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Legal Judgments Put Financial Pressure on Local Governments.

A small rural county in southeast Nebraska might have to declare bankruptcy, not because of mismanagement or high labor costs but because of an unexpected legal judgment that the county government cannot pay.

Gage County on the Nebraska-Kansas border could be the next local government in the nation to file for bankruptcy protection after a federal jury awarded \$28.1 million in damages plus attorneys' fees last July to six people wrongly convicted of a brutal rape and murder.

Leaders from the farming community of about 22,000 people said they can't afford that amount. The county's insurance carriers have declined to cover the verdict.

"No county could prepare for that," Myron Dorn, chairman of the county Board of Supervisors, said in an interview.

Increasing taxes to cover the judgment would be difficult, because Nebraska's property tax cap limits the county from raising taxes by more than about \$3.7 million. Residents could theoretically vote to exceed the state-imposed limit, but that is unlikely.

The county has appealed the verdict and is awaiting a decision; in the meantime, officials have hired bankruptcy attorneys to explore their options in case they lose the appeal.

While municipal bankruptcies are generally rare—only 54 counties, cities, towns, and villages nationwide have filed for bankruptcy since 1980—it's not unusual for lawsuits to contribute to Chapter 9 filings. Of the 18 general purpose local government bankruptcies filed since 2006, legal judgments have been an important factor in five, or nearly 30 percent, according to research by The Pew Charitable Trusts. [General purpose local governments include entities such as counties, cities, towns, and villages and exclude special purpose districts such as school districts or fire districts, which account for a much larger proportion of municipal bankruptcies. Nebraska historically has led the nation in special district bankruptcy filings.]

The legal judgments underscore the importance of local governments maintaining a healthy reserve fund balance to absorb unforeseen expenses. They also reinforce the need for states to be aware of the fiscal health of their local governments, so officials can prepare for situations when the state may need to step in to help. Washington state, for example, asks local governments about "litigation costs or pending legal judgments that risk depleting available fund reserves," to try to anticipate and to plan for potential fiscal shocks.

Elsewhere around the country, Hillview, Kentucky, filed for Chapter 9 in August, 2015, after losing a lawsuit filed by a local truck driving school over a property dispute and being ordered to pay \$15 million. The bankruptcy was dismissed in May, 2016 after city leaders agreed to raise taxes and sell bonds as part of a settlement with Truck America.

Other municipal bankruptcies that were prompted at least in part by lawsuits include:

- Mammoth Lakes, California, filed for bankruptcy in June, 2012, after a property development dispute resulted in a \$43 million legal judgment. Mammoth Lakes later settled with the land acquisition company out of court.
- Boise County, Idaho, was ordered to pay \$5.4 million in damages and attorneys' fees to a developer for violating the federal Fair Housing Act. The county filed for bankruptcy in March 2011, but failed to prove in court that it was insolvent and the bankruptcy was dismissed. The county spent \$2.25 million from its cash reserves and used bond financing to pay the rest. In addition, the Idaho Legislature passed a law to enable the county to levy additional property taxes to repay the bond.
- Washington Park, Illinois, filed for bankruptcy in 2009 after accumulating debts totaling over \$1 million. The village struggled with numerous problems, including public employees stealing money and numerous lawsuits. A federal judge dismissed the bankruptcy, which followed another bankruptcy filing in 2004.
- Westfall Township, Pennsylvania, filed for bankruptcy in April, 2009, after a federal court decided in favor of a developer who had argued that township supervisors illegally halted development of a 1,500-unit residential project.

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