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City of Menasha sued after defaulting on bonds

By Rick Romell of the Journal Sentinel

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Investors are suing the City of Menasha in the wake of its default on financing for an ill-fated power plant project that has seen the Fox Valley community's credit rating sink to junk status.

The lawsuit, filed in federal court in Indiana, accuses Menasha of misrepresentations in seeking financing to convert part of a municipal power plant into a coal-fired, steam-generating facility intended to serve four nearby paper mills.

The project ended up costing more than three times the initial estimate, while revenue from the steam plant has fallen short and the operation has encountered potentially costly environmental issues.

Now, the city is poised to shut down the plant, whose revenue was supposed to secure \$24.2 million in notes.

Defaults such as Menasha's are unusual. Nationwide from 1970 through 2006, there were only seven defaults by local and state governments that had been rated by Moody's Investors Service, one of the country's leading credit-rating organizations.

"The bondholders feel disappointed with the City of Menasha," said Michael A. Wukmer, an Indianapolis lawyer representing the investors who have filed suit.

Those investors - Wisconsin's American Bank; Lafayette Life Insurance Co. of Lafayette, Ind.; and Mercy Ridge Inc., a Maryland retirement complex partly owned by the Catholic Archdiocese of Baltimore - collectively hold \$7.1 million of the \$24.2 million in notes Menasha issued in 2005 and 2006, according to the complaint. The three organizations are asking that their case be made a class action covering all note holders.

Menasha defaulted on the notes on Sept. 1. The city paid the interest it owed but only \$1.4 million of the \$24.2 million in principal due, according to a Moody's report.

Eleven days earlier, Moody's had downgraded its general obligation rating on the city for the second time in three months. The latest action placed the city's rating well below investment grade and in a territory where Moody's considers it likely that a municipality will need extraordinary support such as a bailout from a higher level of government.

Menasha's current problems date to a 2004 decision to refashion its power plant to generate cut-rate steam for four nearby paper mills. The idea, according to a Moody's report, was to preserve the local economic base by helping major employers.

But the project ended up costing more than \$40 million - not the \$12.7 million originally estimated. Costs to correct environmental deficiencies cited by the state Department of Natural Resources would add as much as another \$1.5 million, Moody's said.

With a consultant advising that the steam plant couldn't generate enough money to pay its operating costs, to say nothing of the millions in debt, the Menasha Common Council recently voted to shut the facility down.

In their lawsuit, the investors allege Menasha misrepresented the plant's potential customer base, the terms of the city's agreements with steam users and the status of environmental permits. The suit also accuses the city of improperly diverting money that should have gone to the note holders.

Menasha Mayor Donald Merkes declined to comment Monday, saying lawyers for the city were reviewing the litigation. In a notice to bondholders last week, the city said it will "vigorously defend" itself against the claims in the lawsuit. The notice, posted on the city's Web site, says the city is seeking to work out an agreement with the note holders.



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