



The Commonwealth of Massachusetts
Office of the Inspector General

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Mr. Matthew J. Amorello
Chairman, Massachusetts Turnpike Authority
State Transportation Building
10 Park Plaza
Suite 4160
Boston, Massachusetts 02116

Subject: Surety Bonds – Kemper/Lumbermen's Mutual

Dear Chairman Amorello:

The Office of the Inspector General noticed a discussion of surety bonds in the recent Deloitte Financial Advisory Services (Deloitte) assessment of water intrusion related costs on the Central Artery/Tunnel Project (project). This included a review of surety bonds for 14 construction contracts with a total bonded value of almost \$2.2 billion. Deloitte's findings could have a serious impact on how the cost to repair the many water leaks discovered on the project will be paid. According to Deloitte, no claims have been made against these bonds but the project is exposed in the following areas:

- There could be additional cost exposure if the project is required to make a payment demand under the bonds should one of the contractors file for bankruptcy.
- There may be additional costs if any contractors refuse to make repairs during the warranty period.

Deloitte goes on to state that several surety bonds for the contracts involved with the leak issue have been underwritten by Lumbermen's Mutual (a subsidiary of Kemper Insurance Companies) which, has an A.M. Best Rating of "D" or poor. An A. M. Best rating is an independent opinion based on a comprehensive evaluation of a company's balance sheet strength, operating performance and business profile. The rating is an opinion of the insurer's ability to meet obligation to policyholders.

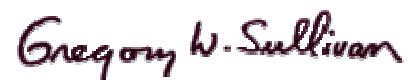
Although Lumbermen's Mutual has a poor A.M. Best rating and is not on the U.S. Treasury approved surety list, we understand from the Deloitte report that the project decided, based on Lumbermen's Mutual being listed by the commonwealth's Division of Insurance as an approved surety, not to request a replacement for Lumberman's.

This office urges the Turnpike Authority to revisit this decision. Companies listed by the Division of Insurance as licensed for surety in the commonwealth represent a diverse group with respect to financial performance and resources. Although most of the licensed insurers are solvent, some have defaulted on their bond commitments to municipalities. The Turnpike Authority does not appear to have been impacted by these defaults.

When a surety company defaults on a public construction project, the taxpayer is exposed financially. The insurance insolvency fund (an association of state licensed property/casualty insurers who are obligated to cover certain claims against insolvent insurers) in Massachusetts does not cover surety losses. To ensure that protection is adequate and that the taxpayers are getting the coverage they are paying for, it is incumbent upon the Turnpike Authority, as project owner to maintain viable coverage. Recently, a multi-state law firm issued a client alert highlighting that Kemper Insurance Companies (or its subsidiary Lumbermen's Mutual Casualty Company) "appears to be in serious financial straits" and that insolvency is possible.

This office urges the project to seriously consider and plan for costs of a Kemper/Lumbermen's Mutual default.

Sincerely,

A handwritten signature in dark ink that reads "Gregory W. Sullivan". The signature is written in a cursive, slightly slanted style.

Gregory W. Sullivan
Inspector General

cc: Julianne M. Bowler, Division of Insurance