



June 9, 2008

Mr. John Croswhite, Bond Projects Manager  
La Honda-Pescadero Unified School District  
620 North Street  
Pescadero, CA 94060

***Subject: Pescadero Elementary School Classroom Replacement***

Dear Mr. Croswhite:

The purpose of this letter is to bring to your attention provisions in the La Honda-Pescadero Unified School District's "Pescadero Elementary School Classroom Replacement" project's performance bond. Specifically, the provisions in question are: 1) The performance bond provisions that give an unusually short amount of time for the surety to respond to a claim and; 2) The performance bond provision that obligates the surety beyond the terms of the agreement. Below we delineate our concerns with each provision separately.

***Surety Response Time***

In section 3.1 of the performance bond the surety must confer with the District within 7 days of the notice of default by the contactor. In Section 5 the Surety must act on the outcome of that conference within 20 calendar days of that conference.

First, seven days does not provide sufficient time to evaluate the claim or be a position to reach an agreement with the District on appropriation actions. By extension, 20 days is not sufficient time to begin responding to the claim.

The fact that it takes more time to properly evaluate and respond to a claim has been acknowledged by the Department of Insurance in its Fair Claims Settlement Practices Regulations. Title 10, Chapter 5, Subchapter 7.5, Article 1, Section 2695.7 (b) specifically states:

*"(b) Upon receiving proof of claim, every insurer, except as specified in subsection 2695.7(b)(4) below, shall immediately, but in no event more than forty (40) calendar days later, accept or deny the claim, in whole or in part. The amounts accepted or denied shall be clearly documented in the claim file unless the claim has been denied in its entirety."*

For a surety to meet its contractual obligations, it must have sufficient time to evaluate any claim before acting. Forcing a surety into such a short time-frame for review places the surety and the contractor in an untenable situation.

Surety bonding is a carefully balanced system formalized over decades to ensure appropriate protections and prevent needless conflict. By inserting language that only allows the surety 20 days to investigate and respond to a claim will only lead to litigation as it is not enough time to conduct a thorough investigation.

To ensure that due diligence is achieved as well as to protect the relationship between the school district, contractors, and the surety, we strongly recommend that the District modify its bond forms and provide a more realistic opportunity for a surety to meet its obligations.

### ***Surety's Open-Ended Obligations***

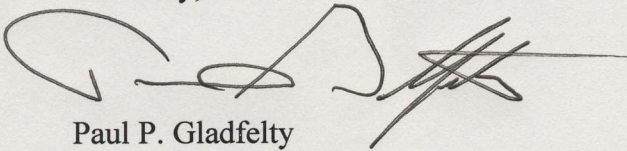
The various provisions in Section 6 are unusual in that they obligate the surety beyond the terms of the agreement. Specifically Sections 6.2 and 6.3 obligate the surety for "additional legal fees"... "delay costs" and....unspecified damages resulting from the default.

The purpose of the surety bond is to provide protections based on a clear set of obligations as delineated in the construction contract. Adding provisions in the performance bond that are open-ended is not common practice and will undoubtedly lead to litigation if a conflict arises.

Including such provisions could also be construed to be punitive as to constitute "unjust enrichment" by going beyond any damage caused by the breach. In addition to the questionable legal status of these provisions, it could have the practical effect of causing some sureties to avoid writing a bond that includes this language, leading to a reduced pool of qualified sureties willing to write such restrictive bonds, costing the District needlessly, and leading to less competition among contractors.

For these reasons, we urge the District to reconsider using these provisions from its bond forms.

Sincerely,

A handwritten signature in black ink, appearing to read "Paul P. Gladfelty". The signature is stylized with a large initial "P" and a long horizontal stroke.

Paul P. Gladfelty

cc: Timothy A. Beard, Superintendent