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Illinois Withstands Legal Challenge to \$14 Billion Bond Deals.

Court says free-market advocate waited too long to challenge 2003 and 2017 bond sales as unconstitutional

The highest court in Illinois rejected litigation seeking to block the state from making further payments on \$14.3 billion in municipal debt, saying a free-market advocate waited too long after the bonds were sold to challenge their legality.

John Tillman, chief executive of the right-leaning Illinois Policy Institute, had “no excuse” for his delay in filing litigation claiming that Illinois breached its constitutional limits on debt issuance with bond sales in 2003 and 2017, the Illinois Supreme Court said in a unanimous ruling Thursday.

Mr. Tillman challenged the bonds in 2019, when he sought a court order declaring their issuance unconstitutional and prohibiting the state from making further payments.

Mr. Tillman said Thursday he was disappointed in the court ruling and is “evaluating options as to how to proceed from here.”

“In the interim, I continue to be profoundly concerned about Illinois’s reckless debt accumulation,” he said.

A foe of public-sector unions, Mr. Tillman in his lawsuit argued that the Illinois constitution bars the state from taking out long-term debt except for “specific purposes” or to refinance longer-term debt. He said the state went outside those limits when it borrowed in 2003 and 2017 to bridge deficits and fund pensions.

Illinois has the lowest credit rating of any U.S. state, largely due to its huge pension burden, and was the only state to tap the Federal Reserve’s emergency pandemic lending facility.

Yet despite the state’s financial woes, demand for municipal debt has been so intense that Illinois sold three-year bonds in mid-March at yields of near 1%.

Mr. Tillman was supported earlier in the litigation by an Illinois bondholder that had also purchased insurance that would pay out after a potential default. Other bondholders sided with the state, saying that letting activist investors challenge the validity of widely held bonds based on side bets would destabilize the municipal-bond market.

In Thursday’s ruling, the justices said that granting Mr. Tillman’s request “would amount to a de facto default on outstanding bonds that are backed by the full faith and credit of the state” or at least hurt its credit rating, the decision said.

Illinois Comptroller Susana A. Mendoza, a defendant in the litigation, praised the justices’ ruling and said the lawsuit was aimed at “tanking Illinois’s finances” so that “named or unnamed hedge funds”

would profit.

“The taxpayers of Illinois should not have to suffer financial Armageddon just so rich people who bet against Illinois can profit,” Ms. Mendoza said.

No state has failed to pay bondholders since Arkansas in 1933, although the island territory of Puerto Rico defaulted in 2016 and was placed under a court-supervised bankruptcy.

Bankruptcy isn’t an option for states under current law. Illinois’s finances have been strained for years, pushing its bond rating to the brink of junk territory as pension obligations ballooned and a budget stalemate from 2015 to 2017 resulted in billions of dollars in unpaid bills.

“All Illinoisans should care about this,” Mr. Tillman said. “If the state doesn’t tackle pension reform now, it will slide into a fiscal crisis beyond repair that will threaten not only taxpayers and the people who depend on government services, but also people who are counting on their public-sector pension in retirement.”

The lawsuit had drawn fierce responses from state officials including Democratic Gov. J.B. Pritzker, who accused Mr. Tillman of a “pathological focus to drive Illinois into bankruptcy.”

The 2003 bond sale that Mr. Tillman challenged raised money to prop up Illinois pensions, in the hope that investment returns would exceed the interest payments to bondholders. The 2017 issuance funded back payments to stretched government vendors.

A trial-court judge initially dismissed the complaint in 2019, saying it risked “an unjustified interference with the application of public funds” and would draw the courts into political questions best left to lawmakers. An appeals court reinstated Mr. Tillman’s claim last year on the basis that it wasn’t frivolous or malicious, before its final dismissal Thursday.

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By Andrew Scurria

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