



February 1, 2017

Mark A. Henry
Vice President, Corporate Development
BAE Systems, Inc.
1101 Wilson Boulevard
Suite 2000
Arlington, VA 22209

Neil M. Turney
President
Puglia Engineering, Inc.
2216 East 11th Street
Tacoma, WA 98401

Dear Mark and Neil:

In 2015, the Port of San Francisco (Port) and BAE Systems San Francisco Ship Repair Inc. (BAE) entered into Lease No. L-15875 (the Lease) to operate a ship repair facility at Pier 70. In early December of 2016, BAE requested the Port's consent to assign the Lease to Puglia Engineering, Inc. (Puglia). Both Puglia and BAE asked the Port to expedite its consent to the assignment so that the transfer would take place by December 31, 2016.

The Port, BAE and Puglia executed a Consent to Assignment (Consent) dated as of December 30, 2016. The Consent states that Puglia shall be bound by all the terms, covenants, conditions, provisions and agreements of the Lease. The Consent also specifies that neither the purchase agreement between BAE and Puglia nor the Consent shall release or discharge BAE from any liability, whether past, present or future, under the Lease or be construed to waive any breach by BAE of the Lease or any rights of the Port as the landlord.

Sections 13.1 and 13.3 of the Lease require the tenant at all times during the term, and at its sole cost and expense, to maintain, repair and replace in good working order and repair the "Port's Equipment" (as defined in the Lease) in accordance with the standards provided in Section 13.3. For Drydock Eureka, these standards include (1) maintaining a minimum commercial lifting capacity of 14,000 tons subject to appropriate third party certifications; (2) maintaining all components of Drydock Eureka; and (3) at all times keeping Drydock Eureka under valid, unexpired third party issued certification with the requisite qualifications and experience to issue such certification. Section 13.3 also includes maintenance standards for the other Port Equipment such as Drydock #2, In-Service Cranes #31, #33 and #35, Out-of-service Cranes #1, #2, #6 and #27, and the Shoreside Power System.

Last week the Port received a copy of a material condition inspection report on Drydock Eureka dated January 19, 2017, prepared by Heger Dry Dock, Inc. (Heger). The report states that the pontoon deck plate has significant diminution in material thickness and the corroded plate in its current condition drastically reduces the transverse strength of the dock. Given these concerns, Heger determined that without a complete pontoon deck replacement, the dock is now in inadequate condition to be rated to a minimum commercial lifting capacity of 14,000 tons, which is a required obligation under the Lease.

The inspection and certification dated November 2015 performed by Heger for BAE details a maintenance plan to be accomplished to keep the Eureka certified and operational. These required repairs and maintenance were categorized as immediate, within six months and within 12 months.

Heger's 2017 material condition inspection report notes that "a pontoon deck repair plan was prescribed by Heger in November 2015" and in Heger's 2017 inspection, BAE made none of the repairs. It appears that BAE did not make the required repairs nor maintain Eureka in good working order and repair, thus exacerbating and accelerating the worsening operational condition. In short, if BAE performed the repairs and regular maintenance required under the Lease and identified in Heger's 2015 inspection, the Eureka would be operational and certifiable today.

On January 30, 2017, the Port received copies of the following documents relating to Drydock #2: (1) a letter dated December 7, 2016 from Heger to Eddie Goldman and Justin Gleaton regarding a request for Heger certification of Drydock #2; (2) an analysis of the wingwall shell plate's as surveyed thickness for Drydock #2 dated December 30, 2016, prepared by Bruce S. Rosenblatt & Associates; and (3) an ultrasonic thickness inspection for Drydock #2 dated December 2016, prepared by DRS Marine Inc. While we have not yet reviewed these documents, they appear to raise concerns about the condition of Drydock #2 and whether it has been appropriately maintained and repaired. In order for the Port to evaluate the tenant's compliance with the repair and maintenance obligations under the Lease, we request that you deliver the following documents and information to the Port no later than February 17, 2017:

1. Copies of all documentation of tenant's compliance with the maintenance standards for Drydock Eureka and the other Port's Equipment identified in Section 13.3; and
2. Copies of all prior inspections and reports relating to the Port's Equipment.

In addition, please confirm the effective date of the transfer and assignment of the Lease from BAE to Puglia; or, if the closing has not yet occurred, please provide a written description of the conditions to closing that remain outstanding.

Mark A. Henry
Neil M. Turney

Page 3 of 3
February 1, 2017

The Port has suffered a loss of revenue due to the decline of its assets resulting from the tenant's failure to perform the repair and maintenance obligations under the Lease. The Port is taking this situation seriously and we reserve the right to pursue all appropriate remedies. We look forward to your response.

Sincerely,



Elaine Forbes
Executive Director

cc: Peter Dailey, Port of San Francisco
Eileen Malley, Office of the City Attorney, City & County of SF
Rona Sandler, Office of the City Attorney, City & County of SF
Ian T. Graham, BAE Systems, Inc. Arlington, VA
Colby W. Smith, Morgan Lewis & Bockius, LLP, Philadelphia, PA
V. L. Scott Hendrickson, Puglia Engineering, Inc., Bellingham, WA
Michael Gerbracht, Puglia Engineering, Inc., San Francisco, CA