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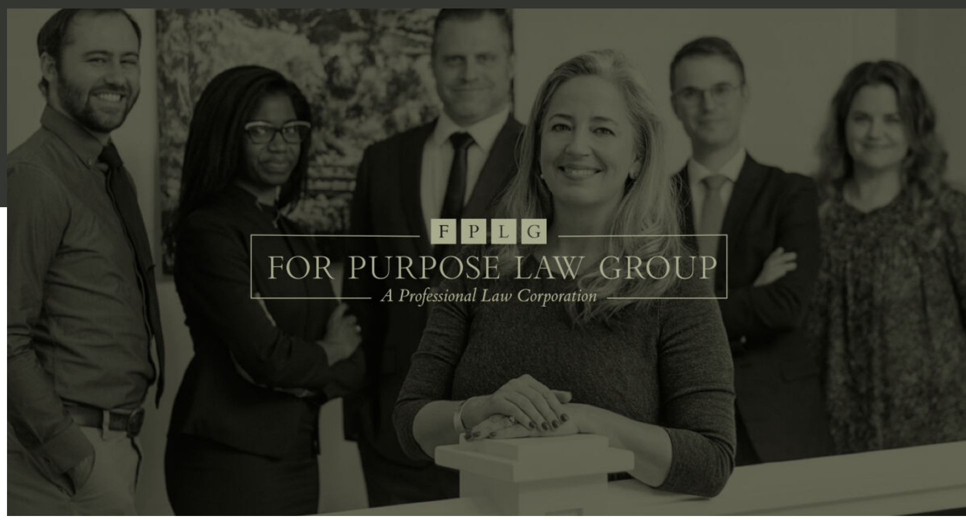
Charities in the Courtroom, Part 7: Yanking Money from Tight Fists

05.30.17 | Linda J. Rosenthal, JD



"You can't get blood out of a stone."

Apparently, that idiom was "first recorded in Giovanni Torriano's *Second Alphabet,* 1662: "To go about to fetch bloud out of stones, viz. to attempt what is impossible."

Times have changed. There are much better lawyers in 2017.

Breach of Contract Lawsuit With a Marital Twist

Like many other states, Illinois has had trouble recently making ends meet.

For at least two years now, the state has been in the throes of an ugly, unrelenting, budget impasse. At the center of this turmoil have been the Democratic legislative leaders and the GOP governor, Bruce Rauner.

There are occasional stop-gap – temporary – fixes, but this lingering financial stalemate has caused a great deal of pain for anyone who wants to get paid by the state: employees and contractors, alike. We reported in "More Nonprofit Woes from State Budget Troubles" that 501(c)(3)s including social service agencies and universities, that contract with the state and depend on it for funding have been particularly hard-hit.

State employees previously filed suit to get paid, and won. Social service organizations have been less successful. but they are trying again now.

A coalition of some 37 social service agencies banded together last year to form Pay Now Illinois. They filed a lawsuit in Cook County in 2016, but a judge dismissed the case and it is on appeal. They are trying again, this time in downstate St. Clair County, where a judge last year approved the payment for state employees. The argument of Pay Now Illinois is that state contractors as well as state employees deserve to get paid for their work.

Having to resort to litigation to collect money owed is undoubtedly particularly galling to the leader of one of these plaintiff-agencies. Heading an early childhood support program called Ounce of Prevention is Diana Rauner, the governor's wife.

According to Pay Now Illinois spokesperson Andrea Durbin,

> *Right now, nobody doing business with the State of Illinois can be certain of getting paid. And that is no way to run a business....If the state can get away with not paying our contracts, does any contract holder have security that the State's word is good?"*

"Within a jurisdiction," she adds, "they're supposed to be consistent. We're asking the court why the state employees can be paid without a budget, and why vendors have not. We're just asking for equal treatment."

Last year's successful employees' lawsuit relied on the theory that Illinois is breaching the constitution's contract clause. Pay Now Illinois is now using that argument as well as a few additional claims, including that the "state's failure to pass a balanced budget is unconstitutional, removing the security to contract holders that they will be paid."

When asked about this new lawsuit, the "governor's office refused comment." His position has been that "he'll work to make sure state employees are paid – even absent a budget, but he has argued against the same treatment for vendors such as his wife's Ounce of Prevention."

Bankruptcy Creditor Lawsuit

In 2014, New York was rocked by a huge scandal: the Federation Employment and Guidance Service (FEGS), the city's largest social service agency failed – seemingly out of the blue. "Onlookers were shocked and more than a little confused" as the agency suddenly announced it had lost $20 million and needed to close.

This abrupt demise left a trail of wreckage. "Its programs and clients were dispersed to other local agencies, as was some portion of the massive staff, many of whom were low-paid direct care employees. Creditors were also left in the lurch as the organization filed for bankruptcy."

There's a new development, though. As part of the continuing bankruptcy proceedings, creditors are now suing some of the principals, along with the FEGS accounting firm.

The former executive vice president, Ira Machowsky, and the former president, Gail Magaliff, may be held liable for "negligence and breach of duty." Loeb & Troper, the accountants, may be held liable for "negligence and aiding and abetting breaches of fiduciary duty."

There are colorful details that will no doubt play a role in this aspect of the bankruptcy proceedings. For instance, Mr. Machowsky (whose annual compensation was over $500,000) received a $92,000 bonus only a month before FEGS revealed its troubles. And Ms. Magaliff sued the estate of the defunct social services agency for $1.2 million in deferred compensation; she also tried to skip ahead of other creditors.

Other employees who earned far less –

> *also have claims for unpaid severance and vacation time, and there will not be enough to pay all such claims off. For instance, Gina Thomas, a 53-year-old case manager for people with mental illness, was laid off after 28 years and is owed $11,000. 'I laughed,' said Ms. Thomas at the time. 'Then I got angry.'*