National Association of Surety Bond Producers
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BY ELECTRONIC TRANSMISSION (kchristiansen@williamsaz.gov)

January 23, 2015

Kyle Christiansen, Public Works Director
City of Williams
113 S. 1st Street
Williams, AZ 86046

Re: Performance Bond Amount for City of Williams Meter Replacement Project

Dear Mr. Christiansen:

I am contacting you on behalf of the National Association of Surety Bond Producers (NASBP), a national trade association of surety bond producers, including licensed resident and nonresident producers placing bid, performance, and payment bonds in the State of Arizona and all other jurisdictions. NASBP was recently forwarded a copy of the Request for Proposals (RFP) for the Meter Replacement Project (Project) issued by the City of Williams (City).

We have reviewed the RFP, and the terms for the performance bond (Bond) give NASBP great concern. More specifically, the increased amount of the Bond, which is intended to cover the "potential risk of substantial losses" to the water meters purchased by the City and which will substantially exceed the contract price, is counter to proper surety and construction practices. Requiring the Bond to protect the City against losses to the water meters treats the Bond as if it were a project insurance policy, which it is not. Please allow me to explain.

As the City observes on page 8 of the RFP, "[g]enerally the City requires such security in an amount equal the contract price." While NASBP understands and appreciates that the City wants to secure itself from the risk of any losses to the water meters, the performance bond is the incorrect vehicle for such security. A performance bond is not a form of property and casualty insurance. The proper vehicle for such security is the contractor's project insurance policy. It is for just such a loss that the contractor carries such insurance.

Surety bonds do not function like traditional insurance policies. Rather, surety bonds function more in the nature of credit arrangements in which sureties extend surety credit to qualified contractors in return for premium payments. A contract of suretyship is a three-party contract whereby the surety underwrites with the expectation of no losses, because the contractor has been carefully prequalified as to its ability to perform the obligation of the construction contract, and the liability for incurred losses, if any, remains with the contractor. A surety seeks to avoid default by its contractor/principal by examining all facets of the contractor's operations, especially its experience, capabilities, and financial soundness. As a result, the fee payable to the surety is more in the nature of a fee for the prequalification process undertaken and the surety credit extended.

A traditional insurance policy, such as a project insurance policy, on the other hand, is a two-party contract on which the insurer expects losses. Insurance premiums are actuarially computed on the assumption that certain losses will occur, based on averages. Unlike sureties, which write bonds only for contractors qualified in relation to specific projects, insurers generally write policies that spread the risks of losses over the entire pool of insureds. Understanding these critical distinctions is important in understanding that sureties do not write contract bonds or calculate premiums with the assumption of being a liability insurer for such purposes as third-party tort liability or property damage, such as the pre-purchased radio read water meters. Rather, sureties issuing contract bonds are guaranteeing the contractor's ability to perform the contract and to pay subcontractors and suppliers--and are not acting as insurers for the project.

By providing for this improper coverage, the Bond becomes a form of project insurance, a role and purpose that it decidedly is not. Even were a surety to write such a bond, it would increase the cost of the project, decrease competition, and impose liability on the surety more akin to project insurance than a performance guarantee.

When contractors seek surety credit for contracts and bonds with improper terms and conditions, sureties are much less likely to extend that surety credit. The sureties will not issue such bonds, except to the very largest, most highly capitalized contractors. By including such onerous terms, the City is restricting competition and ensuring that the State pays more for the work. In addition, such policy makes it more difficult for the City to award work to small, emerging, and minority business enterprises.

For these reasons, NASBP respectfully requests your reconsideration of imposing a performance bond amount in excess of the amount of the contract price and expecting the Bond to respond to any loss to the water meters.

I appreciate your consideration of NASBP's concerns, and I would be happy to answer any questions you may have.

Yours sincerely,

Martha L. Perkins

Martha L. Perkins
General Counsel

cc: Mark H. McCallum, CEO