



NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS

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December 1, 2010

Mr. James P. Schabarum
Executive Vice President
Cavignac & Associates
Bank of America Plaza
450 B Street, 18th Floor
San Diego, CA 92101-8005

Re: Feasibility of longer construction warranties for rehabilitation of pipelines

Dear Jim:

Thank you for your question regarding surety coverage of longer construction warranties. A lengthy warranty period, such as one equaling or exceeding 5 years, poses considerable problems from a surety underwriting perspective. Sureties usually are comfortable in covering a warranty obligation of up to two years. Durations longer than two years increase substantially the uncertainty regarding projections about the contractor's future viability. Simply put, sureties cannot gauge the soundness and financial wherewithal of a company for periods extending too far into the future.

The vagaries of the present economic environment further underscore the impossibility of underwriting guarantee obligations of long duration. Long warranty obligations also reduce competition from the standpoint of eliminating from the bidder pool all but the largest contractors, since only the largest contractors can shoulder the higher risks inherent in such contracts. Small and medium-sized contractors effectively are precluded. In this economic climate, contracting considerations to maximize, not to reduce, competition should be foremost in the minds of contracting officials.

According to the contract documents for Sewer and Water Group 740, Section 6-8.2 calls for a 5-year warranty for pipelines commencing from the date of final acceptance. For the reasons stated above, a warranty duration of 5 years is problematic in and of itself. Furthermore, the pipeline warranty period commences from the date of final acceptance of the project. Standard industry practice is that most warranty periods commence on the date of substantial completion of the project. Thus, a warranty running from the date of final acceptance departs from prevailing industry practices, extending the warranty further and providing another likely cause of concern for surety underwriters.

For these reasons, we strongly recommend that contracting agencies adopt pragmatic approaches of shorter warranty durations, of one to two years, to be provided by the contractor to the awarding agency, with any longer warranty duration solely provided by the manufacturer, if applicable.

Letter to Mr. Schabarum

December 1, 2010

Page 2 of 2

I hope this letter answers your question. Please feel free to contact me should you need further information or assistance.

Sincerely,

A handwritten signature in cursive script, reading "Larry LeClair". The signature is written in black ink and is positioned above the printed name and title.

Larry LeClair

Director, Government Relations