

Bond Case Briefs

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Illinois Bonds Gain as Judge Denies Petition to Void Debt.

- **Tillman, who sought to file lawsuit, says he plans to appeal**
- **'Risk is taken off' for bondholders, Belle Haven says**

Illinois bonds rallied after a judge denied an effort by the head of a conservative think tank to invalidate more than \$14 billion of debt issued by the worst-rated state.

Sangamon County Associate Judge Jack Davis late on Thursday rejected the petition filed by John Tillman, head of the Illinois Policy Institute, and backed by Warlander Asset Management, a New York-based hedge fund, that sought to "restrain and enjoin the disbursement of public funds," according to court documents. Tillman had claimed that Illinois's record pension bond sale in 2003 and debt issued in 2017 were deficit financing that violated the state constitution, which says bonds must be issued for "specific purposes."

"The court finds that to allow the filing of the Complaint would result in an unjustified interference with the application of public funds," Davis wrote in an order on Thursday. "The court finds reasonable grounds do not exist for filing the proposed Complaint."

Tillman said in an emailed statement that he plans to appeal and "strongly" disagrees with the court's decision, adding that it was "premature for the Court to decide the case on the merits at the petition stage."

Some of the bonds targeted by the suit, which had been trading at slightly lower prices than other Illinois securities, gained after the decision. Bonds sold for the pension system that come due in 2033, one of the most actively traded, traded for about 109 cents on the dollar early Friday, up from an average of about 106 cents before the ruling. That cut the yield to about 4.25% from 4.5% on Wednesday.

"There was an inefficiency in the market based on the potential for the bonds being invalidated," said Brian Steeves, portfolio manager for Belle Haven Investments in Rye Brook, New York. "That risk is taken off the table."

During a hearing on Aug. 15, Davis had said Warlander backing the case was a distraction, and the issue warranted further review. The judge had said at the time he would issue an order in 14 days.

"Tillman's proposed Complaint is chock-full of conclusory and argumentative statements describing the financial condition of the state that are irrelevant and which the court must disregard," Davis wrote on Thursday. "Indeed, it resembles far more of a political stump speech than it does a legal pleading."

Illinois officials had rejected the suit as politically-motivated and said the borrowings were valid.

Bondholders Nuveen Asset Management LLC and AllianceBernstein LP had alleged that Warlander, which also owns Illinois debt, stood to profit if the case succeeded because the hedge fund purchased credit-default swaps that would pay off if the court forces the state to stop making

payments on the 2003 and 2017 debt. An attorney representing Warlander and Tillman acknowledged at an Aug. 15 hearing that the hedge fund bought credit default swaps on the challenged bonds.

Hedge Fund Seeking to Void Illinois Debt Made Wager on Default

The case had been closely watched as litigation is a new risk for investors in the \$3.8 trillion U.S. municipal-bond market, long considered a haven given that no state has defaulted since the Great Depression. Borrowers are under increasing scrutiny after high-profile municipal bankruptcies such as the one in Puerto Rico, where a federal oversight board and group of hedge funds want more than \$6 billion of bonds declared null and void.

“There was no question that they were” issued legally in Illinois, said Chris Mier, chief strategist at Loop Capital. He said a trial over the bonds would have been “a television soap opera for finance people.”

Mier said the decision is reassuring because the municipal-bond market would not have to deal with the ramifications of another major lawsuit. Puerto Rico’s record-setting bankruptcy has cast doubt over the legal protections investors have in the safe-haven market.

It’s “one less sideshow that market does not need,” Mier said.

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