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BY ELECTRONIC TRANSMISSION (john.white@sfgov.org)

November 14, 2014

John White, Deputy City Attorney
City & County of San Francisco
Construction & Public Contracts Division
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Re: City & County of San Francisco General Conditions (August 2014 Edition)

Dear Mr. White:

On behalf of the National Association of Surety Bond Producers (NASBP), a national trade association of bond producers, including licensed resident and nonresident producers placing bonds in the State of California and in other jurisdictions, I am contacting you regarding the updated General Conditions (GCs) for construction projects for the City & County of San Francisco (City). NASBP has had an opportunity to review the GCs and has significant concerns regarding some of the provisions, in particular the provisions specifying that the City has no liability for consequential damages while imposing consequential damages on the contractor, and the provision requiring the contractor to co-warrant all the manufacturers' product warranties.

One-Sided and Uncapped Consequential Damages

NASBP has significant concerns regarding the provisions in the GCs that provide for a one-way waiver of consequential damages. Section 2.08 provides that the City has no liability to the contractor for consequential damages; on the other hand, Section 3.21 provides that "Contractor shall be responsible for special, consequential or incidental damages incurred by the City arising out of or connected with Contractor's performance of the Work." This one-sided consequential damages provision is inequitable and onerous. Furthermore, there is no cap at all on the amount of damages for which the contractor could be liable.

In assessing its financial risk and preparing a bid for any project, a contractor will review, among other things, the consequential damages exposure on that specific project. When the contractor is faced with a very broad consequential damages provision, such as the provision in the GCs, the contractor will insert contingencies into the bid to account for the uncapped consequential damages, for which the contractor is unable to assess its risk. The effect of this contingency inserted into the bid is, of course, that the project owner will receive higher bids for the project. Thus, the taxpayer will pay more for public works projects. There will also be less interest in bidding on a project where the consequential damages exposure is so great. As always, less competition means higher project cost to the public entity—and to the taxpayers.

In addition, uncapped consequential damages pose considerable problems from a surety underwriting perspective. Sureties are usually not comfortable in issuing bonds for projects where the contractor/principal has very broad consequential damages exposure. Unlimited consequential damages exposure increases substantially the uncertainty regarding underwriting projections about the contractor's future viability. Simply put, sureties cannot gauge the soundness and financial wherewithal of a particular construction company engaged on projects with such unlimited exposure.

Uncapped consequential damages also reduce competition for the standpoint of eliminating from the bidder/proposal pool all but the largest contractors, since only large contractors can shoulder the higher risk inherent in such contracts. Small contractors effectively are precluded from bidding such projects, for they likely will not have the sophistication to adequately price such uncapped exposure and likely will not have a sufficient level of financial capital on hand to provide the surety with assurance of the small contractor's fiscal strength.

NASBP respectfully requests that the City reconsider the one-sided waive of consequential damages (and the uncapped consequential damages provision) and provide for an industry standard mutual waiver of consequential damages.

Contractor Warranty of Manufacturers' Product Warranties

Section 3.17.A.1 of the GCs provides that "Contractor additionally warrants manufacturers' product warranties." This language requires the contractor to co-warrant all manufacturers' warranties, some of which are twenty (20) and even thirty (30) years. This long-term warranty requirement has prompted us to express our concerns to you about the substantial impact extended warranties have on the construction and surety communities.

A lengthy warranty period, such as one over five years, imposed on the contractor poses considerable problems from a surety underwriting perspective. Sureties usually are comfortable in covering a warranty obligation of one to two years. Longer durations increase substantially the uncertainty regarding underwriting projections about the contractor's future viability. In other words, sureties cannot gauge the soundness and financial wherewithal of a particular construction company for periods extending too far into the future. The tenuousness of the present economic environment further underscores the difficulty, if not impossibility, of underwriting guarantee obligations of more than five years, much less obligations of 20 or 30 years.

As discussed above concerning uncapped consequential damages, long warranty obligations also reduce competition from the standpoint of eliminating from the bidder/proposer pool all but the largest contractors, since only large contractors can shoulder the higher risks inherent in such contracts.

The lengthy warranty requirement imposed on the contractor in Section 3.17 is a non-industry standard warranty requirement, which effectively precludes many, highly qualified contractors, lowering bid and price competition on such projects significantly. While it is standard in the

industry for manufacturers to furnish such long-term warranties on materials and systems, this is not standard for contractors or for their sureties to do so.

For projects financed with public funds, such lengthy warranty requirements will no doubt hamper, if not foreclose, small and disadvantaged business participation at prime and subcontractor levels. Small and disadvantaged businesses usually are more thinly capitalized and cannot assume the higher risks posed by the longer warranty durations. If small business inclusion is a goal of a project, these warranty durations are contrary to realizing that goal.

For these reasons, NASBP respectfully requests the City's reconsideration of imposing a co-warranty requirement for manufacturers' warranties on contractors performing work and the inequitable transfer of risk from the manufacturer to the performance bond surety. Warranty durations of less than three years are pragmatic approaches, which are regularly underwritten by sureties, with longer warranty durations solely provided by manufacturers, which regularly assume longer warranty risks for their products.

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

Yours sincerely,

Martha L. Perkins

Martha L. Perkins
General Counsel

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