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WSJ: Illinois Supreme Court Rules Against Cuts in Retiree Health Benefits.

CHICAGO—A ruling by the Illinois Supreme Court Thursday is casting new doubts on an overhaul of the public employee retirement system that passed last year to prop up the state's deeply underfunded pensions.

The court ruled health-insurance subsidies for retired state workers are protected under the Illinois Constitution, siding with public-sector unions who challenged cuts to the benefits passed by lawmakers two years ago. The decision set off renewed debate over the constitutionality of a larger overhaul of the retirement system, which passed last fall and is being challenged by state workers and retirees on similar grounds.

"If the court's decision is predictive, the challenge of reforming our pension systems will remain," state Senate President John Cullerton said.

Gov. Pat Quinn stood by the pension law, which reduces future retirement costs by shrinking cost-o--living increases for retirees, raising retirement ages for younger employees and capping the size of pensions. He said he expects the law will survive the legal challenge that's pending.

The pension changes came after nearly three years of grueling debate, during which the state's credit rating fell to the lowest among U.S. states. Illinois has underfunded its retirement system for decades, and the shortfall has grown to $100 billion. Chicago also is watching state-level decisions that could affect the city, which is trying to close its own yawning gap between current assets and promised retirement benefits.

Courts are playing a key role in several states in determining just how far lawmakers can go in cutting pension benefits for workers and retirees as they try to stabilize funds and reduce future costs.

In Illinois, lawyers for state workers and retirees took Thursday's decision as a sign the state's top court will hold true to the constitution, which explicitly forbids the diminishment of pension benefits once they're promised. But Illinois Attorney General Lisa Madigan in a statement said the arguments are different in the larger pension overhaul case and aren't directly affected by Thursday's ruling.

A spokeswoman for Chicago Mayor Rahm Emanuel said the court ruling doesn't affect city efforts to address pension or health-care costs.

Still Christopher Mooney, director of the Institute of Government and Public Affairs at the University of Illinois, said the 6-1 ruling likely means the court will scrap the larger overhaul. The case for allowing reductions in health benefits was stronger than what the state will argue when defending the larger cuts in pension benefits, he said.

"We're basically back to square one. They are going to have to figure out something else," he said.

Illinois’s 10-year general obligation bonds were unchanged Thursday, according to Thomson Reuters Municipal Market Data. Trading was light ahead of the Independence Day holiday.

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Updated July 3, 2014 4:23 p.m. ET

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