

# BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

## Minutes of June 23, 2015 Meeting

The Buckeye Tobacco Settlement Financing Authority (the Authority) held a meeting commencing at 3:00 p.m. on Tuesday, June 23, 2015, 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 its 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 had been 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

Kurt Kauffman, Office of Budget and Management

Dana Wasserman, Office of the Treasurer of State

Among others present were Larry Scurlock, Cassie Sanfrey and Amber Teitt (Office of Budget and Management); JD Pisula and Lisa Eisenberg (Office of the Treasurer); Greg Stype and Allison Binkley (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 25, 2014 meeting minutes. Mr. Kauffman moved, seconded by Mr. Grodhaus, to approve the minutes of the June 25, 2014 Authority meeting. There being no discussion, the motion was approved upon roll call as follows: Ayes – Grodhaus, Kauffman, Wasserman; Nays – None. The Chair declared the motion passed.

Mr. Kauffman provided an overview of the fiscal year (FY) 2014 financial statement preparation and audit process and presented a brief summary of the audit results.\* Mr. Kauffman noted that the FY 2014 audit opinion was 'unqualified' with no material weaknesses or deficiencies in internal controls or any instances of noncompliance with material laws or regulations identified. He further noted the audit did include a management letter noting three immaterial misstatements in amounts in the financial statements, to which the Authority's staff provided a response.

Mr. Kauffman then presented an update on the tobacco settlement receipts (TSRs) received in calendar year (CY) 2015.\* He explained that CY 2015 receipts were lower than CY 2014 receipts by \$6.7 million or 2.3% and that the reasons for the decline included an approximately \$2.78 million overpayment received in fiscal year 2014 that was corrected in fiscal year 2015, as well as a 3.5% decline in domestic cigarette consumption in calendar year 2014. 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 2015 and that, barring the receipt of additional revenue in the near-term (e.g., a release from the disputed accounts), there will be a draw on the Reserve Fund estimated at \$35-36 million for the December 1, 2015 debt service payment on the Authority's bonds. This would lower the Reserve Fund balance

to approximately \$307 million at that time. A voluntary disclosure notifying bondholders of this anticipated December 1, 2015 draw on the Reserve Fund has already been released.

On behalf of the Treasurer's office, Mr. Pisula presented an overview of the current investment of the Reserve Fund and considerations in choosing appropriate investments. He explained that the Reserve Fund is currently invested in high-grade, short-term commercial paper maturing every six months on the date of each bond debt service payment. Mr. Pisula noted that investing in high-grade commercial paper balanced the need for safe, highly-rated and qualified investments with the desire to achieve the best available investment return that commercial paper was yielding 20 basis points more than comparable U.S. Treasuries.

Ms. Wasserman then provided an update on the status of the Authority's claim in bankruptcy against the provider of the Forward Delivery Agreement for investment of the Reserve Fund that was terminated in October 2008 due to that provider's default. Ms. Wasserman explained that the Authority continues to participate in a court-ordered mediation process in an attempt to settle the claim, but noted it appears increasingly likely that resolution of the claim may require litigation. In response to a question from Mr. Grodhaus, Mr. Stype explained that the mediation was progressing slowly and that commencement of any litigation is not imminent.

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 provided for under the Master Settlement Agreement. She reminded the Authority that with respect to the arbitration process for the 2003 Non-Participating Manufacturer (NPM) adjustment, Ohio was successful based on the finding of the arbitration panel in September 2013 that the State diligently enforced its model statutes. Ms. Mosholder then addressed the 2004 NPM adjustment arbitration noting that the 28 states including Ohio that have not yet settled have begun discussions with the tobacco manufacturers and that an arbitration panel is expected to be impaneled by the end of 2015 with the individual state arbitration hearings expected to begin in 2016. In response to a question from Mr. Kauffman, Ms. Mosholder noted that even if Ohio is found to have diligently enforced its model statutes with respect to the 2004 NPM adjustment, she does not expect the tobacco manufacturers would stop disputing amounts to be paid to Ohio because the State's share of the MSA payments is relatively large at more than 5% and the tobacco manufacturers have a history of contesting every possible issue.

Mr. Scurlock then presented the Authority's operating budget for FY 2015 and its proposed operating budget for FY 2016.\* He reviewed the FY 2015 year-to-date expenses, noting that under spending relative to the budgeted amount is largely due to fees and expenses of the quantitative consultant of which only \$25,000 is expected to be paid this FY and lower than budgeted expenses for mediation of the reserve fund claim. Mr. Scurlock noted that approximately \$150,000 in unspent balances from FY 2015 and prior fiscal years is available in FY 2016 and future fiscal years. He further explained that the FY 2016 budget is comparable in total to the FY 2015 budget with the \$25,000 FY 2015 underspending for the quantitative consultant moved into the FY 2016 budget.

Ms. Grodhaus then moved, seconded by Mr. Kauffman, to approve the release of a request for proposals (RFP) to improve the economic performance of the pledged tobacco receipts against bond debt service. . In discussion, Ms. Wasserman explained that the Authority is seeking, through a competitive and open RFP process, advice and assistance in determining whether pledged tobacco receipts can be used more efficiently to benefit the BTSFA bondholders. In particular, through this RFP the Authority will be seeking ideas on how to improve the economic performance of the pledged tobacco settlement receipts against bond debt service and for advice and strategies for implementation of those ideas. Proposals that involve the issuance of debt with any security or

source of payment other than the pledged TSRs or the use of any other State financial resources as a credit enhancement will not be considered. There being no further discussion, the motion was approved upon roll call as follows: Ayes – Grodhaus, Kauffman, Wasserman; Nays – None. The Chair declared the motion passed.

There being no further business, the meeting was adjourned.



Timothy S. Keen, Secretary  
Buckeye Tobacco Settlement Financing Authority





## THE BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

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**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 23, 2015 at 3:00 p.m. was posted on Thursday, June 18, 2015 in the State House press room, the Office of Budget and Management (34<sup>th</sup> Floor, 30 East Broad Street), and the Office of the Treasurer of State (9<sup>th</sup> 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 18, 2015

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Kurt Kauffman  
Assistant Secretary of the  
Buckeye Tobacco Settlement Financing Authority



**BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY**  
**STAFF PRESENTATION**  
**June 23, 2015**

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FY2014 Audit Process

- U.S. Bank (bond trustee) and BTSFA staff provided the account statements, reports, and other information to Rea & Associates (REA) for compilation of the FY 2014 financial statements.
- Once the financial statements were compiled, Secretary Keen, TOS and OBM met with REA to review the report, confirm the cash balances, 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 late August and the audit work was essentially completed by the end of October.
- The FY2014 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 Audit did include a management letter noting three immaterial misstatements in amounts, the largest of which was a \$526,764 understatement of accrued interest. The Authority responded in writing that it will strengthen efforts to find such miscalculations in its draft financial statements.

CY 2015 Tobacco Settlement Receipts versus Debt Service Requirements

*\$ in Millions*

Calendar Year (CY)	Pledged MSA Tobacco Settlement Receipts	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)	(\$7.4)
2012	\$294.6	\$1.2	\$295.8	(\$0.1)	(\$294.7)	--
2013	\$294.9	\$1.1	\$296.0	(\$0.2)	(\$309.4)	(\$13.6)
2014	\$292.5	\$1.0	\$293.5	(\$0.3)	(\$320.3)	(\$27.9)
2015 Est.	\$285.8	\$0.9	\$286.7	(\$0.3)	(\$321.7)	(\$35.3)

\* Includes SLRA interest earnings which are retained by the SLRA and thus not applied against the SLRA draw. Thus, the SLRA draw will be slightly higher than the estimated shortfall amount.



- Pledged Tobacco Settlement Receipts (TSRs) for CY 2014 totaled \$285.8 million, a decrease of 2.3% from CY 2013 TSRs.
  - The CY2015 TSRs reflect an overall decline of about 3.5% in domestic cigarette consumption in CY 2014 which was only partially offset by the minimum 3.0% inflation adjustment and other components of the MSA payment formula.
  - Domestic cigarette consumption decline slowed from CY 2013 (4.9%), but is still greater than annual declines in CY 2012 (2.0%) and CY 2011 (2.8%).
- The three largest participating tobacco manufacturers (Philip Morris, RJ Reynolds, and Lorillard) again all paid a portion of their payment to disputed accounts.
- The 2015 TSRs along with interest earnings on those receipts are not sufficient to cover principal and interest payments required to be paid in 2015.
  - Assuming the status quo, a draw on the liquidity reserve fund in the amount of about \$36 million will be necessary to cover the December 1, 2015 debt service payment.
  - Following that expected December 1, 2015 draw, the reserve fund balance is estimated to be \$307 million (versus the reserve requirement of \$389 million).
- Amounts potentially due and payable to Ohio (and pledged to the BTSFA bond holders) currently on deposit in disputed accounts or withheld is approximately \$260 million.
  - This amount currently on deposit in disputed accounts and pledged to bondholders relates to sales years 2006 through 2012 due to the 3-year lag. Disputed amounts relating to the 2003 sales year and paid in 2006 were released to the States in April 2014.
  - Resolution of disputed amounts continues to be 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.



**Buckeye Tobacco Settlement Financing Authority  
FY 2015 Operating Budget**

<b>Service or Activity</b>	<b>FY 2015 Budget</b>	<b>FY 2015 Year-to-Date</b>	<b>Variance</b>	<b>Approved &amp; Submitted For Payment</b>	<b>Notes</b>
Rating Agency Annual Surveillance Fees:					
-- Moody's	35,000	35,000	0	10/21/14	annual surveillance
-- Fitch	10,000	10,000		3/10/15	annual surveillance
-- S&P	15,000	15,000		10/8/14	annual surveillance
U.S. Bank Annual Trustee Fee	550	550	0		
-- Annual Trustee Fee		550		11/13/14	annual trustee fee
Financial Statement Preparation	6,000	6,000	0		
-- REA & Associates		1,000		8/14/14	financial statement preparation
		4,200		12/2/14	financial statement preparation
		800		1/5/15	financial statement preparation
Financial Statement Audit	40,000	40,528	(528)		
-- Auditor of State		132		8/29/14	FY14 financial statement audit
		6,131		10/6/14	FY14 financial statement audit
		33,804		11/14/14	FY14 financial statement audit
		461		1/5/15	FY14 financial statement audit
Financial Advisor / Claim Consultant	50,000	34,127	15,873		
-- Public Financial Management		2,825		7/8/14	SDSR claim and mediation
		6,302		7/8/14	SDSR claim and mediation
		25,000		6/25/15	SDSR claim and mediation
Legal Fees & Expenses (incl. disclosure)	50,000	50,000	0		
-- Squire Patton Boggs		25,035		7/8/14	SDSR claim and mediation
		3,078		7/8/14	Authority annual meeting; SDSR claim
		14,924		11/4/14	SDSR claim and mediation
		6,963		12/2/14	SDSR claim and mediation
Reserve Fund Mediation or Litigation**	117,400	32,652	84,748		
-- Squire Patton Boggs		10,422		12/2/14	SDSR claim and mediation
		5,358		12/10/14	SDSR claim and mediation
		12,170		3/27/15	SDSR claim and mediation
		4,703		6/4/15	SDSR claim and mediation
Contingency/Other	8,450	0	8,450		
<b>FY 2015 Total:</b>	<b>307,400</b>	<b>198,857</b>	<b>108,543</b>		

\*\* Transferred August 2014 into Operating Account



**Buckeye Tobacco Settlement Financing Authority  
FY 2016 Operating Budget**

Service or Activity	FY 2016 Budget	FY 2016 Year-to-Date	Variance	Approved & Submitted For Payment	Notes
Rating Agency Annual Surveillance Fees:	35,000	0	35,000		
-- Moody's	10,000	0			
-- Fitch	10,000	0			
-- S&P	15,000	0			
U.S. Bank Annual Trustee Fee	550	0	550		
-- Annual Trustee Fee		0			
Financial Statement Preparation	5,000	0	5,000		
-- REA & Associates		0			
Financial Statement Audit	40,000	0	40,000		
-- Auditor of State		0			
Financial Advisor / Claim Consultant	75,000	0	75,000		
-- Public Financial Management		0			
Continuing Legal, Disclosure & Reporting (incl. reserve fund litigation)	156,050	0	156,050		
-- Squire Patton Boggs		0			
Contingency/Other	5,000	0	5,000		
<b>FY 2016 Total:</b>	<b>316,600</b>	<b>0</b>	<b>316,600</b>		

Note: This 2016 Operating Budget excludes a cash balance of approximately \$150,000 carried forward from prior Fiscal Years and available for trust indenture agent services and other qualified uses.