National Association of Surety Bond Producers
1140 19th Street, NW, Suite 800, Washington, DC 20036-5104
Phone: 202-686-3700
Fax: 202-686-3656
Website: http://www.nasbp.org
Email: info@nasbp.org

BY ELECTRONIC TRANSMISSION (liveoak@liveoakcity.org)

June 25, 2014

Mr. Jim Goodwin, City Manager
9955 Live Oak Blvd
Live Oak, CA 95953

Re: Bond Forms for the City of Live Oak, California

Dear Mr. Goodwin:

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 California and all other jurisdictions. NASBP was recently forwarded a copy of the Performance Bond and Payment Bond (Bond Forms) that were used on the City of Live Oak (Live Oak) Soccer Park Project (Project), which bid on June 17, 2014. We have reviewed these Bond Forms, and the terms and conditions of these forms give NASBP great concern. The Performance Bond in particular is among the most onerous that we have ever encountered. More specifically, the terms and conditions of these Bond Forms are generally counter to prevailing surety and construction industry practices and to the market reputation of Live Oak as a desirable procurer of construction services.

A number of the terms and conditions in the Bond Forms substantially increase the risks to both the contractor and the surety. This increased risk certainly affects the number of contractors that are able to submit bids for Live Oak projects. These documents are drafted so broadly, so vaguely, so unusually, and so ambiguously that it is our understanding that they have acted as a significant deterrent to sureties wishing to write bonds for the Project. Indeed, NASBP has received information that several sureties would not provide the bid bond to certain contractors that wanted to bid on the Project because of the onerous terms and conditions in the Performance Bond. We provide below general commentary and comments on specific terms and conditions that will elucidate our concerns and that we hope will be beneficial to you.

Both the Performance Bond and the Payment Bond permit the obligee to recover expenses and attorneys' fees, in addition to and above the penal sum of the bonds. This condition does not comport with customary practice in the surety industry; it is standard that the surety's maximum liability is capped by the penal sum of the bond. The language of the Bond Forms "opens" the penal sum. Such a condition makes it more difficult for the surety to assess its risk, and much less likely that it will issue a bond with such a condition. Furthermore, this

right of the prevailing party to collect attorneys' fees is only provided to the obligee, which is highly unfair. If such a provision is included in the Bond Forms, then the surety should have the ability to collect expenses and fees if it prevails in litigation. This provision should be stricken or modified to make it fair and for the benefit equally of the surety and the obligee.

The Performance Bond is significantly deficient in other ways: specifically, the surety's obligations under the Performance Bond are triggered by the default of the principal, regardless of whether the surety has notice of the default. This can only be denominated onerous and ludicrous; if the surety is not aware of a default, then how can it know that its obligations have arisen under the bond? Such language does not make sense.

The Performance Bond provides that, if the surety elects to complete the obligations of the principal, then the surety must complete the principal's work "in no event later than three (3) months following knowledge of the breach by the principal." The surety cannot reasonably commit to such a provision without knowing how long the work will take. The surety should complete the work in accordance with the contract documents, and this provision should be deleted.

Entirely inappropriate in a bond form, the obligee gains the right to obtain equitable relief against the surety in the form of an injunction compelling the surety to undertake a particular remedy of the default. The remedy for breach of contract is almost exclusively money damages and not an equitable remedy. This provision, too, should be removed from the Performance Bond.

Another onerous clause provides that, if the surety elects not to perform the principal's obligations, the surety must deposit with Live Oak the city engineer's estimate of the cost of the uncompleted portion of the work within five days of receipt of the estimate. This excludes the surety from the investigation of the remaining scope of work and the cost to complete the contract, which it has an obligation under law to perform. These are inappropriate and should be revised. A more acceptable approach would require the surety to consult with the city engineer in determining the remaining scope and cost to complete. Otherwise, the surety would be forced to ignore the interests of its principal and simply pay a sum dictated by the obligee. A surety in such a scenario would likely be precluded from obtaining indemnity from the principal and other indemnitors for any losses it sustained under the bond. Issuing such a bond would be highly risky for a surety, and any surety company that reads such language would only issue such a bond for the most highly capitalized contractor, precluding small contractors from bidding.

And, finally, the Performance Bond concludes with a long and confusing paragraph about underwriting decisions and cost estimates. Relying on cost estimates that turn out to be faulty has never been a valid surety defense to a performance bond claim. It is, therefore, entirely unclear why this strange and unnecessary language is included in the Performance Bond.

These overly broad, confusing, and onerous conditions place undue risk on contractors and sureties. When contractors seek surety credit for bonds with onerous terms and conditions, sureties are much less likely to extend that surety credit. The sureties will issue such bonds, if

at all, only to the very largest, most highly capitalized contractors. By including such onerous terms, Live Oak is restricting competition and ensuring that it pays considerably more for public work. In addition, such policy does not comport with one of the State's top priorities—to award work to small, emerging, and minority business enterprises, such as disabled veteran business enterprises, for which California state law requires a certain percentage of participation in public contracts. Unfortunately, it appears that other cities, including the City of Gridley, are also using these Bond Forms, restricting bid and price competition.

For these reasons, NASBP respectfully requests your reconsideration of imposing such onerous bond terms and conditions on the contractors and sureties on the Project. We respectfully recommend that you revise the Bond Forms to accord more with industry practices and standards. Alternatively, 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 happy to answer any questions you may have. NASBP would be pleased to work with you to craft bond language that will properly provide contract performance protection to Live Oak, as owner, and payment protection to certain laborers and suppliers.

Yours sincerely,

Martha L. Perkins

Martha L. Perkins
General Counsel

cc: Mark H. McCallum, CEO
Larry LeClair, Director of Government Relations