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M E M O R A N D U M

To: Joseph F. Beach
Montgomery County, Maryland
Director of Finance

Marc P. Hansen
Montgomery County, Maryland
County Solicitor

From: Paul D. Shelton
Carlos J. Santos

Date: December 1, 2015

Re: Bill No. MC 7-16 Purchases From the Department of Liquor Control-Exception for Wholesalers

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ATTORNEY-CLIENT PRIVILEGED COMMUNICATION

You have asked us to review Bill No. MC 7-16 (the "Legislation") and provide you with advice related to its impact, if any, on the outstanding bonds issued as Montgomery County, Maryland Revenue Bonds (Department of Liquor Control) (the "Revenue Bonds"), and the possible reaction of rating agencies and the market to the passage of the proposed Legislation.

Background Statement

Montgomery County, Maryland (the "County") has over $100,000,000 in Revenue Bonds outstanding. Since 2009, the County has continually represented in Official Statements, rating agency presentations, and annual financial disclosures posted on EMMA, that the Revenue Bonds are secured by the net revenues from the sale of alcoholic beverages in the County over which the County exercised a virtual monopoly under state and local laws. The bondholders purchased the Revenue Bonds and the rating agencies rated the Revenue Bonds in reliance on data produced to them by the County, demonstrating the strength and consistency of this pledge. The data produced by the County included charts and statements setting forth the amount of net revenues deposited annually in the County's General Fund for a five-year period. The ratings and the confidence of the bondholders is based partially upon the evidence of hundreds of millions of dollars generated annually for the County and the legal foundation that creates the near monopoly for the County with respect to the sale of alcoholic beverages in the County. The monopoly provides assurance to the bondholders that the County, through the Department of Liquor Control (the "DLC"), maintains a reliable legal structure to generate relatively consistent levels of revenue as long as the Revenue Bonds are outstanding.

In a Memorandum dated November 17, 2015 we discussed in detail the contractual relationship between the County and bondholders created by Resolution No. 16-676 (the "Resolution") and the Trust Agreement between the County and U.S. Bank National Association, as Trustee (the "Trustee"), dated May 1, 2009 (the "Trust Agreement"). The property rights of the bondholders to the pledged revenues are rooted both in the legislative action and the contractual arrangement created under the Trust Agreement, which is protected both by the common law of contracts and the constitution of the United States.

Any legislation that would deprive the bondholders of their contractual rights and constitutional protections would create the likelihood of legal action against the County and downgrading by the rating agency.

The Passage of Bill No. MC 7-16 Would Create the Possibility of Reduced Pledged Revenues to Secure the Revenue Bonds.

As currently worded, the Legislation empowers the County Council of the County (the "County Council") to allow private wholesalers to sell and distribute beer and light wine products that are currently sold only by the County. Assuming the County Council takes this action and the DLC classifies the beer and light wine that the wholesalers can sell and distribute, there will occur a reduction in the net revenues generated by the DLC for deposit into the County's General Fund. Upon deposit into the County's general fund, the net revenues become Pledged Revenues. If this reduction were material, the bondholders could bring an action to protect their property rights and for breach of contract. This is not likely to occur if the reduction is not seen as material or if there is a replacement of the lost net revenues.

The Protection of the Bondholders from Economic Harm

The Legislation requires the DLC to impose a surcharge on private wholesalers distributing beer and light wine that is sufficient to replace the net revenues lost by allowing the private wholesalers to sell beer and light wine. The wording in the Legislation is mandatory, so the DLC would be required to estimate the lost net revenues and set the surcharge to replace the lost net revenues. While the Legislation seems to be revenue neutral for bondholders, it is ambiguous because it does not state how often the estimate of lost net revenues is to be undertaken or how often the surcharge is to be adjusted.

We would not expect bondholders or the rating agencies to react negatively to the Legislation as drafted. We would, however, expect questions related to the method of estimation of lost net revenues and the frequency of the estimation and the surcharge. The County could respond by assuring bondholders that the DLC will establish procedures that protect the interest of bondholders in the implementation of the Legislation.