

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

Minutes of June 19, 2013 Meeting

The Buckeye Tobacco Settlement Financing Authority (the Authority) held a meeting commencing at 2:00 p.m. on Wednesday, June 19, 2013, 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 no new designations, pursuant to Section 183.52 of the Revised Code, were filed since the last meeting of the Authority.

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

Seth Metcalf, Treasurer of State

Kurt Kauffman, Office of Budget and Management

Also present were Dana Wasserman, Ryan Bilsky, and Katie O'Brien (Treasurer's office); Larry Scurlock, Cassie Sanfrey, and John Sohner (Office of Budget and Management); Greg Stype (Squire Sanders); Bill Kennedy (Kennedy Cottrell Richards); 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 15, 2012 meeting minutes. After discussion, Mr. Metcalf moved, seconded by Mr. Kauffman, to approve the minutes of the June 15, 2012 Authority meeting. There being no discussion, the motion was approved upon roll call as follows: Ayes – Grodhaus, Kauffman, Metcalf; Nays – None. The Chair declared the motion passed.

Mr. Kauffman provided an overview of the fiscal year (FY) 2012 financial statement preparation and audit process and presented a brief summary of FY 2012 audit results.* Mr. Kauffman noted that the FY2012 audit opinion was 'unqualified,' that no material weaknesses or deficiencies in internal controls were identified, and that they did not receive a management letter. In response to a question, Mr. Kennedy talked briefly about the factors that contributed to a negative net asset value in the Authority's FY 2012 income statement.

Mr. Kauffman then presented an update on the tobacco settlement receipts (TSRs) received in calendar year (CY) 2013.* He explained that CY 2013 receipts exceeded CY 2012 receipts by just \$0.3 million or 0.1%. 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 2013. 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, 2013 draw on the Reserve Fund of an estimated \$13.7 million. This action would lower the Reserve Fund balance to approximately \$369 million. Mr. Grodhaus asked if there were would be any market issues with dipping into the Reserve Fund. Mr. Kauffman noted that this

is not an event of default under the Trust Indenture, but would constitute a material event requiring notice to bondholders. A voluntary notice notifying bondholders of the potential 2013 draw has already been released.

Mr. Metcalf then presented an overview* of the current investment options for the Reserve Fund and considerations in choosing investments. He explained that the Reserve Fund is currently invested mostly in short-term, high-grade commercial paper maturing every six months in advance of each distribution date. Mr. Metcalf further explained that the Treasurer's Office plans to continue with this approach to comply with the investment parameters of the Trust Indenture and to ensure liquidity on potential draws from the Reserve Fund.

Mr. Metcalf then provided an overview of the May 2, 2013 Request for Proposals (RFP) for selection of a quantitative consultant for the calculation, valuation, and collection of the Authority's claim on the Reserve Fund. He stated that based on the RFPs received, TOS recommends selecting Public Financial Management. After some discussion, Mr. Metcalf moved the motion, seconded by Mr. Grodhaus, to (i) approve the selection of Public Financial Management and (ii) authorize the Treasurer, in consultation with the Attorney General's office, to take all necessary and appropriate steps to resolve the Reserve Fund claim, including the execution of any agreements on behalf of the Authority. The motion was approved upon roll call as follows: Ayes – Grodhaus, Kauffman, Metcalf; Nays – None. The Chair declared the motion passed.

Mr. Metcalf then moved the motion, seconded by Mr. Kauffman, to appoint Dana Wasserman as the Assistant Treasurer of the Authority to assist with the duties of the Treasurer. There being no discussion, the motion was approved upon roll call as follows: Ayes – Grodhaus, Kauffman, Metcalf; Nays – None. The Chair declared the motion passed.

Next, Mr. Kauffman discussed the motion to approve renewal of the contract with Kennedy Cottrell Richards (KCR) for preparation of the Authority's financial statements for the fiscal 2012-2013 biennium. Mr. Kauffman noted that the original contract with KCR was for a six-year and is subject to renewal every two years. Mr. Metcalf moved, seconded by Mr. Grodhaus, to approve renewal of the KCR contract. The motion was approved upon roll call as follows: Ayes – Grodhaus, Kauffman, Metcalf; Nays – None. The Chair declared the motion passed.

Mr. Metcalf then gave a brief overview of the RFP for preparation of the Authority's annual financial statements for FY's 2014-2019. Mr. Metcalf moved, seconded by Mr. Grodhaus, that the Treasurer is authorized to (i) distribute the RFP (including advertising its availability) in substantially the form previously provided to the Authority members, (ii) direct staff to review and evaluate the proposals received for their compliance with the RFP and recommend the firm having submitted the best proposal based on the criteria set forth in the RFP, with that recommendation reported to the Authority members, and (iii) negotiate and enter into a contract with the firm submitting the best proposal in accordance with the RFP. The motion was approved upon roll call as follows: Ayes – Grodhaus, Kauffman, Metcalf; Nays – None. The Chair declared the motion passed.

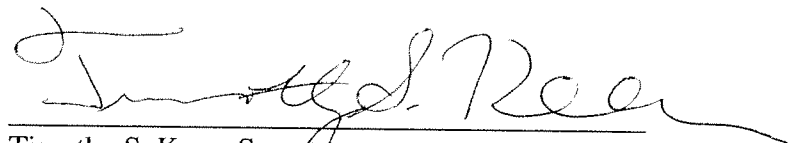
Ms. Mosholder then gave a presentation regarding the status of arbitration relating to tobacco settlement payments that were disputed by tobacco manufacturers and are currently being held in the disputed payments account. The Attorney General's office prepared a memo* providing some background on the Master Settlement Agreement (MSA) and its Non-Participating Manufacturer (NPM) provisions and updating the status of current arbitration process relating to the NPM adjustment. Ms. Mosholder explained there are amounts potentially due and payable to Ohio that have been deposited in "disputed payments accounts" or otherwise withheld by the participating manufacturers as provided for under the MSA. She explained the 2003 Non-

Participating Manufacturer Adjustment (NPM Adjustment) arbitration process wrapped up in May and a decision is expected by the end of the summer. Ohio's individual case hearing was in October 2012 and Ms. Mosholder felt that Ohio presented its case well. Ms. Mosholder noted that there is a three-year lag between the NPM adjustment and the payment year, such that the 2003 NPM Adjustment affects the 2006 MSA payment. Ms. Mosholder stated her intent to timely report to the Authority once the decision on the 2003 NPM Adjustment is decided. Following the presentation, the Authority asked clarifying questions regarding upside and downside risk, the impact of the NPM term sheet recently signed by several States and the possible timing of arbitration decisions.

Mr. Scurlock then presented the Authority's operating budget for FY 2013 and its proposed budget for FY 2014. He began by reviewing the FY 2013 year-to-date expenses, noting modest year-to-date under spending relative to the budgeted amount. Mr. Scurlock explained that the FY 2014 budget is higher when compared to FY 2013 due to costs associated with the quantitative consultant for the Reserve Fund claim and legal work on the IRS audit. Mr. Grodhaus asked how the Auditor of State costs are derived for auditing the Authority's financial statements. Mr. Scurlock and Mr. Kauffman stated that the Authority has an agreement with the Auditor of State and that it is based on an hourly rate as determined in the engagement letter.

In other business, Mr. Scurlock informed the Authority that it was notified by the IRS that the Authority's 2007 Tobacco bonds were selected for a routine audit. Mr. Scurlock explained that Authority staff worked with Squire Sanders and has responded in full to the first Information Document Request and are awaiting a response from the IRS. Mr. Scurlock noted that he will keep the Authority apprised of future developments.

There being no further business, the meeting was adjourned.



Timothy S. Keen, Secretary
Buckeye Tobacco Settlement Financing Authority



***** Public Meeting Notice *****

June 14, 2013

TO: Members of the Buckeye Tobacco Settlement Financing Authority and their designees

John R. Kasich, Governor
Josh Mandel, Treasurer of State

Mike Grodhaus
Seth Metcalf

FROM: Timothy S. Keen, Secretary, Buckeye Tobacco Settlement Financing Authority

SUBJECT: **Meeting on Wednesday, June 19, 2013, at 2:00 p.m. in Conference Room A of the Office of Budget and Management (35th Floor, Rhodes State Office Tower)**

Pursuant to the Bylaws of the Buckeye Tobacco Settlement Financing Authority, I am notifying you of the meeting of the Authority to be held on Wednesday, June 19, 2013, commencing at 2:00 p.m. in Conference Room A of the Office of Budget and Management (35th Floor, Rhodes State Office Tower, 30 East Broad Street, Columbus, Ohio). Staff will present an overview of the Authority's fiscal year 2012 audit results, its fiscal year 2013 and proposed fiscal year 2014 operating budgets, and the status of tobacco settlement receipts and debt service payments for calendar year 2013. The Treasurer of State's office will present information regarding selection of a quantitative consultant for the Authority's reserve fund claim, release of an RFP for preparation of the Authority's financial statements, and investment of the Senior Liquidity Reserve fund. The Attorney General's office will provide an update on the status of the arbitration process for monies paid into and being held in disputed payment accounts.

Enclosed please find: i) a meeting agenda; ii) minutes of the prior June 15, 2012 meeting; iii) copies of the fiscal year 2012 audited financial statements; iv) the operating budget for fiscal years 2013 and 2014; v) the RFP for financial statement preparation; and vi) a memo from the Attorney General's office on resolution of disputed payments, all as referred to in that agenda.

If you or members of your staff have any questions, please contact me or Kurt Kauffman of my staff at 466-0691.

cc. Mike DeWine, Attorney General
Carol Mosholder, Tobacco Counsel, Office of Ohio Attorney General
Dana Wasserman, Deputy Director, Office of Debt Management, Treasurer of State
Larry Scurlock, Assistant Debt Manager, Office of Budget and Management



THE BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

JOSH MANDEL, TREASURER
TREASURER OF STATE

JOHN R. KASICH, CHAIRMAN
GOVERNOR

TIMOTHY S. KEEN, SECRETARY
DIRECTOR OF BUDGET AND MANAGEMENT

CERTIFICATION REGARDING NOTIFICATION OF MEETING TO THE PUBLIC AND NEWS MEDIA

The undersigned, Assistant Secretary of the Buckeye Tobacco Settlement Financing Authority, hereby certifies that the notice of the time, place and purposes of the meeting of the Authority of June 19, 2013 at 2:00 p.m. was posted on Friday, June 14, 2013 in the State House press room, the Office of Budget and Management (34th Floor, 30 East Broad Street), and the Office of the Treasurer of State (9th Floor, 30 East Broad Street), all in accordance Section 121.22 of the Revised Code and the Open Meetings Rule for notification of meetings to the public and news media adopted by the Authority July 2, 2007.

Dated: June 19, 2013

Kurt Kauffman
Assistant Secretary of the
Buckeye Tobacco Settlement Financing Authority



BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
STAFF PRESENTATION
June 19, 2013

FY2012 Audit Process

- Staff and U.S. Bank (bond trustee) provided the account statements, reports, and other information to Kennedy Cottrell Richards (KCR) for compilation of the FY 2012 financial statements.
- Once the financial statements were compiled, Secretary Keen, TOS and OBM met with KCR to confirm all cash based numbers in the report and examine all line-items that experienced a variance of 5% or more from its prior fiscal year value.
- Financial Statements were turned over to the Auditor of State in August and the audit work took place in mid-August through September.
- The FY2012 Audit Opinion was ‘unqualified’ and the financial statements were found to fairly present, in all material aspects, the financial position of the Authority in accordance with Generally Accepted Accounting Principles.
- The Audit did not identify any significant deficiencies or material weaknesses in internal controls nor any instances of noncompliance with material laws and regulations.
- The FY2012 Audit did not include a Management Letter.

CY 2013 Tobacco Settlement Receipts versus Debt Service Requirements

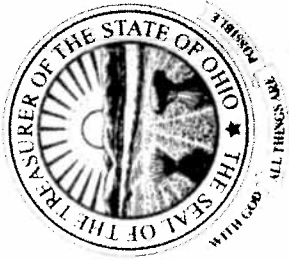
\$ in Millions

Calendar Year (CY)	Pledged MSA Payments to Ohio	Interest Earnings	Total Pledged Funds	Less Operating Expenses	Less Debt Service Payments	Shortfall
2008	\$333.1	\$22.3	\$355.5	(\$2.6)	(\$352.7)	--
2009	\$364.9	\$5.3	\$370.2	(\$2.6)	(\$367.8)	--
2010	\$305.6	\$1.7	\$307.3	(\$1.3)	(\$306.0)	--
2011	\$289.3	\$1.4	\$290.7	(\$0.3)	(\$297.7)	(\$7.3)
2012	\$294.6	\$1.2	\$295.8	(\$0.1)	(\$294.7)	--
2013 Est.	\$294.9	\$1.0	\$295.9	(\$0.2)	(\$309.4)	(\$13.7)

- Pledged Tobacco Settlement Receipts (TSRs) for CY 2013 totaled \$294.9 million, an increase of just 0.1% from CY 2012 TSRs.
 - The CY2013 TSRs reflect a decline of about 2% in domestic cigarette consumption in 2012 which was more than offset by the inflation adjustment and other components of the MSA payment formula.
- As they did in 2012, the three largest participating tobacco manufacturers (Philip Morris, RJ Reynolds, and Lorillard) all made a portion of their payment to disputed accounts.



- The 2013 TSRs along with interest earnings on those receipts are not sufficient to cover principal and interest payments required to be paid in 2013.
 - Assuming the status quo, a draw on the liquidity reserve fund in the amount of about \$13.7 million will be necessary to cover the December 1, 2013 debt service payment.
 - Following that expected December 1, 2013 draw, the reserve fund balance is estimated to be \$369 million (versus a reserve requirement of \$389 million).
- Amounts potentially due and payable to Ohio (and pledged to the BTSFA bond holders) on deposit in disputed accounts or withheld is \$183 million.
 - Resolution of disputed amounts is the subject of ongoing arbitration related to the Non-Participating Manufacturer (NPM) adjustment included in the MSA payment formula.
 - The NPM adjustment is disallowed if States can demonstrate 'diligent enforcement' of their qualifying statutes that require NPMs to make escrow deposits analogous to the MSA required payments.
 - The Attorney General's office will be providing an update on this arbitration process later in today's meeting.



JOSH MANDEL

STATE TREASURER OF OHIO

Buckeye Tobacco Settlement Financing Authority

Review of the Senior Liquidity Reserve Account

6/19/13



JOSH MANDEL

STATE TREASURER OF OHIO

Considerations in Choosing BTSFA Investments

- Future rising interest rate environment
- Rating agencies acceptance of investments
- Counterparty risk
- Liquidity needs
- Return to bondholders
- Concentration of Credit Risk



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STATE TREASURER OF OHIO

Eligible Investments

(Per the Trust Agreement dated 10/1/2007)

- Bonds backed by the US Government
 - Commercial Paper
 - Bank Deposits/Certificates of Deposit
 - STAR Ohio
- US Agency Debt
- Municipal Bonds
- Repurchase Agreements
 - Money Market Mutual Funds



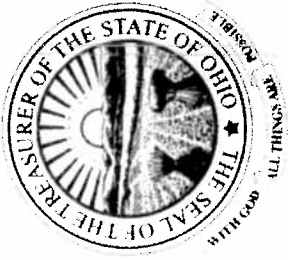
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Limitations on Investments

(Per the Trust Agreement dated 10/1/2007)

- Eligible investments must generally mature or be redeemable on or before the Business Day preceding each distribution date (e.g., every June 1 and December 1)



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Considered Investment Options

- US Agency Debt - *Slightly higher yield than U.S. Treasuries*
- Commercial Paper



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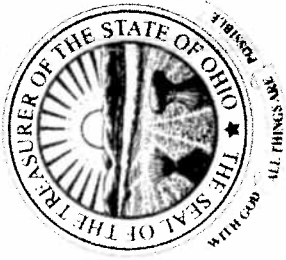
US Agency Debt

Pros

- Implicitly guaranteed by the US Government
- Typically higher yields than US Treasury debt
- Diversification of credit risk

Cons

- Lower rate of return than most CP of quality issuers



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Commercial Paper

Pros

- Very safe, highly rated companies
 - S&P A-1/Moody's P-1/Fitch F1
 - State approved issuers list
- Typically higher yields than equivalent US Agency and Treasury debt
- Diversification of credit risk

Cons

- Unsecured debt
- Credit risk compared to US Agency Debt



MIKE DEWINE

★ OHIO ATTORNEY GENERAL ★

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MEMORANDUM

TO: BUCKEYE TOBACCO SETTLEMENT FINANCE AUTHORITY

FROM: SUSAN C. WALKER, CHIEF, EXECUTIVE AGENCIES SECTION

DATE: JUNE 11, 2013

SUBJECT: UPDATE FROM THE AG REGARDING THE 2003 NPM ADJUSTMENT ARBITRATION

I have prepared this short synopsis of the 2003 NPM Adjustment Proceedings for the Buckeye Tobacco Settlement Finance Authority. I apologize for not being present; I am on a preplanned vacation out of state.

I. Background

In 1998, the largest U.S. tobacco companies entered into a settlement agreement called the "Master Settlement Agreement" or "MSA" with most States and Territories. Key provisions of the settlement include a requirement that the signatory tobacco companies make annual payments in perpetuity and comply with various marketing restrictions. These annual payments are potentially subject to adjustments. One such adjustment is the "Non-Participating Manufacturer Adjustment," or "NPM Adjustment" that applies if it is determined that the participating tobacco companies have lost market share to those tobacco companies that have not signed the MSA because of the provisions of the MSA. States are exempt from this adjustment, however, if (1) they have in place a statute that requires tobacco companies that didn't sign the MSA to deposit funds into escrow for tobacco products sold in the State and (2) have "diligently enforced" that statute.

The dispute that the Court ordered to arbitration stems from the tobacco companies' claim that the NPM Adjustment should apply to their 2003 annual MSA payment in order to reduce their payment to the States by approximately \$1.1 billion. Ohio has steadfastly asserted that it diligently enforced its escrow statute during 2003 and is not subject to the NPM Adjustment. The tobacco companies claim that Ohio did not meet the diligent enforcement standard during 2003 and should be subject to the NPM Adjustment. At issue in this dispute is Ohio's entire 2003 MSA payment of approximately \$350 million. The tobacco companies have made the same allegation against every State for every year since 2003 and claim that each year's MSA payment should be likewise reduced.

Most tobacco companies placed the disputed portion of their 2003 annual payment into escrow pending the resolution the 2003 dispute. They continued this practice for many subsequent years' payment as well, resulting in an escrow fund, called the "Disputed Payments Account," that has grown through the years. ¹

II. The Current Litigation

In 2006, pursuant to its continuing jurisdiction over MSA-related matters, the Franklin County Common Pleas Court referred the issue of whether Ohio's 2003 MSA payment was subject to the NPM Adjustment to arbitration. A national arbitration panel, comprised of three former federal judges (the "Panel") was convened and has been administering this dispute since 2010. The last phase of the proceedings, which are individual State-specific diligent enforcement hearings, began in May 2012 and were completed in May 2013. Ohio's individual case hearing was held in Chicago during October, 2012. The Panel has reserved rulings on individual state hearings and has advised the

¹ Please note that there is a 3 year lag due to MSA contract provisions. Accordingly, the 2003 NPM Adjustment portion placed into the Disputed Payment Account was applicable to the 2006 Annual Payment. That same lag will apply to the 2004 NPM Adjustment impacting the 2007 payment, the 2005 NPM Adjustment impacting the 2008 payment and so forth.

States that they will not release any Orders until at least the end of June 2013. I anticipate a decision from the Panel by the end of the summer.

III. Recent Developments

In recent months, a minority group of 22 States and Territories and the tobacco companies entered into the Term Sheet agreement to settle their 2003 through 2014 NPM Adjustment disputes. Ohio did not join the Term Sheet. The Term Sheet (1) provides for the early release of part of the funds the tobacco companies deposited into the escrow account to the Term Sheet States and Territories, (2) grants the tobacco companies billions of dollars in credits against their future MSA payments and (3) imposes significant new escrow enforcement obligations on the Term Sheet States and Territories.

The Term Sheet Parties submitted their agreement to the Panel for approval on December 17, 2012. Ohio and 23 other States representing approximately 55% of the payment shares of the MSA objected to the Term Sheet because it adversely affected their rights under the MSA and constituted an impermissible amendment to the MSA. On March 12, 2013, the Panel entered a Stipulated Partial Settlement and Award incorporating the Term Sheet Parties' agreement and overruling the objections of Ohio and the majority of States. Ohio filed a motion for preliminary injunction and a motion to vacate and/or to modify the Partial Award on March 25, 2013. Although the Franklin County Common Pleas court denied the motion for preliminary injunction on April 12th, the motion to vacate/modify has not yet been briefed.

IV. Future Proceedings

I anticipate that the 2004 NPM Adjustment Proceeding process will commence shortly after the Panel releases its Orders for the 2003 NPM Adjustment Proceeding.