



National Association of Surety Bond Producers

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BY ELECTRONIC TRANSMISSION (juanita.komoro@readingpa.org)

October 19, 2015

Ms. Juanita Komoro, Purchasing Assistant
City of Reading Purchasing Office
815 Washington Street
Reading, PA 19601

Re: Bid Package for Fritz Island Wastewater Treatment Plant Upgrade Project

Dear Ms. Komoro:

I am contacting you on behalf of the National Association of Surety Bond Producers (NASBP), a national trade association of agencies employing surety bond producers, including licensed resident and nonresident producers placing bid, performance, and payment bonds in the Commonwealth of Pennsylvania and all other jurisdictions. NASBP was recently forwarded a copy of the bid package for the City of Reading's (City) Fritz Island Wastewater Treatment Plant Upgrade Project (Project). We have reviewed the bid package for the Project, and the terms and conditions of these documents give NASBP great concern. More specifically, we believe that many of the terms and conditions of these documents are counter to prevailing surety and construction industry practices and to the market reputation of the City as a desirable procurer of construction services.

A number of the terms and conditions in the bid package create unbalanced allocation of risks and substantially increase the risks to both the contractor and the surety. This increased risk will almost certainly affect the number of contractors that are able to submit bids for the Project. While I expect that the drafters of this bid package believe, erroneously, that the onerous terms protect the public interest, they, in fact, do just the opposite, acting as a significant deterrent to sureties wishing to write bonds for the Project. We provide below comments on some of these onerous terms and conditions, which we hope will be beneficial to you.

Surety bonds function similarly to credit arrangements, by 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.

Accordingly, sureties write bonds only for contractors qualified in relation to specific projects, 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. Thus, a bid package with unbalanced language, unusual risks, and onerous terms and conditions represents a greater risk for the contractor and the surety. Such onerous terms and conditions translate into fewer bidders and higher prices.

The Bid Bond Form (Bid Bond) incorporates by reference all the Bid Documents and includes a 100% forfeiture provision of the bond penalty if the owner cannot contract with another bidder within 30 days of acceptance of the bid by the principal. This likely would represent a huge windfall to the City, as the custom in the industry is for the surety to pay only the actual re-procurement costs, not the entire penal sum of the Bid Bond.

In a highly unusual provision, the Bid Bond contains confessed judgment language, by which the obligee—the City—is the sole determiner, with no apparent recourse, of whether a bid default has occurred. In an even more highly unusual provision, the Bid Bond contains a 20% attorneys' commission, in addition to all costs of suit. This simply does not comport with custom and practice in the industry. Such conditions make it more difficult for the surety to assess its risk, and less likely that it will issue a bond with such conditions.

The Performance Bond contains a “sole judgment” provision, which provides that it is solely the judgment of the obligee—the City—to determine if there are “defective or inferior materials or workmanship.” Such language is a completely unbalanced risk allocation and functions to chill surety participation on bids for the Project.

Furthermore, the Performance Bond is deficient in other ways. It provides that the Bond is automatically and immediately increased upon any amendments to the contract up to 20% of the contract price. This provision is problematic from a surety standpoint because a surety could end up with bonds on a project that it didn't actually underwrite. Just as importantly, an increased bond amount is unnecessary for changes, because with a 100% performance bond and a 100% payment bond, the obligee (and the labor and material suppliers) remains thoroughly protected as the project progresses and the contract balance is decreased.

The Payment Bond language appears to open up the contractor and the surety to claims from subcontractors and suppliers. The Payment Bond, in addition, contains the same 20% automatic increase provision as the Performance Bond. The Payment Bond provides that the surety will pay the obligee's legal fees and costs if the obligee incurs legal fees to enforce its rights under the Payment Bond. The payment bond is for the direct benefit of laborers and material suppliers, not for the benefit the obligee. None of these provisions are customary or usual in the industry.

There are also a number of onerous provisions in the General Conditions and the Agreement between the Owner and Contractor. Below I address two such provisions, by way of example.

In the Agreement between Owner and Contractor, on page 5, Special Damages (B) provides that, if more than one prime contractor is delayed in the achievement of substantial completion, that

prime contractor will be jointly and severally liable for the special damages in that paragraph. What this means is that a prime contractor can be delayed, and, even if it did not cause the delay, it is still liable with all other contractors to the owner. This is a dramatically unbalanced contract provision, and it is a risk that sureties cannot assess.

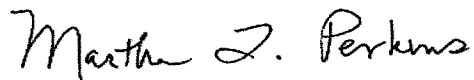
In the General Conditions, at Article 18.04C, the contractor waives its right to consequential and/or incidental damages. On the other hand, the owner is accorded the right to recover liquidated damages, consequential and/or incidental damages from the contractor. This is an unbalanced and unfair allocation of risk that neither contractors nor sureties find appealing.

These onerous terms and conditions place undue risk on contractors. When contractors seek surety credit for contracts and bonds with onerous 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 it pays more for the work. In addition, such language will make it extremely difficult for small, emerging, and minority business enterprises to obtain work on the Project.

For these reasons, NASBP respectfully requests the City's reconsideration of imposing such onerous bond and contract terms and conditions on the contractors and sureties on the Project. We respectfully recommend that you revise the bond forms and general conditions to accord more with industry practices and standards and to enhance bidder participation. You may wish to consider adopting the well-known standard bond forms developed by industry organizations, which could be amended appropriately to address specific concerns. These include the American Institute of Architects (AIA A312-2010 Performance Bond and Payment Bond), ConsensusDocs (ConsensusDocs 260 Performance Bond and ConsensusDocs 261 Payment Bond), and Engineers Joint Contract Documents Committee (EJCDC C-610 Performance Bond and EJCDC C-615 Payment Bond). Among the benefits of these forms is that they are well-known in the industry and have been well-tested in the court system.

I appreciate your consideration of our concerns, and I would be pleased to answer any questions you may have.

Yours sincerely,

A handwritten signature in cursive script that reads "Martha L. Perkins".

Martha L. Perkins
General Counsel

cc: Mark H. McCallum, CEO, NASBP
John Miravich, Esq., Fox Rothschild