

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

Minutes of June 25, 2014 Meeting

The Buckeye Tobacco Settlement Financing Authority (the Authority) held a meeting commencing at 2:30 p.m. on Wednesday, June 25, 2014, in the 35th Floor Conference Room, Office of Budget and Management, James A. Rhodes State Office Tower, 30 East Broad Street, Columbus, Ohio, pursuant to notice of meeting given by the Secretary of the Authority pursuant to Section 4.2 of Bylaws.

*[Copies of the items marked * are attached hereto and made a part of these minutes.]*

The Chairman called the meeting to order.

Mr. Kauffman, as Assistant Secretary, reported that since the last meeting of the Authority a new designation, pursuant to Section 183.52 of the Revised Code, had been filed by the Treasurer of State designating Seth Metcalf or Dana Wasserman, in the alternative.

Pursuant to Section 3.1 of the Bylaws, Mr. Grodhaus presided as Chair of the meeting. Upon roll call, the Chairman declared a quorum to be present. The following member and designees of the Authority, eligible to vote at the meeting, were present:

Michael Grodhaus, Office of the Governor

Timothy S. Keen, Office of Budget and Management

Dana Wasserman, Treasurer of State

Also present were Kurt Kauffman, Larry Scurlock and Cassie Sanfrey (Office of Budget and Management); Ryan Bilsky, Katie O'Brien and Lisa Eisenberg (Treasurer's office); Greg Stype (Squire Patton Boggs); and Carol Mosholder (Attorney General's Office).

The Assistant Secretary filed the certificate of compliance* with the public meeting notice provisions of Section 121.22 of the Revised Code.

Mr. Grodhaus requested approval of the June 19, 2013 meeting minutes. Mr. Keen moved, seconded by Ms. Wasserman, to approve the minutes of the June 19, 2013 Authority meeting. There being no discussion, the motion was approved upon roll call as follows: Ayes – Grodhaus, Keen, Wasserman; Nays – None. The Chair declared the motion passed.

Mr. Kauffman provided an overview of the fiscal year (FY) 2013 financial statement preparation and audit process and presented a brief summary of the audit results.* Mr. Kauffman noted that the FY 2013 audit opinion was 'unqualified,' that no material weaknesses or deficiencies in internal controls nor any instances of noncompliance with material laws or regulations were identified, and that the Authority did not receive a management letter.

Mr. Kauffman then presented an update on the tobacco settlement receipts (TSRs) received in calendar year (CY) 2014.* He explained that CY 2014 receipts were lower than CY 2013 receipts by \$4.9 million or 2.0% and that the reasons for the decline, though speculative, include higher cigarette taxes in several jurisdictions across the country and a possible substitution effect involving e-cigarettes that are not covered by the tobacco MSA. Mr. Kauffman noted that the TSRs along with estimated interest earnings on the Senior Liquidity Reserve Fund (Reserve Fund) and other pledged accounts are insufficient to fully pay the annual debt service for 2014. Barring the receipt of additional revenue in the near-term (e.g., a release from the disputed accounts), the consequence of this debt service shortfall is an anticipated December 1, 2014 draw on the Reserve Fund of an estimated \$31-32 million. This action would lower the Reserve Fund balance on that December 1,

2014 date to approximately \$339 million. A voluntary notice notifying bondholders of the potential 2014 draw on the Reserve Fund has already been released.

On behalf of the Treasurer's office, Mr. Bilsky then presented an overview of the current investment options for the Reserve Fund and considerations in choosing appropriate investments. He explained that the Reserve Fund is currently invested in short-term, high-grade commercial paper maturing every six months in advance of each distribution date. Mr. Bilsky further explained that the decision to invest in high-grade commercial paper balanced the need for safe, highly-rated and qualified investments with the desire to increase return and that commercial paper generally offered 6-10 basis points more in yield than comparable U.S. Treasury and Agency securities. Mr. Bilsky also explained that the Treasurer's office plans to continue with this approach to comply with the investment parameters of the Trust Indenture.

Ms. Wasserman then provided an update on the status of the Authority's claim regarding the Forward Delivery Agreement for investment of the Reserve Fund that was terminated in October 2008 due to a provider default. Ms. Wasserman explained that six years later the Authority is participating in a court-ordered mediation process in an attempt to settle the claim. The first mediation session was held May 30, 2014 and concluded with no progress being made toward a resolution or settlement. Both the Authority and the provider were asked to and have submitted a report to the mediator and are awaiting the mediator's ruling at which time the next steps will be determined. In response to a question from Mr. Grodhaus, Mr. Stype explained that the mediation was non-binding and next steps could include additional mediation or litigation of the claim through the court.

Ms. Wasserman then provided an update, pursuant to a motion passed at the last meeting of the Authority, on the release of the RFP for preparation of the Authority's financial statements and the selection by the Treasurer's office of Rea & Associates. Ms. Wasserman explained that based on the assessment of staff pursuant to the evaluation criteria set forth in the RFP, Rea & Associates was determined to be the lowest qualified bidder and the Treasurer has negotiated and entered into a contract with that firm.

Ms. Mosholder then gave a presentation regarding the status of arbitration relating to tobacco settlement payments that were disputed by tobacco manufacturers and deposited into the disputed payments account. She reminded the Authority that with respect to the arbitration process for the 2003 Non-Participating Manufacturer (NPM) adjustment, Ohio was successful having been found to have diligently enforced its model statutes. As a result, Ohio's 2014 TSRs included releases of certain monies from the Disputed Payment Account (DPA) that were deposited in 2006 in connection with 2003 sales (i.e., there is a three-year lag between the NPM adjustment year and the payment year). Ms. Mosholder addressed the 2004 NPM adjustment arbitration noting that the 29 states including Ohio that have not yet settled for that year have begun discussions with the tobacco manufacturers to establish procedures and to select the arbitration panel. Following the presentation, the Authority asked clarifying questions regarding the chance of revisions to the non-pledged amounts paid to Ohio in connection with the 2003 NPM adjustment and the possible timing of future arbitration decisions.

Mr. Scurlock then presented the Authority's operating budget for FY 2014 and its proposed operating budget for FY 2015.* He began by reviewing the FY 2014 year-to-date expenses, noting year-to-date under spending relative to the budgeted amount is largely due to fees and expenses of the quantitative consultant which have not yet been submitted for payment. Mr. Scurlock explained that the FY 2015 budget is comparable in total to the FY 2014 budget with lower financial

statement preparation costs offset by higher estimated legal fees as we work through the Authority's Reserve Fund claim.

Mr. Grodhaus requested a motion to approve an increase of 10% in the annual fee for bond trustee services. In discussion, Mr. Kauffman noted the original RFP for bond trustee services did not address annual increases nor did any of the three proposals submitted in response to that RFP. He further explained that the annual trustee fee was currently \$500 and that this increase was a one-time adjustment that would increase that annual fee to \$550 going forward. There being no further discussion, the motion was brought for a vote and was approved upon roll call as follows: Ayes – Grodhaus, Keen, Wasserman; Nays – None. The Chair declared the motion passed.

In other business, Mr. Kauffman noted that the IRS closed its audit of the Authority's 2007 Bonds with no change in the determination that the interest on those Bonds is exempt from the federal income tax.

There being no further business, the meeting was adjourned.

Timothy S. Keen, Secretary
Buckeye Tobacco Settlement Financing Authority