

Illinois consent decrees shake-up payment priorities

By Gunjan Banerji and Andrew Scurria

12 February, 2016

The **Illinois** governor can't simply overturn consent decrees to cure the state's cash crunch, said two public finance attorneys. As the state continues without a budget, it enters unprecedented, and muddled, territory regarding which payments to make first.

A consent decree is a public settlement that requires certain actions by defendants in a case. For Illinois, the decrees have mandated state funding for human services providers and other state agencies. Over a year ago, the state lost USD 3.6bn in revenue after a temporary income tax expired. Compiling Illinois' problems, lawmakers have not passed a budget for FY16. The state operates through a series of consent decrees and court orders alongside legislature-approved education spending.

Recently, Governor Bruce Rauner (R) publicly stated that he hopes to overturn the various decrees governing state spending, a concept that may hold no legs in Illinois courts. However, as the state continues to suffer without a budget and spending outpaces revenues, which payments to prioritize is not crystal clear.

Comptroller plays God

The comptroller has been distinguishing between constitutional mandates and judicial mandates, said Much Shelist attorney and former Illinois associate general counsel Bob Morgan. That's not her job, Morgan added.

Deciding which bills to pay is a daily task, said a spokesperson for Illinois Comptroller Leslie Munger. Each day the state receives a certain amount of revenue and evaluates the obligations that it must pay against the additional obligations that have come in, the spokesperson said. The first payment to come in is usually the first payment to be paid out. Currently the state is making payments that came in on 21 December, the spokesperson said.

Meanwhile, money for larger payments such as pensions and debt service is accrued, the spokesperson said. On average, the office receives around USD 100m in revenue a day.

The lowest-rated-state's backlog of bills is projected to climb to USD 9bn by the end of FY16, and USD 25bn by FY19, according to the governor's office of management and budget's three-year budget projection. This figure includes ongoing debt service and pension payments. Moody's Investors Service rates Illinois' USD 26.5bn in outstanding general obligation debt Baa1/negative while Standard & Poor's assigns it an A-/negative rating.

Consent decrees

Overturning consent decrees as Rauner has suggested may not be the budget panacea the governor hopes it will be.

"Getting dismissed from a consent decree is a tall order," said Clark Hill attorney John Schomberg, adding that the mandates cannot be unilaterally reversed by a defendant subject to its terms. Schomberg was general counsel to former Illinois Governor Pat Quinn until 2015.

Illinois is bound to these agreements, agreed Fox Rothschild attorney William Choslovsky. Choslovsky intervened in a case on behalf of developmental disability providers and against the Illinois comptroller regarding human services payments that were neglected during the budget impasse. The case escalated to federal court.

If Illinois doesn't comply with court orders and consent decrees, it risks being held in contempt of court and strapped in even more controlling or draconian measures by the court, including the risk of special masters and monitors being put in place to direct the state and carry out orders of the court, Schomberg and Morgan said.

Additionally, getting dismissed from a consent decree does not mean that a government defendant no longer has to provide the service levels outlined on an ongoing basis—such rights and services are still required by law, said Schomberg and the American Civil Liberties Union's Ed Wohnka. The ACLU represents clients in five Illinois consent decrees. It just means that the court's ongoing oversight and the plaintiffs' quick path for enforcement are no longer in place, Schomberg said.

"The larger unknown is what happens if you have dueling court orders/consent decrees making demands on the same limited dollars," Schomberg said.

Prioritizing debt and decrees, so far

The state has had to make some choices. While the Illinois legislature is supposed to start discussions on an FY17 budget soon, it has still not reached agreement on FY16 finances, causing the state to accrue unpaid bills and leave its local municipalities hanging, in many cases.

The two items that the state has prioritized thus far are consent decrees/court orders and bond payments, Schomberg said. Comptroller Munger delayed a USD 560m pension payment in November 2015, promising to make it up in the spring. Pension payments are not subject to any outstanding consent decrees.

Illinois will make the delayed November pension payment in March or April of this calendar year as planned, said the comptroller's spokesperson. It is required under state law to contribute to its pension systems by the fiscal year-end on 30 June, as reported.

The Midwestern state is shorting public universities and human services and other areas of government USD 5.1bn, according to the Civic Federation.

Default scenarios

"We're in this netherworld of not having a budget for many months," Wohnka said. "There's a lot of strain and stress at various levels. It's confusing."

A consent decree is a type of settlement that Illinois agrees to because the state already determined that if it went all the way to a court trial, it wouldn't prevail, Wohnka said.

But, in a default scenario, it's impossible to predict which of the state's obligations would have to be satisfied first, Morgan said. The state's obligations under the federal and state court orders are "substantively different in their origin." While consent decrees are a federal matter, the

state's pension contributions are governed under Illinois law, on which the state Supreme Court has the final word.

There is no precedent on whether a federal or state court order would take primacy if there were competing claims on Illinois' resources, said Tabet DeVito & Rothstein pension attorney John Fitzgerald. As a state, Illinois cannot file for bankruptcy, where a judge would normally sort out competing post-petition claims.

If the state were unable to make the pension payments due at the FY16 close, retirement systems or unions could sue to collect. But there is a wrinkle: To have legal standing to enforce the funding statutes, the systems must be on the brink of insolvency, Fitzgerald said.

But, it's not clear what the brink of insolvency means, Fitzgerald said, and no state court has ever allowed a union or a pensioner to enforce statutory funding requirements.

"The situation is highly ambiguous and we are reaching a degree of chaos that is unusual even for Illinois," Fitzgerald said. "Oftentimes you assume that some order from a federal court would trump some contrary order from a state court, but it's not always that simple."

Other options

Illinois lawmakers may have to find other creative ways to manage its cash flow. The state's revenues through FY19 are projected to dwindle by 4.5% to USD 34.2bn in FY19 from USD 35.8bn in FY15 as its expenditures rise by 11.1% to USD 39.3bn in FY19 from USD 35.4bn in FY15, according to the three-year budget projection.

While the General Assembly passed and the governor signed a K-12 education budget for FY16, it is possible for the state, via the Illinois State Board of Education, to lower their payments to school districts in coming months to manage cash flow issues, said the Center for Budget and Tax Accountability's Bobby Otter. Most of those funds are considered grants.

Illinois lawmakers passed legislation to help the state with cash flow issues under former Governor Quinn, giving the state six months rather than two months to catch up on the last fiscal year's contractual obligations. The state has already been tapping this law to manage cash flow and plans to use this mandate again, said the comptroller's spokesperson.

Last year, the Illinois legislature swept a number of different funds in order to make it through the fiscal year. The state legislature could do this again, Otter said. However, this would require an agreement between the general assembly and governor, Otter said.

The governor's office did not respond to a request for comment.