EXECUTIVE COMMITTEE MEETING

Wednesday, April 2, 2003, 8:30 a.m.

General Assembly Building

3rd Floor Conference Room East

Richmond, Virginia

APPEARANCES:

Senator Charles R. Hawkins, Chairman
Delegate Terry G. Kilgore, Vice-Chairman
Michael J. Schewel, Secretary of Commerce and Trade
Senator Frank M. Ruff
Senator William C. Wampler, Jr.
Senator Philip P. Puckett
Delegate Joseph P. Johnson, Jr.
Delegate Kathy J. Byron
Delegate Clarke N. Hogan
The Honorable Gary D. Walker

Commission Staff:
Carthan F. Currin, III, Executive Director
Mary Cabell Sherrod, Manager of Communications and Committee Operations
Stephanie S. Wass, Director of Finance
Tim Pfohl, Grants Program Administration Manager

Attorney General's Office:
Frank Ferguson, Senior Assistant Attorney General
Stephanie Hamlett, Senior Assistant Attorney General

SENATOR HAWKINS: Good morning, everyone. This meeting has been called and this is all based on as you well know, the securitization problems we're facing. Jody is here from the State Treasurer's Office to bring us up to date as quickly as anything. What I would like to say is that we want to find out exactly how this thing is working. Please make sure in the process, make notes of any questions you have in this process, because we're going to have to make some decisions based on the information before us as to what recommendations we're going to make to the Full Commission. Jody, do you want to bring us up to date?

MS. WAGNER: Sure. Mr. Chairman, as you know we had priced the bonds on March 20th, and at that time we had what I thought was a very successful sale with a price considerably below what we discussed with the Commission at our meeting on February 6. So we were very pleased with the outcome. Unfortunately the next day the judge in Illinois rendered a decision of a ten point one billion dollar verdict against Philip Morris and required the posting of a twelve billion dollar bond for them to appeal. That threw the tobacco industry, or at least Philip Morris' case, into a bit of disarray. During the next week the bond rating agency down graded Philip Morris significantly on their bonds, and we were hoping to continue with the securitization until it became clear to the rating agencies and to the financial communities that Philip Morris may not be able to make its April 15th payment as a result of them needing to post bond. Philip Morris sent out a letter to all the Attorney Generals, which I think was sent out on Thursday of last week and made public on Friday, indicating that they were not sure whether they, they wanted to make their April 15th Master Settlement Agreement payments, but they were not sure that they could do so because of the bond requirement. As a result the rating agencies took a hard look at tobacco securitization bonds, not just Virginia's but every state and every municipal bond out there. Moody’s downgraded all the bonds. In Virginia's case we went from A1 to A3. Standard & Poor's did not yet downgrade them, but had a conference call where they indicated that if the April 15th payment was missed it is likely they would be downgraded, and we discussed that.

Then that afternoon we had a call from the underwriters, the underwriters indicated that because of the market reaction and because of the downgrading of the bonds it was questionable whether we'd be able to close as scheduled because they certainly remain committed to the transaction. We scheduled another call for yesterday morning, and yesterday morning Senator Hawkins was on the phone, Senator Wampler was on the phone, and the rating agency, the underwriters still indicated at this time they could not close. We asked them what would happen if we insisted that they close, and they said, you can deliver the bonds but nobody would be there to pay for them. A lot of their purchasers had used the opportunity to decide not to purchase the bonds. Some of the bigger purchasers, particularly the one that was doing a hundred and fifty million indicated that they might very well be there once things settled down, but they aren't there right now until there's more clarity of what's going on.

So, at this point we really are in a position where we can't force a closure based on the bond purchase agreement which has several material events listed and one of which is the downgrading of the bonds. Because there was a downgrade the bond

purchase agreement appears to present the underwriters with an opportunity not to close the transaction.

We had several conversations with Morgan Stanley over the past few days, and I think they're committed to try to make this happen at a date in the future, but at this point we have to let the market settle down.

SENATOR HAWKINS: Any questions of Ms. Wagner? Thank you, ma'am, appreciate it very much. So, that's where we are.

DELEGATE JOHNSON: Mr. Chairman, suppose the verdict is appealed and then it may take five years before they do anything, where would that leave us?

SENATOR HAWKINS: I think there's several scenarios we can build on. One being the 15th is one of the dates that we need to look at, the 15th is the payment date, and if that payment is made, then on the 21st when the bonds are supposed to be issued in Illinois where that lawsuit is, and if that's capped, which is what they're trying to do. When the water starts settling I think the market may get back and we can have a discussion on the securitization again. I think that's two benchmarks we need to look at as a Commission as we go along, either one of those two could play into our favor or to our disadvantage depending on how it goes. I think all of us still feel committed to securitization as our top priority. I think the main thing we need to understand is that regardless of discussion with Philip Morris today there are three other players involved in the securitization and we'll be getting checks through the Master Settlement Agreement with them. So, we'll still have money coming into our account and we are able to make our commitments, plus we have some cash balance. The main thing I tried to send out last night to people in my area, is to make sure that the farmers understood that this has nothing to do with our commitment to the farmers or the quota holders or to economic development. It's just a process we're going through, and we need to work our way through this. We're still in the same posture we were last month and the month before, the Commission is still operating. Delegate Kilgore.

DELEGATE KILGORE: Mr. Chairman, as far as the Illinois case and what's going on with that, I believe I read, and I should have asked the Attorney General personally, and I rode in with him this morning, but are we intervening or trying to get into the situation in Illinois or trying to find out more information?

MR. FERGUSON: I guess that question is to me, since his ride isn't here to discuss it. The answer is yes, those efforts are under way. I would anticipate that it's likely that some filing by the Attorneys General will occur by the end of this week. We haven't done anything yet because we're going to wait and see what Philip Morris was going to file. We were expecting a filing late yesterday or this morning, and I have not yet heard if they have done that or not. I would anticipate that they would file at minimum a motion to reduce the appeal bond and their arguments to support that. There are any number of other post trial motions which I'm sure they will litigate at some point. It's just a question of whether they will do that contemporaneous with these or whether they'll wait until this is fleshed out a little bit. The issue, of course, is if they do not post an appeal bond by the time they're required to then as I understand Illinois law they then

have no ability to appeal and they're stuck with the verdict. Other than the trial court's action on it or reducing it, but no appellant ability.

SENATOR HAWKINS: I think we also need to remember this is a state court, and it's unheard of in my mind.

DELEGATE KILGORE: It's like a circuit court judge here?

SENATOR HAWKINS: Yes, imposed a fine of ten point six billion on them and a bond of twelve billion cash, cash.

MR. FERGUSON: It was a bench trial and not a jury verdict.

DELEGATE BYRON: I had two questions for the Attorney General's Office with regard to the comment just made. What is the obligation as far as Philip Morris continuing to make its payments under the regular Master Settlement Agreement since the Chair said that does not affect the regular payment, it's already possible that it'll affect the regular payment. How does that play into the Master Settlement Agreement, and what repercussions do they see if they don't make those payments? Are there certain things in there that allow them not to make it, or do they have to take further action? You hear of rumors of bankruptcy and other things down the line that you have to consider.

MR. FERGUSON: I guess that can be answered in two or three parts. Their payment under the MSA is due on the 15th like the Chairman said, and that payment for Philip Morris is roughly two and a half billion dollars, of which something like fifty-three million would be for Virginia. That obligation is there, and the fact of this verdict against them hasn't changed that obligation. Practicality of course is whether they've got money available to do both. Not to make the argument for them, but I suppose from Philip Morris' point of view they're willing to risk making the MSA payments late or reduced or something one time or even being sued by the states at some point to make those payments if it means they retain their right to appeal this case. I'm sure from their point of view, in the order of priority, making sure they can appeal is probably right now the most important thing to them. Beyond that, certainly we've all heard rumors of bankruptcy, and I don't think I know any more about that than anyone else has read in the paper or heard rumors. Certainly that would be something that I'm sure is on their list of options. One of the things you hear from NAAG, the Attorney Generals' organization, is concern that all of this is really litigation strategy, and I can't address that. Obviously from an advocate's point of view that's a possibility as well.

DELEGATE BYRON: On the fifty-three million that comes to Virginia out of that two and a half billion dollar payment, does that all go into a pot and then it's divided out, or how do they determine that? Can they make part of it, or do they have to make all of it, or do we know how much we might possibly get?

MR. FERGUSON: They certainly are required to make the full payment. If they elect to make a partial payment that'll be credited against their obligation, but that will not, the MSA does not contemplate a partial payment. That doesn't mean they wouldn't accept it if made, but it also does not mean that they would waive any amounts that were owed. It's all paid into a pot, to answer the first part of your question, through a national trustee or through an independent auditor and so forth. The

banks and the independent auditor makes a determination of how much is to be paid, and then the amounts are paid out to the states and wire transferred, based on an allocation formula. Virginia's piece is 2.04 percent of the whole thing.

DELEGATE BYRON: I have one more question. You're saying that you've been able to say to constituents it's not going to affect the tobacco growers?

SENATOR HAWKINS: Right now because we've got money set aside to be able to meet our obligations when it comes to indemnification in this pay schedule.

DELEGATE BYRON: You also said there'll be moneys coming from the other tobacco companies. Do you have a breakdown of that?

SENATOR HAWKINS: It's forty-eight percent of the total, about forty-eight percent of the total comes from the other three companies.

MR. FERGUSON: Philip Morris is just over half of the total amount owed.

DELEGATE BYRON: When those moneys come in we'll still be using the same formulas to divide it up for our general fund as far as how much money to divide?

SENATOR HAWKINS: That's one of the scenarios we need to build on, Kathy. If we can build a scenario based on enough moneys from Philip Morris and use the other moneys to be able to start allocations on that. And another scenario, two scenarios, the worst case and best case that we're trying to deal with, and both of those are trying to figure out what happens.

DELEGATE KILGORE: It looks to me, Mr. Chairman, and, Frank, you can correct me if I'm wrong, but the next thirty days are going to be the crucial time. In the next thirty days we should have a better understanding of what's going on.

SENATOR HAWKINS: I think the 15th and 21st will be, the 15th will be the date if the payments are made, the MSA payment is made on time, I think you'll see a firming up of the market at that point, personally.

DELEGATE KILGORE: Second point is that in the next fifteen to thirty days we ought to know more. I've got a meeting scheduled on the 7th for Southwest Economic Development Committee to put out some grants, and I think the Southside has another meeting on the 9th. Can we back off of that for a little while? I don't feel comfortable giving money out and not knowing what money we've got coming in.

SENATOR HAWKINS: The only thing we can do in that regard if we have the meeting prior to the 15th, is have it based on contingencies on the amounts of money we receive and let people understand that as we start talking to them and going through this process. I think you'd be better off to postpone these meetings until after we get a better read of what's going on, which is only a week or so.

DELEGATE KILGORE: I think that's a better course of action, because I don't want to get people thinking they're going to get something and then come back and say, well, we can't do it.

SENATOR HAWKINS: I think it's better to do that. I think if you

look at the stream flow that we have in place most of the things that we've obligated ourselves to do we've pretty much taken care of that problem. I think as we go through the process in the worst case scenario we need to start discussing about the investments we made, particularly on the economic development side that has direct jobs involved with that. That should be top priority, and then we'll start working from there.

DELEGATE KILGORE: I think we ought to have the leeway if there's some jobs or something coming up I think we ought to be able to continue to do, if we're in a deal closing and things like that, and I think we need to continue that. As far as these economic committee meetings we're having, things like that in Southwest and Southside, I'm just not sure we need to have those until we know more about what's going on.

SENATOR HAWKINS: We're scheduled to have a Full Commission meeting on the 24th of April, and both of those trigger days will be gone by then, the 15th and 21st. If we could have a meeting some time in that time frame it would probably help.

MR. WALKER: Postpone everything thirty days.

SENATOR HAWKINS: Joe.

DELEGATE JOHNSON: The unpleasant word bankruptcy was used. Mr. Ferguson, in the event that Philip Morris files bankruptcy the funds that we receive ninety days or, those that would come in would we recoup those?

MR. FERGUSON: Bankruptcy law is one of many areas of the law that is outside my core area of expertise. We do have bankruptcy counsel through NAAG tied to the Tobacco Commission for all this, but generally that's something that's a possibility. As a general bankruptcy rule, any payments made within whatever period of time prior to the filing are considered to be made in contemplation of that bankruptcy and may be a fraud on creditors and all that, and the bankruptcy court may come looking for them.

SENATOR HAWKINS: If the Master Settlement payments are made on the 15th, something is worked out, I don't know if that's been contemplated right now, who can predict the future. So the two critical dates are the 15th and the 21st, and we'll continue to watch that very closely.

DELEGATE JOHNSON: Mr. Chairman, suppose on the first day of June Philip Morris files bankruptcy then, under bankruptcy law they have a right to, or the trustee can come in and recall all payments that have been made by Philip Morris for ninety days?

SENATOR HAWKINS: I don't know about the law whatsoever. I can imagine particularly in a commission like we have here that by the time these moneys are out in the hands of the public and to farmers and in the community it would be a real thicket to try to go out and try to get these moneys back in their hands, I would think.

DELEGATE JOHNSON: Would Mr. Ferguson be kind enough to check that out and see where we are and where we would be?

MR. FERGUSON: I will. We actually have through NAAG a very competent outside bankruptcy counsel that was retained several years ago

just to be prepared for this sort of thing.

SENATOR HAWKINS: I think you're right, we need to make sure that we understand all the things that we're dealing with, and we are certainly in uncharted waters. Any other questions?

MR. WALKER: Given the fact that other states have already sold bonds, and if they don't make their payment on the 15th, I guess my question is for the Treasurer, but isn't that going to be devastating to the market? Somebody else was talking about six fifty to five fifty, if they don't make that payment then the bond-holders, we're done.

MS. WASS: I think, because of the reserve requirements they have, I don't think they're going to default immediately. There are reserve amounts set aside for every transaction.

SENATOR HAWKINS: Are there any other public comments that need to be made at this point? We need to go into Executive Session and get advice from Counsel on various aspects of things we're dealing with. Prior to that motion does anybody have any other public comments before we go into Executive Session? Is there a motion to that effect?

DELEGATE JOHNSON: So moved.

MR. WALKER: Second.

MR. FERGUSON: For purposes of the record, the motion should be if you want to consult with legal counsel to go into a closed meeting under the Freedom of Information Act for purposes of consulting with legal counsel pursuant to Section 222-3011A-4, I believe. If that is the motion my statement can be adopted by reference.

DELEGATE KILGORE: I'll make the motion that Frank just gave.

MR. WALKER: Second.

SENATOR HAWKINS: It's been moved and seconded that we go into Executive Session based upon the articulation of counsel. All in favor say aye. (Ayes) Opposed? (No response.)

NOTE: Whereupon the Executive Committee goes into closed Executive Session. Whereupon, the meeting is re-opened to the public.

SENATOR HAWKINS: Let the record show we're now back in regular session. Do we have a motion to come out of Executive Session to the regular session?

DELEGATE KILGORE: So moved.

DELEGATE JOHNSON: Second.

SENATOR HAWKINS: It's been moved and seconded to come out of Executive Session and established by Counsel that we discussed only those matters --

MS. HAMLETT: -- Certified that we only discussed legal matters in the Executive Session related to possible litigation and a vote.

SENATOR HAWKINS: We'll have to have a roll call vote on that, Carthan.

MR. CURRIN: Delegate Byron?
DELEGATE BYRON: Yes.
MR. CURRIN: Delegate Dudley?
DELEGATE DUDLEY: (No response)
MR. CURRIN: Vice-Chairman Kilgore?
VICE-CHAIRMAN KILGORE: Yes.
MR. CURRIN: Delegate Johnson?
DELEGATE JOHNSON: Yes.
MR. CURRIN: Senator Puckett?
SENATOR PUCKETT: Yes.
MR. CURRIN: Senator Ruff?
SENATOR RUFF: Yes.
MR. CURRIN: Secretary Schewel?
SECRETARY SCHEWEL: Yes.
MR. CURRIN: Mr. Walker?
MR. WALKER: Yes.
MR. CURRIN: Senator Wampler?
SENATOR WAMPLER: Yes.
MR. CURRIN: Mr. Chairman?
SENATOR HAWKINS: Yes. We're back, and I thank you all for your patience. Is there a motion?
SENATOR WAMPLER: Mr. Chairman, I'd make a motion that we contact the Office of the Attorney General to seek advice as to what legal options we may have pertaining to maximizing the securitization proceeds and any matters related to that. That's my motion.
SENATOR HAWKINS: Is there a second?
DELEGATE JOHNSON: Second.
SENATOR HAWKINS: Are there any questions to Senator Wampler's motion? It's been moved and seconded, all in favor say aye. (Ayes) Opposed? (No response) Motion carries.
DELEGATE KILGORE: Mr. Chairman, as far as the other meetings, then, and as we discussed before we went into the closed session, do we need to make a motion to that or can I just call if off?
SENATOR HAWKINS: Each Chair has the ability to call their own meetings.
SENATOR WAMPLER: Mr. Chairman, I would say Special Projects is scheduled for the 16th of April. I will postpone it, but I'll be in touch with the Executive Director as to our future schedule.
DELEGATE KILGORE: I'll say that the April 7th meeting for the Southwest Economic Development Committee is postponed.
DELEGATE HOGAN: Mr. Chairman, for my edification, do you know if Tom Arthur has made the same?
SENATOR HAWKINS: I think Tom said he'd like to go ahead with

the meeting just to find out about the things, but I'm not sure he will make any long term commitments based on what we talked about. You may want to talk to him about postponing it, and maybe it's better to do that. The only other thing that's ongoing is the Search Committee for the Investment Council. Claude told me this morning he wants to have another meeting to find a firm, that's fine, and he's going to look into that.

DELEGATE KILGORE: I move we adjourn.

DELEGATE JOHNSON: Second.

SENATOR HAWKINS: It's been moved and seconded that we adjourn. All in favor say aye? (Ayes) So moved, we're adjourned.

PROCEEDINGS CONCLUDED.

CERTIFICATE OF THE COURT REPORTER

I, Medford W. Howard, was the Court Reporter who took down and transcribed the Minutes of the Virginia Tobacco Indemnification and Community Revitalization Commission, Executive Committee Meeting, Public Meeting, when held on Wednesday, April 2, 2003 at 8:30 a.m. in the Virginia General Assembly Building, 3rd Floor Conference Room East.

I further certify this is a true and accurate transcript to the best of my ability to hear and understand the proceedings.

Given under my hand this 3rd day of April, 2003.

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Medford W. Howard
Registered Professional Reporter
Notary Public for the State of Virginia at Large

My Commission Expires: October 31, 2006.