muska, Purchasing Agent (collectively, the "Evaluation Committee" or "Committee") as assisted by ~~Ed~~Edward McManimon and Frances McManimon of McManimon, Scotland & Baumann, LLC, Special Counsel to the City ("Special Counsel"). The evaluation process was undertaken in accordance with the competitive contracting provisions of the LPCL and all other applicable law.

B. Initial Proposals

On May 4, 2018 the City received Proposals from the following entities in response to the RFP:

1. Suez Water Environmental Services, Inc. ("Suez")
461 From Road, Suite 400, Paramus, New Jersey 07652

2. Utility Service Affiliates (Perth Amboy), Inc. (a Middlesex Water Company Affiliate) (“USA-PA”)
1500 Ronson Road, Iselin, New Jersey 08830
3. Veolia Water North America Operating Services, LLC (“Veolia”)
53 State Street, 14th Floor, Boston, MA 02109

C. Evaluation Committee Review

The Evaluation Committee conducted a thorough review of each of the Proposals for compliance with the RFP and on May 14, 2018 the Evaluation Committee and Special Counsel conducted interviews with Veolia and USA-PA. Suez was not interviewed as, following submission of their Proposal, they indicated they would not execute the proposed Contract. The Evaluation Committee concluded the three Proposals contained provisions that were not compliant with the terms of the RFP and/or contained unacceptable deficiencies. On May ~~23~~, 2018 the City Council adopted Resolution # 219-5-18 rejecting the Proposals submitted by Suez, USA-PA and Veolia and authorizing the re-issuance of the RFP.

D. Re-Issuance of RFP

On May 24, 2018, the City re-issued the RFP with minor revisions to ensure Respondents agree to execute the proposed Contract without further negotiations as required by the competitive contracting provisions of the LPCL. The City issued two (2) addenda to the re-issued RFP which were emailed to all recipients of the re-issued RFP and posted on the City’s website. On June 15, 2018 the City received Proposals from USA-PA and Veolia. Suez sent correspondence indicating they would not agree to the terms of the proposed Contract requiring the Selected Respondent agree to indemnify the City for unlimited liability for damages arising as a result of the negligence of the Selected Respondent in operating the City Systems and therefore did not submit a Proposal. The Proposal from USA-PA incorporated its May 4, 2018 Proposal by reference and added a revised Cost Proposal. The Proposal from Veolia incorporated its May 4, 2018 Proposal by reference and once again provided for continued negotiation of several Contract provisions.

E. Evaluation

After reviewing the Proposals, the Evaluation Committee deemed the Proposal from Veolia non-compliant with the requirements of the RFP. The Veolia Proposal calls for negotiation of the following contract provisions in direct violation of the RFP requirements and the competitive contracting provisions of the LPCL under which the RFP was issued:

1. Negotiation of Contract provision requiring indemnification of the City without limitation for liability for damages occurring as a result of negligence by the Selected Respondent;
2. Veolia seeking City waiver of subrogation rights with regard to property damage to the City Systems’ facilities;
3. Veolia seeking annual fee adjustment for:
 - a. chemical costs

- b. electrical rates and volume
 - c. natural gas rates; and
4. Veolia seeking Contract provision for City payment of a portion of engineering services.

The Evaluation Committee conducted a comprehensive review and evaluation of the single compliant Proposal. The review of the Proposal from USA-PA (“USA-PA Proposal”) was based upon qualifications, experience, proposed operation and management plan and approach, project team, staffing, cost proposal and other factors, as set forth in the Proposal. The review and evaluation of the USA-PA Proposal was conducted in accordance with the proposal evaluation criteria set forth in the RFP. This criteria was developed to meet the specific needs of the City in obtaining the Services. The Evaluation Committee, with the assistance of the Special Counsel, drafted this Report for the City Council.

II. COMPREHENSIVE RFP CONTENT DETAILS

On February 9, 2018, the City issued an RFP for Proposals for Operation and Management Services for the City Systems as stated in more detail in the RFP and its accompanying documents. The City issued eight (8) addenda to the RFP in response to questions from the potential respondents. The City rejected the three (3) proposals received on May 4, 2018 and re-issued the RFP on May 24, 2018. The City issued two (2) addenda to the re-issued RFP in response to questions from the potential respondents. It is the intent of the City to enter into a Contract with a qualified vendor for a term of ten (10) years commencing January 1, 2019. The Contract, which was provided as an attachment to the RFP as Appendix A, requires the Selected Respondent to operate and manage the Systems in accordance with the Contract. The RFP also requires the Selected Respondent to provide these Services in accordance with all Federal, State and local requirements, laws, rules and regulations, and to meet and implement certain processes and procedures as minimum standards. The RFP also advised potential respondents, that the City would evaluate each Proposal on the basis of established criteria as set forth in the RFP, and in accordance with the competitive contracting provisions of the LPCL and applicable law.

A. Form of Proposals and Required Forms

Respondents were required to submit, as part of their Proposal submission, the documents and information described in the RFP, to demonstrate that the Respondent meets or exceeds the required technical, administrative and financial criteria of the RFP. Respondents were invited to submit supplemental information, in addition to the required information, that might be useful in evaluating the Respondent’s qualifications. Respondents were encouraged to be clear, factual, and concise in the presentation of their information.

Proposal submissions were required to include:

- General Information (RFP – Section II, 2.5.2)
- Administrative Information (RFP-Section III, 2.5.3);
- Financial Information (RFP-Section IV, 2.5.4);
- Technical Information (RFP-Section V, 2.5.5); and
- Cost Proposal (RFP –Section VII, 2.5.7)

Proposal submissions were required to include the following, among other items:

Proposal Form D-1: Respondent Form/Cover Letter

Proposal Form D-2: Ownership Disclosure Statement

Proposal Form D-3: Consent to Investigate

Proposal Form D-4: Non-Collusion Affidavit

Proposal Form D-5: Equal Employment Opportunity Certificate

Proposal Form D-6/Form D-7/Form D-8: Form of Performance Bond/Form of
Performance Letter of Credit/
Guaranty Agreement

Proposal Form D-9: Financial Information

Proposal Form D-10: Cost Proposal

Proposal Form D-11: Disclosure of Investment Activities in Iran Form

Proposal Form D-12: Acknowledgement of Contract Acceptance

B. Evaluation Process

Prior to the receipt of Proposals, the City formed an Evaluation Committee to review the Proposals. The review and evaluation of proposals were based on the model evaluation criteria and methodology set forth in N.J.A.C. 5:34-4.2 and the competitive contracting review process set forth in N.J.S.A. 40A:11-4.5 of the LPCL. Prior to reviewing the Proposals, each member of the Committee, along with Special Counsel, submitted a Certification confirming no conflict in accordance with N.J.A.C. 5:34-4.3(f). A copy of each of the Proposals was then submitted to each member of the Evaluation Committee. A copy of each Proposal was also sent to the Special Counsel, for technical review to determine if the Respondents included and completed the documentation and information set forth in the RFP. Special Counsel advised the Evaluation Committee that the Proposal submitted by Veolia failed to comply with several of the RFP requirements. The Evaluation Committee deemed the Veolia Proposal non-compliant and did not evaluate the Proposal.

Each member of the Evaluation Committee reviewed the USA-PA Proposal, particularly with respect to the Respondent's Administrative, Technical and Financial information and Cost Proposal. The Evaluation Committee met to discuss their review, and as a Committee, evaluated the information and documentation based on the evaluation criteria and categories set forth in the RFP (Section 3).

III. PROPOSAL EVALUATION CRITERIA

The following sets forth the evaluation criteria and percentage weighing that was applied by the Evaluation Committee in their review and evaluation of the USA-PA Proposal.

- A. Administrative Criteria: Proposal follows RFP format, corporate resources and staff, organizational chart, experience of personnel dedicated to the Systems, pending/threatened legal and administrative proceedings and corporate restructuring which could materially affect ability to provide Services, material pending legal and administrative proceedings in which respondent/guarantor officers, directors, employees, principals, property is subject, criminal charges brought against the respondent and disposition, civil proceedings instituted by DEP, EPA or other governmental agency/disposition, disqualification/prevented from bidding/contract termination of federal, state local government project, default, compliance history, refusal to testify, permit violations, geographic location, vicinity of other systems
- B. Financial Criteria: Performance security, financial strength and resources (Respondent's net worth for the most recent fiscal year, Respondent's annual pre-tax earnings for the three most recent fiscal years,, Respondent's cash and/or cash equivalents (such as marketable securities) as of the date of its most recent audited financial statement.) Financials of affiliate, joint venture or partnership, major financial commitments presently outstanding, liabilities and contingent liabilities, executed and pending contracts, financial and personnel impacts of transition from present operator, transition plan
- C. Technical Criteria: Regulated Utility/wholly owned subsidiary of regulated utility, years in the business providing similar services, ability to meet or satisfy procurement timetable, number of systems of equivalent size they have under successful operation, either by virtue of ownership or service contracts, number of supervisory, engineering, technical and administrative personnel assigned to the Systems with experience with similar systems, supervisory personnel with applicable licenses, staff experience, available vehicles and equipment, ability to conduct Systems evaluations and engineering reviews and implement improvements, past experience with the DEP and EPA with all regulatory reporting requirements and submissions, experience with emergency contingency plans for systems comparable to the Systems, soundness of Preliminary Operation Plan, previous experience with similar systems
- D. Cost Proposal (50%): The total of the Annual Fee over the term of the Contract.

IV. SUMMARY MEMORANDUM

Greg Fehrenbach, Consultant to the City, delivered a memorandum, attached hereto as Attachment A, to the members of the Evaluation Committee including a summary of the RFP

process, an analysis of the Proposals received in response thereto and a recommendation for the City to award the Contract to USA-PA.

V. RECOMMENDATION – SELECTED RESPONDENT

The Evaluation Committee applied the Evaluation Criteria set forth in the RFP to the USA-PA Proposal, the only compliant Proposal submitted in response to the RFP. The USA-PA Proposal was also reviewed for legal compliance, as well as administrative, technical, experience, financial strength requirements and cost proposal, all as set forth in the RFP. The Evaluation Committee believes that USA-PA has the experience, administrative and technical capability and financial strength to work with the City and efficiently and effectively provide the Services sought under the RFP. The Evaluation Committee also believes the Cost Proposal in the amount of \$6,700,000 per year for the term of the Contract is reasonable and justifiable based on the Services to be provided. Accordingly, the Evaluation Committee recommends that the City Council award the Contract to USA-PA in the contract amount of \$67,000,000. The proposed form of Contract, attached hereto as Attachment B, sets forth the terms, Services and other provisions described in this Report.

ATTACHMENT A
SUMMARY AND RECOMMENDATION MEMORANDUM

**ATTACHMENT B
PROPOSED CONTRACT**

Document comparison by Workshare Compare on Thursday, June 21, 2018
12:06:08 PM

Input:	
Document 1 ID	interwovenSite://MSBDMS14/iManage/789590/4
Description	#789590v4<iManage> - Evaluation Report and Recommendation for RFP for Operation and Management of Water, Wastewater and Stormwater Systems
Document 2 ID	interwovenSite://MSBDMS14/iManage/789590/5
Description	#789590v5<iManage> - Evaluation Report and Recommendation for RFP for Operation and Management of Water, Wastewater and Stormwater Systems
Rendering set	standard

Legend:	
<u>Insertion</u>	
Deletion	
Moved from	
<u>Moved to</u>	
Style change	
Format change	
Moved deletion	
Inserted cell	
Deleted cell	
Moved cell	
Split/Merged cell	
Padding cell	

Statistics:	
	Count
Insertions	28
Deletions	6
Moved from	0
Moved to	0
Style change	0
Format changed	0

Total changes	34
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**CONFIDENTIAL
MEMORANDUM**

TO: WWWU EVALUATION COMMITTEE MEMBERS

FROM: G.C. FEHRENBACH, GMA, LLC

SUBJECT: RECOMMENDATION REGARDING OPERATIONS AND
MAINTENANCE CONTRACT FOR AND WASTE WATER UTILITY

DATE: 20 JUNE 2018

It is my intention to try to make this matter very simple and not go into all of the details that for the unfamiliar will make the decision-making process complicated. Below is the substance of my proposal for a recommendation to the Advisory Committee and then to the City Council:

The City has gone out twice under the Competitive Contracting regulations of the State to obtain proposals for the operations and maintenance contract to manage the WWU. During the first round, three submissions were received on 4 May 2018. Each either had assumed negotiations were permitted or appeared to have included City costs in their pricing structure. Due to the failure of the parties to abide by the RFP directives, the City rejected the proposals submitted and sought new proposals. On 15 June 2018, two of the original three parties submitted revised proposals, USAPA and Veolia.

Alternative courses of action that the City might consider are to reject proposals again and either change the insurance requirements or change the statutory process to permit negotiations. This is advised against for these reasons:

1. All involved have endeavored to make sure the integrity of this process was unassailable. Rejecting these proposals would suggest that the City is trolling for a predetermined outcome.
2. In order to obtain compliant proposals from Veolia and/or Suez would entail eliminating unlimited liability for the Company, which is the highest level of protection for the City and/or waiving the City's right to subrogate regarding a property insurance claim.
3. As can be seen below, we have learned what the reasonable range for the cost of this service is likely to be. It is therefore probable that we have seen reasonable cost proposals, and at least one proposal complies with the process requirements.
4. We do not want to stretch this process to the very end of the contract period.
5. We do not want to be the subject of a possible lawsuit.

From the data gained through these two RFP processes, we are able to achieve a very clear understanding of what the best choice among possible alternative actions might be.

FINDINGS:

- The City chose to use the competitive contracting process due to the compressed time line for the renewal/replacement process. While the recommendation to seek proposals was made about 3 years prior to the expiration of the current contract, the City only began the process with less than 15 months remaining.
- Both Suez and Veolia North America have expressed their objections to the “unlimited liability” provision in the form of contract contained in and required by the RFP. This provision has been a part of the current contract since its inception. To seek less would create a potential liability that the City has not been subject to for this entire period. If something unfortunate occurred, how would elected officials explain that to save money in the short run, they gave up “unlimited liability” being held by the operator?
 - Suez **chose to not make a submission** during the second round due to this provision remaining in the form of contract. Their first round proposal had as a condition, the elimination of this provision, which was in violation of the statute. They felt that it put the company at too much risk.
 - Veolia, in their latest submission, did not revise their price proposal. Their original price proposal included numerous exceptions to various provisions in the form of contract. One of these exceptions called for replacement of the “unlimited liability” provision.
 - Because of these exceptions, Veolia’s proposal is not compliant with the RFP and under the provisions of the Local Public Contracts Law negotiations between the parties cannot take place.
 - In addition they requested the City waive its subrogation rights against the Company, which again is not compliant.
- Suez’ original price proposal (1st round) was for \$64,582,000 with two conditions, each of which have an unknown additional dollar cost (value):
 - First, the price proposal was based on a 2% per year increase over the life of the contract. This increase however, was not fixed but rather an illustration. Their proposal reads: “The proposed pricing assumes a 2% inflation increase in years 2020-2028 for *illustration purposes only*.” (Emphasis added.)
 - Second, assuming the removal of the “unlimited liability” provision is the removal of a significant real premium cost to the Company or a significant Company-assumed liability which has a future value that must be identified as a real cost of doing business either for the City or the Company.
- Possible alternative actions to awarding the contract based on the 2nd round submissions:
 - Decide to remove the “unlimited liability” provision from the form of contract and replace it with a liability limit of no less than \$15 to 25 million. Then go out again for proposals under the competitive

contracting procedure or the more complicated and time consuming but more flexible Public Private Partnership (PPP) Act.

- The impacts of this course of action would be:
 - Losing another month or so using competitive contracting or losing about 5 months using the PPP Act provisions.
 - Incurring a cost for MS&B and GMA, LLC of about another \$50,000 to \$100,000 depending on the method chosen. (Note that both MS&B and GMA have already expended **more than twice the time originally estimated** for this project which will cause us to submit requests for additional authorizations.)
 - Incur a liability greater than that which the City has held for the past 20 years.
 - Probably not see much change in the pricing of the companies given Veolia's behavior in this 2nd round.
- If an outside company such as Suez or Veolia were successful, it has been stated by almost all governing body members that they would wish to bring on the current manager of the system as the contract administrator of this contract. Given the fact that this person would need resources and compensation to accept the position, I would estimate that the annual cost which would increase each year would be in the range of \$350,000 in addition to some probable legacy costs.
 - In addition, the City has a liability to reimburse MWC (USAPA) for monies they expended in 2009 on behalf of the City to create a GIS Mapping system, which is \$100,000, if the City does not renew the contract.
 - Therefore, any proposal from another company must add about \$4,000,000 to the cost over the ten (10) years of the contract. This is "Est. added cost" in the table below.

CONCLUSIONS

So,

- if the City went out again, and
- if the "unlimited liability" provision were removed, and
- if the ability to subrogate were waived, and
- if the Companies submitted price proposals substantially similar to that which they have already submitted which is highly likely given all of the information we presently have in hand, the City would in all probability see the following outcome:

	USAPA	Suez (1st Round)	Veolia, NA
<u>10 yr O&M cost</u>	\$67,000,000	\$64,582,000 with	\$48,914,525**
<u>Est. added cost</u>	0	\$ 4,000,000	\$ 4,000,000
<u>Liability</u>	No current objection	-no unlimited liability	-no unlimited liability
<u>Staffing</u>	Current levels	Current levels	Reduce 7 positions
<u>Admin Cost*</u>	Add \$50-100,000	Add \$50-100,000	Add \$50-100,000
<u>Added Costs</u>	None	due to inflation > 2%	due to unidentified add-ons

* Admin Cost is the additional costs of MS&B and GMA.

**Veolia's cost proposal is calculated using contract provisions which are not acceptable to the City; specifically incorporating a liability cap and true-up mechanisms for gas and electric utility rates and chemical costs in addition to a reduction in staff, allegedly offset by technology improvements which presents a potential threat to customer service with the reduction of staff to perform vital services.

A prime indicator in the first round was: Suez proffered a price proposal more in line with that which the City currently pays, but with the add-on costs, it is more costly than USAPA.

RECOMMENDATION

Award a contract renewal now to USAPA in accordance with their 15 June 2019 proposal. Doing so will have the following effects:

- Execute a contract providing the same liability protection and retaining the same subrogation rights under which the systems have operated for the past 20 years.
- Avert the new administrative costs that would be incurred going out again for additional proposals.
- Avert the potential challenge to the integrity of the process.
- Eliminate the concerns about management of the transition process.
- Allow the O&M manager to perform the advance work needed to be ready for the new contract in January, e.g. acquire vehicles and equipment, acquire personnel, put systems in place in advance so the system can have a seamless transition from the current PPP to the O&M contract, etc.
- Provide employees of USAPA the knowledge of continued employment and stop the USAPA staff leaving for fear that the contract will go another vendor. (This was a principal reason for the advice back in 2015 that the procurement process should have begun then.)

ATTACHMENTS:

Summary of discussion with Risk Manager 19 June 2018

This provided the Evaluation Committee members and will provide the Advisory Committee members with an understanding of the gravity of reducing the liability limit and waiving subrogation rights

Article on waiver of Subrogation

For those who do not fully understand the concept of subrogation in the insurance industry, this article was supplied by the City's risk manager.

On 19 June 2018, Jill Goldy, Gary Muska, and G C Fehrenbach raised questions with Wayne Dietz and John Carrasco of D&H Risk Solutions, the City's Risk Manager (insurance). These questions related to issues raised by two interested parties in the Operations and Maintenance Contract for the City's Water and Waste Water Utility. Below is a summary of the outcome of the discussion:

1. What is their advice on the question of retaining the "unlimited liability" under the general liability provision in the RFP or eliminating it in favor of a liability cap?
 - a. D&H Risk Solutions stated that they do not know how the Company would obtain an insurance policy for unlimited liability coverage. Insurance coverage typically has limits.
 - b. The agreement would require the City be named on the "Companies" Liability policy as an additional insured on a primary and non-contributory basis.
 - c. Rather; in the event of a covered loss with the company determined to be liable; holding unlimited liability, the responsibility for payment would be covered as follows:
 - i. Payment by the Company of their deductible or self-insured retention (SIR).
 - ii. Payment by the Company's insurance carrier(s) for the amount(s) over the deductible or SIR, up to the limit of their coverage which could be a \$5 million, \$10 million, or higher limit.
 - iii. Any claim beyond their upper limits would be a responsibility of the Company itself.
 - iv. This is the standard method of allocating payment responsibility for payment by a responsible party to a claimant in the event of a loss.
 - d. The Company would provide a Certificate of Liability outlining the coverage and limits with a minimum liability limit of \$15,000,000 (this is the City's coverage and the agreements states coverages "equivalent" to that held by the City.
2. What is their advice regarding the request that subrogation by the City be waived for property coverage?
 - a. D&H asked what the Company's concern is that would cause them to seek a waiver of subrogation regarding property coverage.
 - b. Since the only condition under which there would be subrogation by the City's insurance carrier against the Company for damage to property would be in a case where the Company or its employees were deemed negligent, why would the City waive subrogation rights?
 - c. Lastly, they pointed out that the City is part of joint insurance fund that provides the City all liability, property and casualty insurance coverage. D&H greatly doubts the willingness of the PEJIF to accept such a waiver of rights. This would then put the City on the line for payment of dollar one and all subsequent payments in the event of a loss and a claim. Essentially, by waiving subrogation rights, the City could be "bare", or subject to additional costs to have the insurer agree to the waiver or without notice to the insurer end up without insurance in this regard.

Signed

Gregory C. Fehrenbach, Principal
Government Management Advisors, LLC

News & Alerts

June 27, 2013

Waiver of Subrogation: What Does It Mean To You?

Subrogation. It is a phrase appearing in virtually every insurance contract, but rarely understood except by insurers and attorneys. It is a term frequently glazed over by insureds as they are daunted by a veritable mountain of insurance documents on their desk, often over an inch thick. But what does it mean? And what if, in a contractual setting, you are asked to waive subrogation? Waiver of subrogation is not something that should be agreed to lightly, because a misstep without fully understanding the ramifications could very well lead to a denial of coverage.

First things, first. What is subrogation? In the insurance context, subrogation is defined as "... [t]he principle under which an insurer that has paid a loss under an insurance policy is entitled to all the rights and remedies belonging to the insured against a third party with respect to any loss covered by the policy" Lee R. Rugg, Couch On Insurance § 222.2, at 222-14 (3d ed.2000). In layman's terms, subrogation occurs when an insurer pays an insured for a loss caused by a third party. The insurance company is then "subrogated" – or steps into the shoes of the insured – to sue that third party for the loss suffered by the insured. In short, the insurance company pays its insured to make the insured whole. The insurer, to make itself whole, then has the right to sue the third-party that caused the damage.

Because an insurer pays on its policy for losses suffered by the insured to make that policy holder whole, the insurer is out significant amounts of money. The only way for it to recoup that money is to sue the party responsible for the loss. Therefore, insurance policies include terms that require its insured not take any actions which would compromise the insurer's right to subrogation. The general policy language usually states "Insured will not act in any way that would limit or otherwise diminish the insurer's right of subrogation."

Despite this generally universal insurance policy term, often times commercial contracts between parties (not the insurer) will include "waiver of subrogation" provisions. These are most often found in construction and lease contracts. A waiver of subrogation provision prevents the insurance company (who steps into the shoes of the insured after it pays a loss) from suing the other party to the contract – which likely caused the loss. Moreover, waiver of subrogation provisions found in contracts are generally upheld by Courts.

Because insurance policies almost always include terms which prevent the insured from taking any actions which would limit or diminish the insurer's right of subrogation, what happens if you sign a contract that includes a waiver of subrogation? The simple answer is: you, the insured, have breached the insurance contract. Simply stated: the insurance company will deny you coverage and will not cover you for the loss incurred under the insurance policy.

What if, however, you entered into a contract with a party who then sub-contracts a portion of the work, and the sub-contract contains a waiver of subrogation? Such issue occurs more

often than one might expect and was an issue that was raised in *Travelers Indem. Co. v. Crown Corr., Inc.*, 2011 WL 6780885 (D.Ariz. 2011). In that case, Tourism and Sports Authority, the owner of the University of Phoenix Stadium, entered into a contract with the Arizona Cardinals and Hunt Construction for the design and construction of the Arizona Cardinal's stadium. To complete the stadium, Hunt entered into a sub-contract with Crown Corr, Inc. to design the exterior enclosure system for the stadium. Unbeknownst to Tourism and Sports Authority, the Hunt-Crown sub-contract contained a waiver of subrogation provision.

After the stadium opened, during a wind and rain storm, certain panels installed by Crown Corr fell off the exterior of the stadium, causing roughly \$1.5 million in damage. Tourism and Sports Authority, owner of the stadium submitted its claim to Travelers, who paid the claim – and then filed suit against Crown Corr (as subrogee of the stadium owner) to recover the \$1.5 Million claiming negligent construction. Crown Corr responded by filing a motion to dismiss, asserting that the contract it entered into as a subcontractor contained a waiver of subrogation clause.

The Court held that although the owner of the stadium did not enter into the subcontractor agreement with Crown Corr, Inc., it had the right to review the contract which contained the waiver of subrogation clause. Travelers, as subrogee, stands in the shoes of its insured and is bound by these agreements. The Court went on to say: "insurers are in the best position to protect themselves against waivers of subrogation entered into by their insured before the acquisition of the insurance policy by (1) inserting an exclusion into their policies that permits the insurers to deny coverage if any insured waive[d] the insurer's subrogation rights, (2) raising premiums to offset outlays incurred from the loss of their subrogation rights, (3) investigating whether a potential insured has already waived any subrogation rights, (4) requiring insureds to warrant at the time a policy is issued that their insureds have not, and will not, waive the insurers' subrogation rights, and (5) obtaining reinsurance to cover any waiver of subrogation rights." Based on this, the Court held that Travelers was bound by the waiver of subrogation rights and was barred from asserting claims against Crown Corr.

While Crown Corr narrowly escaped liability based on the Court's ruling, many insureds are not so fortunate. In the majority of cases, if an insured enters into a waiver of subrogation without the insurer's knowledge, the insurer is well within its rights to deny coverage and leave the insured to its own devices and cover the loss out-of-pocket.

Based on the foregoing, the question now becomes: what if I am presented with a contract that contains a waiver of subrogation? Do I have to reject the contract? Should I demand that the provision be deleted? Should I sign it and hope the insurance company never finds out? NO! The simple answer is to present this issue to your insurer. It is likely that the insurer will enter into an endorsement allowing for the waiver of subrogation. As you may expect, this endorsement will come with an increased premium, as the insurer has to recoup its risk through higher prices. Also, it goes without saying, if you have entered into an agreement with a waiver of subrogation clause and then seek insurance, be sure not to hide this from the insurer, as the gambit could result in denial of coverage in the event of a claim. Another easy solution is to consult an attorney specializing in this area who understands the risks involved in these types of waivers and who is able to negotiate with the insurer to ensure you are not left without coverage.

Frank Cragle is a trial lawyer and a member of Hirschler Fleischer's Insurance Recovery Team. He handles a variety of commercial business disputes, including insurance recovery and policyholder claims. Frank also devotes a substantial portion of his time to business tort litigation and intellectual property claims. For more information, contact Frank at 804.771.9515 or fcragle@hf-law.com