NEW ISSUE **BOOK-ENTRY ONLY**

*In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Series 2007 Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "**Code**"), and (ii) interest on the Series 2007 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In addition, in the opinion of Bond Counsel to the Corporation, pursuant to the provisions of the Tobacco Settlement Financing Corporation Act, income on the Series 2007 Bonds, including any profit made on the sale thereof, is free from State of Rhode Island and Providence Plantations (the "State") personal income taxes. See "TAX MATTERS" herein.*

$197,005,742.20
TOBACCO SETTLEMENT FINANCING CORPORATION
Tobacco Settlement Asset-Backed Bonds, Series 2007

$176,974,412.70 Series 2007A **$17,336,217.50 Series 2007B** **$2,695,112.00 Series 2007C**

Dated Date: Date of Delivery **Maturity Dates: As shown on inside cover**

The Tobacco Settlement Asset-Backed Bonds, Series 2007 (the "**Series 2007 Bonds**") are being issued by the Tobacco Settlement Financing Corporation (the "**Corporation**"), a public corporation of the State established pursuant to the Tobacco Settlement Financing Corporation Act, as amended (the "**Act**"). The Corporation has a legal existence distinct from the State and is not a department of the State government.

Pursuant to the Act and a Purchase and Sale Agreement, dated as of June 1, 2007 (the "**Purchase Agreement**"), between the State and the Corporation, the State will sell to the Corporation, on the Closing Date, all of its right, title and interest in certain amounts (the "**Residual Tobacco Assets**") evidenced by that certain Residual Certificate dated June 27, 2002 (the "**2002 Residual Certificate**"), paid or payable to the State, under the Master Settlement Agreement (the "**MSA**") entered into by participating cigarette manufacturers (the "**PMs"**), the State, 45 other states and six U.S. jurisdictions in November 1998 in the settlement of certain smoking-related litigation, including future annual and strategic contribution fund payments to be made by the PMs under the MSA and that are no longer subject to the lien of the 2002 Indenture, as hereinafter defined.

The Series 2007 Bonds and any series of additional bonds will be issued pursuant to an Indenture, dated as of June 1, 2007 (the "**Indenture**"), between the Corporation and Wells Fargo Bank, N.A., as Trustee (the "**Trustee**"). The Indenture provides that additional bonds may be issued subject to the satisfaction of certain conditions described herein. The Series 2007 Bonds and any additional bonds issued under the Indenture are collectively referred to herein as the "**Bonds**". See "THE SERIES 2007 BONDS – Additional Bonds and Additional Obligations."

The Series 2007 Bonds will be secured by and are payable solely from the "**Collateral**" consisting of (i) the Residual Tobacco Assets, all of which will be pledged under the Indenture (the "**Residual Pledged TSRs**") and all future aid, rents, fees, charges, payments, investment earnings and other income and receipts with respect thereto (collectively, the "**Revenues**"), (ii) all rights to receive the Revenues and the proceeds thereof, (iii) all accounts established under the Indenture and the assets thereof, and (iv) subject to certain limitations, all rights and interest of the Corporation under the Purchase Agreement. The proceeds of the Series 2007 Bonds and other assets of the Corporation (other than the Residual Pledged TSRs) are not pledged to the payment of, and are therefore not available to the holders of, the Series 2007 Bonds. Pursuant to the Act, the Purchase Agreement and the Indenture, the Corporation has, in the opinion of Bond Counsel, validly included the pledge and agreement of the State not to limit or alter the rights of the Corporation to fulfill the terms of the Purchase Agreement and the Indenture or impair the rights and remedies of the Bondholders.

The Corporation has previously purchased from the State all of its right, title and interest in certain amounts paid or payable to the State by the PMs under the MSA, including future annual and strategic contribution fund payments (such payments as more fully described herein, the "**TSRs**"). Pursuant to an indenture, dated as of June 1, 2002 (the "**2002 Indenture**"), between the Corporation and Wells Fargo Bank, N.A., as trustee (the "**2002 Indenture Trustee**"), the Corporation has issued its Tobacco Settlement Asset-Backed Bonds, Series 2002A and Series 2002B, of which $663,155,000 remain outstanding (such bonds and any refunding bonds issued under the 2002 Indenture being termed, collectively, the "**2002 Indenture Bonds**"). The 2002 Indenture Bonds are secured by and payable from the TSRs (such pledged TSRs, the "**2002 Tobacco Assets**"). Except as specifically provided herein, the Collateral securing the Series 2007 Bonds does not include the rights of the Corporation to the receipt of the 2002 Tobacco Assets under the 2002 Indenture.

The Trustee is only entitled to receive payments of Residual Pledged TSRs on and after the date on which there are no 2002 Indenture Bonds outstanding under the 2002 Indenture. Accordingly, the Series 2007 Bonds are structurally subordinate to the payment in full of all 2002 Indenture Bonds issued under the 2002 Indenture. If the 2002 Indenture Bonds are not paid in accordance with their terms or there is a default or event of default with respect to the 2002 Indenture Bonds, Holders of the Series 2007 Bonds may suffer a complete loss of their investment and have no remedy for the loss.

The Series 2007B Bonds are subordinate to the Series 2007A Bonds, and Holders of the Series 2007B Bonds are not entitled to receive any payment, including any Extraordinary Prepayment, until all Holders of Series 2007A Bonds and any other Bonds senior to the Series 2007B Bonds issued under the Indenture have been fully paid, regardless of the occurrence of an Event of Default. The Series 2007C Bonds are subordinate to the Series 2007B Bonds, and Holders of the Series 2007C Bonds are not entitled to receive any payment, including any Extraordinary Prepayment, until Holders of all Series 2007B Bonds and any other Bonds senior to the Series 2007C Bonds issued under the Indenture have been fully paid, regardless of the occurrence of an Event of Default.

The amount of Residual Pledged TSRs received is dependent on many factors, including future cigarette consumption and the financial capability of the PMs as well as litigation affecting the MSA, related state legislation and state enforcement thereof and the tobacco industry. See "RISK FACTORS" herein.

Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (Grand River and Freedom Holdings, both discussed in "RISK FACTORS" herein), that are pending in the U.S. District Court for the Southern District of New York. The court in the Grand River and Freedom Holdings actions is considering plaintiffs' allegations of an illegal output cartel under the federal antitrust laws and allegations of violations under the Commerce Clause of the U.S. Constitution. A determination that the MSA or state legislation enacted pursuant to the MSA is void or unenforceable would have a materially adverse effect on the payments by PMs under the MSA and the amount or the timing of receipt of Residual Pledged TSRs available to make payments on the Series 2007 Bonds, and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

THE SERIES 2007 BONDS ARE PAYABLE AS TO ACCRETED VALUE ON THEIR RESPECTIVE MATURITY DATES SOLELY OUT OF THE ASSETS OF THE CORPORATION PLEDGED FOR SUCH PURPOSE; NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OR ANY POLITICAL SUBDIVISION THEREOF IS PLEDGED TO THE PAYMENT OF THE ACCRETED VALUE ON THE SERIES 2007 BONDS; THE SERIES 2007 BONDS DO NOT CONSTITUTE AN INDEBTEDNESS OF THE STATE OR ANY POLITICAL SUBDIVISION OF THE STATE; THE SERIES 2007 BONDS ARE SECURED SOLELY BY AND ARE PAYABLE SOLELY FROM THE RESIDUAL PLEDGED TSRS SOLD TO THE CORPORATION AND OTHER MONIES OF THE CORPORATION PLEDGED UNDER THE INDENTURE; THE SERIES 2007 BONDS DO NOT CONSTITUTE A GENERAL, LEGAL, OR MORAL OBLIGATION OF THE STATE OR ANY POLITICAL SUBDIVISION THEREOF AND THE STATE HAS NO OBLIGATION OR INTENTION TO SATISFY ANY DEFICIENCY OR DEFAULT OF ANY PAYMENT OF THE SERIES 2007 BONDS. THE CORPORATION HAS NO TAXING POWER.

The Series 2007 Bonds are subject to mandatory redemption in whole or in part on each December 1 and June 1 from amounts on deposit in the Turbo Redemption Account at the redemption price of 100% of the Accreted Value thereof. The Series 2007 Bonds are also subject to optional redemption at the redemption prices described herein. In addition, the Series 2007 Bonds are subject to Extraordinary Prepayment upon an Event of Default under the Indenture and from Lump Sum Payments at the redemption price of 100% of the Accreted Value thereof. See "THE SERIES 2007 BONDS" herein.

Individual purchases of beneficial ownership interests in the Series 2007A Bonds and the Series 2007B Bonds may be made in the principal amount of $5,000 or any integral multiple thereof. The Series 2007C Bonds are being reoffered only to Qualified Institutional Buyers (as described herein). The Series 2007C Bonds are issued and reoffered in the authorized denomination of any integral multiple of $100,000 of Accreted Value at the Maturity Date thereof. Upon purchase of any of the Series 2007C Bonds, a purchaser will be deemed to have represented that it is a Qualified Institutional Buyer and that it has a holding in Series 2007C Bonds in an amount equal to at least $100,000 in aggregate purchase price.

**See Inside Front Cover for Maturity Schedules,
Initial Principal Amounts, Accreted Value at Maturity and Approximate Yield to Maturity Date.**

See "RISK FACTORS" for a discussion of certain factors that should be considered in connection with an investment in the Series 2007 Bonds.

This cover page contains information for quick reference only. It is not a summary of this issue. Potential purchasers must read the entire Offering Circular to obtain information essential to making an informed investment decision.

Joint Book-Running Senior Manager **Joint Book-Running Senior Manager**

Citi **Morgan Stanley**

Bear, Stearns & Co. Inc. **First Albany Capital Inc.** **Merrill Lynch & Co.** **UBS Investment Bank**

The Series 2007 Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Hawkins Delafield & Wood LLP, New York, New York, as Bond Counsel. Certain legal matters will be passed upon by Nixon Peabody LLP, Providence, Rhode Island, as Disclosure Counsel to the Corporation and for the Underwriters by Edwards Angell Palmer & Dodge LLP, Providence, Rhode Island, as Underwriters' Counsel. It is expected that the Series 2007 Bonds will be available for delivery in book-entry form only through The Depository Trust Company in New York, New York on or about June 27, 2007.

June 21, 2007

MATURITY SCHEDULE

$197,005,742.20
Tobacco Settlement Financing Corporation
Tobacco Settlement Asset-Backed Bonds, Series 2007

Dated: Date of Delivery

$176,974,412.70 Series 2007A Turbo Capital Appreciation Bonds
Due June 1, 2052, Approximate Yield 6.000%
Projected Final Turbo Redemption Date: June 1, 2032*
Projected Weighted Average Life: 20.8 years
CUSIP No. 888809AH3‡

Initial Principal Amount	Accreted Value at Maturity	Initial Amount per $5,000 Accreted Value at Maturity
$176,974,412.70	$2,520,285,000.00	$351.10

$17,336,217.50 Series 2007B Turbo Capital Appreciation Bonds
Due June 1, 2052, Approximate Yield 6.125%
Projected Final Turbo Redemption Date: June 1, 2033*
Projected Weighted Average Life: 25.6 years
CUSIP No. 888809AJ9‡

Initial Principal Amount	Accreted Value at Maturity	Initial Amount per $5,000 Accreted Value at Maturity
$17,336,217.50	$260,695,000.00	$332.50

$2,695,112.00 Series 2007C Turbo Capital Appreciation Bonds
Due June 1, 2052, Approximate Yield 6.750%
Projected Final Turbo Redemption Date: June 1, 2033*
Projected Weighted Average Life: 25.9 years
CUSIP No. 888809AK6‡

Initial Principal Amount	Accreted Value at Maturity	Initial Amount per $100,000 Accreted Value at Maturity
$2,695,112.00	$53,200,000.00	$5,066.00

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* Assumes Turbo Redemptions are made based on the receipt of Surplus Collections (as defined herein) in accordance with the Global Insight Base Case Forecast and other structuring assumptions. Projections of expected average lives and Final Turbo Redemption Dates have not been rated by the Rating Agencies. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS - Effect of Changes in Cigarette Consumption Levels on Turbo Redemptions." No assurance can be given that these structuring assumptions will be realized, and the ratings of the Turbo Term Bonds do not reflect any assessment by the Rating Agencies of the probability of payment of Turbo Redemptions.

‡ Copyright 2006, American Bankers Association. CUSIP data herein are provided by Standard & Poor's, CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. The CUSIP numbers listed above are being provided solely for the convenience of Bondholders only at the time of issuance of the Series 2007 Bonds and the Corporation, the State and the Underwriters do not make any representation with respect to such numbers or undertake any responsibility for their accuracy now or at any time in the future. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2007 Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part of such maturity or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Series 2007 Bonds.

† The Series 2007B Bonds are subordinate to the Series 2007A Bonds, and Holders of the Series 2007B Bonds are not entitled to receive any payment, including any Extraordinary Prepayment, until all Holders of Series 2007A Bonds and any other Bonds senior to the Series 2007B Bonds issued under the Indenture have been fully paid, regardless of the occurrence of an Event of Default.

†† The Series 2007C Bonds are subordinate to the Series 2007B Bonds, and Holders of the Series 2007C Bonds are not entitled to receive any payment, including any Extraordinary Prepayment, until Holders of all Series 2007B Bonds and any other Bonds senior to the Series 2007C Bonds issued under the Indenture have been fully paid, regardless of the occurrence of an Event of Default.

THE UNDERWRITERS PARTICIPATING IN THIS OFFERING MAY ENGAGE IN TRANSACTIONS THAT STABILIZE OR MAINTAIN THE PRICE OF THE SECURITIES AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET OR OTHERWISE AFFECT THE PRICE OF THE SECURITIES OFFERED HEREBY, INCLUDING OVER – ALLOTMENT AND STABILIZING TRANSACTIONS. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

NO DEALER, BROKER, SALESPERSON OR OTHER PERSON IS AUTHORIZED IN CONNECTION WITH ANY OFFERING MADE HEREBY TO GIVE ANY INFORMATION OR MAKE ANY REPRESENTATION OTHER THAN AS CONTAINED HEREIN, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE CORPORATION, THE STATE OR THE UNDERWRITERS. THIS OFFERING CIRCULAR DOES NOT CONSTITUTE AN OFFER TO SELL, OR A SOLICITATION OF AN OFFER TO BUY, ANY OF THE SECURITIES OFFERED HEREBY BY ANY PERSON IN ANY JURISDICTION IN WHICH IT IS UNLAWFUL FOR SUCH PERSON TO MAKE SUCH AN OFFER OR SOLICITATION.

THERE CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES 2007 BONDS WILL DEVELOP OR, IF ONE DEVELOPS, THAT IT WILL PROVIDE BONDHOLDERS WITH LIQUIDITY OR THAT IT WILL CONTINUE FOR THE LIFE OF THE SERIES 2007 BONDS.

This Offering Circular contains information furnished by the Corporation, the State and Global Insight (herein defined) and other sources, all of which are believed to be reliable. Information concerning the tobacco industry and industry participants has been obtained from certain publicly available information provided by certain participants and certain other sources. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY." The tobacco industry participants have not provided any information to the Corporation for use in connection with this offering. In certain cases, tobacco industry information provided herein (such as market share data) may be derived from sources which are inconsistent or in conflict with each other. The Corporation and the State have no independent knowledge of any facts indicating that the information under the caption "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" herein is inaccurate in any material respect, but have not independently verified this information and cannot and do not warrant the accuracy or completeness of this information. The information contained under the caption "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" and in the Global Insight Cigarette Consumption Report attached as Appendix A hereto have been included in reliance upon Global Insight as an expert in econometric forecasting, and have not been independently verified for accuracy or appropriateness of assumptions, although the Corporation and the State have no independent knowledge that the information is not materially accurate and complete.

The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Offering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Corporation, in the matters covered by the report of Global Insight attached hereto as Appendix A to this Offering Circular, or tobacco industry information, since the date hereof, or that the information contained in this Offering Circular is correct as of any date subsequent to the date hereof. Such information and expressions of opinion are made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other person. With respect to certain matters relating to the Series 2007 Bonds, the Corporation has undertaken to provide updates to investors through certain information repositories. See "CONTINUING DISCLOSURE UNDERTAKING" herein.

This Offering Circular contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the factors that may materially affect the amount of Revenues (as defined in the Indenture) (see "RISK FACTORS," "LEGAL CONSIDERATIONS," "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT," and "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT"), the inclusion in this Offering Circular of such forecasts, projections and estimates should not be regarded as a representation by the Corporation, the State, Global Insight or the Underwriters that the results of such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

If and when included in this Offering Circular, the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," "assumes" and analogous expressions are intended to identify forward-looking statements and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those that have been projected. Such risks and uncertainties include, among others, general economic and business conditions, changes in political, social and economic conditions, regulatory initiatives and compliance with governmental regulations, litigation and various other events, conditions and circumstances, many of which are beyond the control of the Corporation. These forward-looking statements speak only as of the date of this Offering Circular. The

Corporation and the State disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any changes in the expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

THE SERIES 2007 BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION OR ANY OTHER REGULATORY AGENCY, NOR HAS ANY OF THE FOREGOING PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The Underwriters have provided the following sentence for inclusion in this Offering Circular: The Underwriters have reviewed the information in this Offering Circular in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

The Series 2007 Bonds have not been registered under the Securities Act of 1933, as amended, in reliance upon an exemption from registration contained in such Act. The Series 2007 Bonds have not been registered or qualified under the securities laws of any state.

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Offering Circular and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Series 2007 Bonds to potential investors is made only by means of the entire Offering Circular. For locations of definitions of certain terms used herein, see the "Index of Defined Terms."

Overview .... The $197,005,742.20 aggregate initial principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2007 (the "**Series 2007 Bonds**") are being issued by the Tobacco Settlement Financing Corporation (the "**Corporation**"), a public corporation of the State of Rhode Island and Providence Plantations (the "**State**"), created by the State's Tobacco Settlement Financing Corporation Act, as amended (the "**Act**"). Pursuant to the Act and a Purchase and Sale Agreement, dated as of June 1, 2007 (the "**Purchase Agreement**"), between the State and the Corporation, the State will sell to the Corporation, on the Closing Date, all of its right, title and interest in certain amounts (the "**Residual Tobacco Assets**") evidenced by that certain Residual Certificate dated June 27, 2002 (the "**2002 Residual Certificate**"), under the Master Settlement Agreement (the "**MSA**") entered into by participating cigarette manufacturers (the "**PMs**"), the State, 45 other states and six U.S. jurisdictions in November 1998 in the settlement of certain smoking-related litigation, including future annual and strategic contribution fund payments to be made by the PMs under the MSA and that are no longer subject to the lien of the 2002 Indenture, as hereinafter defined.

Issuer .... The Corporation is a public corporation of the State created by the Act.

Securities Offered .... The Series 2007 Bonds and any series of additional bonds will be issued pursuant to an Indenture, dated as of June 1, 2007 (the "**Indenture**"), between the Corporation and Wells Fargo Bank, N.A., as Trustee (the "**Trustee**"). The Indenture provides that additional bonds may be issued subject to the satisfaction of certain conditions described herein. The Series 2007 Bonds and any additional bonds issued under the Indenture are collectively referred to herein as the "**Bonds**". See "THE SERIES 2007 BONDS – Additional Bonds and Additional Obligations." Individual purchases of beneficial ownership interests in the Series 2007A and the 2007B Bonds may be made in the principal amount which will accrete to $5,000 or any integral multiple thereof at their Maturity Date and individual purchases of beneficial ownership interests in the Series 2007C Bonds may be made in the principal amount which will accrete to $100,000 or any integral multiple thereof at their Maturity Date (each, respectively, an "**Authorized Denomination**").

It is expected that the Series 2007 Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about June 27, 2007 (the "**Closing Date**"). Individual purchases of beneficial ownership interests may be made in the initial principal amount of $5,000 of Accreted Value at Maturity or any integral multiple thereof. Beneficial owners of the Series 2007 Bonds will not receive physical delivery of bond certificates.

Security and Subordination............... The Series 2007 Bonds will be secured by and are payable solely from the "**Collateral**" consisting of (i) the Residual Tobacco Assets, all of which will be pledged under the Indenture (the "**Residual Pledged TSRs**") and all future aid, rents, fees, charges, payments, investment earnings and other income and receipts with respect thereto (collectively, the "**Revenues**"), (ii) all rights to receive the Revenues and the proceeds thereof, (iii) all accounts established under the Indenture and the assets thereof, and (iv) subject to certain limitations, all rights and interest of the Corporation under the Purchase Agreement. The proceeds of the Series 2007 Bonds and other

assets of the Corporation (other than the Residual Pledged TSRs) are not pledged to the payment of, and are therefore not available to the holders of, the Series 2007 Bonds. Pursuant to the Act, the Purchase Agreement and the Indenture, the Corporation has, in the opinion of Bond Counsel, validly included the pledge and agreement of the State not to limit or alter the rights of the Corporation to fulfill the terms of the Purchase Agreement and the Indenture or impair the rights and remedies of the Bondholders.

The Corporation has previously purchased from the State all of its right, title and interest in certain amounts paid or payable to the State by the PMs under the MSA, including future annual and strategic contribution fund payments (such payments as more fully described herein, the "**TSRs**"). Pursuant to an indenture, dated as of June 1, 2002 (the "**2002 Indenture**"), between the Corporation and Wells Fargo Bank, N.A., as trustee (the "**2002 Indenture Trustee**"), the Corporation has issued its Tobacco Settlement Asset-Backed Bonds, Series 2002A and Series 2002B, of which approximately $663,155,000 remain outstanding (such bonds and any refunding bonds issued under the 2002 Indenture being termed, collectively, the "**2002 Indenture Bonds**"). The 2002 Indenture Bonds are secured by and payable from certain of the TSRs (such pledged TSRs, the "**2002 Tobacco Assets**"). Except as specifically provided herein, the Collateral securing the Series 2007 Bonds does not include the rights of the Corporation to the receipt of the 2002 Tobacco Assets under the 2002 Indenture before the 2002 Indenture Bonds are deemed paid under the 2002 Indenture.

The Trustee is only entitled to receive payments of Residual Pledged TSRs on and after the date on which there are no 2002 Indenture Bonds outstanding under the 2002 Indenture. Accordingly, the Series 2007 Bonds are structurally subordinate to the payment in full of all 2002 Indenture Bonds issued under the 2002 Indenture for the benefit of the 2002 Indenture Bonds. If the 2002 Indenture Bonds are not paid in accordance with their terms or there is a default or event of default with respect to the 2002 Indenture Bonds, Holders of the Series 2007 Bonds may suffer a complete loss of their investment and have no remedy for the loss.

The Series 2007B Bonds are subordinate to the Series 2007A Bonds, and Holders of the Series 2007B Bonds are not entitled to receive any payment, including any Extraordinary Prepayment, until all Holders of Series 2007A Bonds and any other Bonds senior to the Series 2007B Bonds issued under the Indenture have been fully paid, regardless of the occurrence of an Event of Default. The Series 2007C Bonds are subordinate to the Series 2007B Bonds, and Holders of the Series 2007C Bonds are not entitled to receive any payment, including any Extraordinary Prepayment, until Holders of all Series 2007B Bonds and any other Bonds senior to the Series 2007C Bonds issued under the Indenture have been fully paid, regardless of the occurrence of an Event of Default.

The Series 2007 Bonds are payable as to Accreted Value solely out of the assets of the Corporation pledged for such purpose; neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the Accreted Value on the Series 2007 Bonds; the Series 2007 Bonds do not constitute an indebtedness of the State or any political subdivision of the State; the Series 2007 Bonds are secured solely by and are payable solely from the tobacco receipts sold to the Corporation and other monies of the Corporation pledged under the Indenture; the Series 2007 Bonds do not constitute a general, legal, or moral obligation of the State or any political subdivision thereof and the State has no obligation or intention to satisfy any deficiency or default of any payment of the Series 2007 Bonds. The Corporation has no taxing power. The Series 2007C Bonds are being reoffered only to "Qualified Institutional Buyers" as such term is defined in Rule 144A under the Securities Act of 1933. Upon purchase of any of the Series 2007C Bonds, a purchaser will be deemed to have represented that it is a Qualified Institutional Buyer and that it has a holding in Series 2007C Bonds in an amount equal to at least $100,000 in aggregate purchase price. See "RISK FACTORS – Limitation on Transferability" herein.

Use of Proceeds .... The Corporation will apply the proceeds of the Series 2007 Bonds (i) to pay the cash portion of the purchase price for the Residual Tobacco Assets and (ii) to pay certain costs of issuance relating to the Series 2007 Bonds.

Master Settlement Agreement .... The MSA was entered into on November 23, 1998 among the attorneys general of the State, 45 other states, the District of Columbia, Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively, the "**Settling States**") and the four largest United States tobacco manufacturers: Philip Morris Incorporated ("**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**"). Philip Morris, Reynolds Tobacco, B&W and Lorillard are collectively referred to as the "**Original Participating Manufacturers**" or the "**OPMs**"). On January 5, 2004, Reynolds American Inc. ("**Reynolds American**") was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities and operations of B&W with those of Reynolds Tobacco. References herein to the "**Original Participating Manufacturers**" or "**OPMs**" means, for the period prior to June 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard and for the period on and after June 30, 2004, means collectively Philip Morris, Reynolds American and Lorillard.

The MSA resolved cigarette smoking-related litigation between the Settling States and the OPMs and released the OPMs from past and present smoking-related claims and provides for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the Settling States (including Initial Payments, Annual Payments and Strategic Contribution Payments as defined herein), and imposed certain tobacco advertising and marketing restrictions on the OPMs, among other things. The MSA represents the resolution of a large potential financial liability of the OPMs for smoking-related injuries. The costs of the MSA have been passed along to cigarette consumers, who will likely continue to bear such costs. The Corporation is not a party to the MSA.

The MSA provides for tobacco companies other than the OPMs to become parties to the MSA. Tobacco companies that have become or become parties to the MSA after the OPMs are referred to herein as "**Subsequent Participating Manufacturers**" or "**SPMs**" and the SPMs, together with the OPMs, are referred to herein as the "**Participating Manufacturers**" or "PMs." Tobacco companies that did not or do not become parties to the

MSA are referred to herein as "**Non-Participating Manufacturers**" or "**NPMs**."

Under the MSA, the State is entitled to 0.7189054% of the Annual Payments and 1.0954758% of the Strategic Contribution Payments made by PMs under the MSA.

Litigation Regarding the MSA and Related Statutes .... Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (Grand River and Freedom Holdings, discussed in "RISK FACTORS" herein), that are pending in the U.S. District Court for the Southern District of New York. The plaintiffs in both cases seek, inter alia, a determination that state statutes enacted pursuant to the MSA conflict with and are preempted by the federal antitrust laws. The plaintiffs in the Grand River and Freedom Holdings cases also seek a determination that state statutes enacted pursuant to the MSA violate the Commerce Clause of the U.S. Constitution. A determination that the MSA or state legislation enacted pursuant to the MSA is void or unenforceable would have a materially adverse effect on the payments by PMs under the MSA and the amount or the timing of receipt of Residual Pledged TSRs available to make payments on the Bonds, and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

Payments Pursuant to the MSA .... Under the MSA, the OPMs are required to make the following payments to the Settling States; (i) five initial payments, all of which have been made (the "**Initial Payments**"), (ii) annual payments (the "**Annual Payments**") which are required to be made annually on each April 15, having commenced April 15, 2000, and continuing in perpetuity in the following base amounts (subject to adjustment as described herein):

Year	Base Amount†	Year	Base Amount†
2000	$4,500,000,000	2010	$8,139,000,000
2001	5,000,000,000	2011	8,139,000,000
2002	6,500,000,000	2012	8,139,000,000
2003	6,500,000,000	2013	8,139,000,000
2004	8,000,000,000	2014	8,139,000,000
2005	8,000,000,000	2015	8,139,000,000
2006	8,000,000,000	2016	8,139,000,000
2007	8,000,000,000	2017	8,139,000,000
2008	8,139,000,000	2018	9,000,000,000
2009	8,139,000,000	thereafter	9,000,000,000

† As described herein, the base amounts of Annual Payments are subject to various adjustments which have resulted in reduced annual payments in all prior years. See "SUMMARY OF MASTER SETTLEMENT AGREEMENT – Annual Payments," "RISK FACTORS – Other Potential Payment Decreases Under the Terms of the Master Settlement Agreement – Disputed or Recalculated Payments" and "SUMMARY OF MASTER SETTLEMENT AGREEMENT – Annual Payments" herein.

and (iii) ten annual payments in the amount of $861 million each, each of which is subject to adjustment (the "**Strategic Contribution Payments**"), required to be made on each April 15 commencing April 15, 2008 and ending April 15, 2017.

See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Initial Payments," "– Annual Payments" and "– Strategic Contribution Payments" herein.

Under the MSA, each OPM is required to pay an allocable portion of each Annual Payment and Strategic Contribution Payment based on its respective market share of the United States cigarette market during the preceding calendar year, in each case, subject to certain adjustments as described herein. Each SPM has Annual Payment and Strategic Contribution Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share only if its market share exceeds the higher of its 1998 market share or 125% of its 1997 market share. The SPMs did not have a payment obligation with respect to the Initial Payments under the MSA. The payment obligations under the MSA follow tobacco product brands if they are transferred by any of the PMs. Payments by the PMs under the MSA are required to be made to the MSA Escrow Agent, which is required, in turn, pursuant to the instructions of the MSA Escrow Agreement, to remit an allocable share of such payments to the parties entitled thereto.

Under the MSA, the Annual Payments and Strategic Contribution Payments due under the MSA are subject to numerous adjustments, some of which may be material. Such adjustments include, among others, reductions for decreased domestic cigarette shipments and to account for those states that settle or have settled their claims against the PMs independently of the MSA and increases related to inflation in an amount of not less than 3% per year in the case of the Annual Payments and Strategic Contribution Payments.

Industry Overview .... The three OPMs, Philip Morris, Reynolds American and Lorillard, are the largest manufacturers of cigarettes in the United States (based on 2006 domestic market share). The market for cigarettes is highly competitive, and is characterized by brand recognition and loyalty. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY."

Cigarette Consumption .... As described in the Global Insight Cigarette Consumption Report, domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and are forecasted to be 373 billion cigarettes in 2006. For 2006, industry shipments of 372.5 billion cigarettes were 2.4% less than the 381.7 billion now reported for 2005. A number of factors affect consumption, including, but not limited to, pricing, industry advertising, expenditures, health warnings, restrictions on smoking in public places, nicotine dependence, youth consumption, general population trends and disposable income. See "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" herein and Appendix A – "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached hereto.

Global Insight Cigarette Consumption Report........................... Global Insight (USA), Inc. ("**Global Insight**"), an international econometric and consulting firm, was retained on behalf of the Corporation to forecast cigarette consumption in the United States from 2007 through 2052. Global Insight's report, entitled "A Forecast of U.S. Cigarette Consumption (2007-2052) for the Tobacco Settlement Financing Corporation" dated June 21, 2007 (the "**Global Insight Cigarette Consumption Report**") is attached hereto as Appendix A and should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions contained therein. The Global Insight Cigarette Consumption Report is subject to certain disclaimers and qualifications as described therein. See Appendix A attached hereto.

Global Insight considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effects of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation and health warnings. Global Insight found the following variables to be effective in building an empirical model of adult per capita cigarette consumption: real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places and the trend over time in individual behavior and preferences. Using data from 1965 to 2005 and an analysis of the variables, Global Insight constructed an empirical model of adult per capita cigarette consumption ("**CPC**") for the United States. Using standard multivariate regression analysis to determine the relationship between such variables and CPC along with Global Insight's standard adult population growth statistics and adjustments for non-adult smoking, Global Insight projected adult cigarette consumption through 2052.

While the Global Insight Cigarette Consumption Report is based on United States cigarette consumption, Annual Payments and Strategic Contribution Payments are computed based in part on shipments in or to the fifty United States, the District of Columbia and Puerto Rico. The Global Insight Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the United States may not match at any given point in time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time. See "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" herein. The projections and forecasts regarding future cigarette consumption included in the Global Insight Cigarette Consumption Report are estimates which have been prepared on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of, and no representation or warranty should be inferred from, these projections and forecasts.

No Current Interest............................. Interest on the Series 2007 Bonds is not paid currently but accrues at the yield set forth on the inside cover page from the Date of Delivery, which interest shall be compounded every December 1 and June 1, commencing December 1, 2007, until their respective maturity dates or earlier redemption. See Appendix G – "TABLE OF ACCRETED VALUES" attached hereto.

Principal Payments............................. The Accreted Value of the Series 2007 Bonds will be paid on the maturity dates as set forth on the inside front cover of this Offering Circular or upon prior redemption. "**Accreted Value**" means an amount equal to the initial principal amount of such Bonds, plus interest accrued thereon from its date of issuance, compounded on each December 1 and June 1, commencing on December 1, 2007 through and including the Maturity Date or earlier redemption date of such Bond at the interest rate for such Bond, as set forth in the Series Supplement therefor and in accordance with the Accreted Value Table attached thereto; provided, however, that the Corporation shall

calculate or cause to be calculated the Accreted Value on any date other than each December 1 and June 1 by straight line interpolation of the Accreted Values as of the immediately preceding and succeeding December 1 and June 1. See Appendix G – "TABLE OF ACCRETED VALUES" attached hereto.

Failure by the Corporation to pay the Accreted Value at maturity on any Series 2007 Bonds will constitute an Event of Default under the Indenture. Failure to make Turbo Redemption payments on the Series 2007 Bonds will not constitute an Event of Default. See "SECURITY FOR THE SERIES 2007 BONDS – Flow of Funds" herein.

Turbo Redemption .... The Series 2007 Bonds are subject to mandatory redemption in whole or in part prior to their stated maturity, from amounts on deposit in the Turbo Redemption Account on any Distribution Date, at the redemption price of 100% of the Accreted Value thereof, without premium ("**Turbo Redemption**"). Amounts in the Turbo Redemption Account may not be applied to purchase the Series 2007 Bonds on the open market. Any redemption of the Series 2007 Bonds from amounts in the Turbo Redemption Account pursuant to the Indenture shall be made by Series in accordance with the Payment Priorities and Pro Rata within each Series of Bonds. For purposes of defeasance, such Series 2007 Bonds shall have the assumed redemption schedule set forth in Appendix H – "DEFEASANCE TURBO SCHEDULES" hereto. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

A failure by the Corporation to make Turbo Redemption payments on the Series 2007 Bonds will ***not*** constitute an Event of Default under the Indenture.

"**Payment Priorities**" means, subject to the issuance of Additional Bonds which may be payable prior to the Series described below, payment of the Bonds in the following order of priority: (1) first, the Series 2007A Bonds until they are Fully Paid (as defined in the Indenture); (2) second, the Series 2007B Bonds until they are Fully Paid; and (3) third, the Series 2007C Bonds until they are Fully Paid.

"**Distribution Date**" means each December 1 and June 1, commencing December 1, 2007.

"**Pro Rata**" means, for an allocation of available amounts to any payment of interest or Accreted Value to be made pursuant to the Indenture, the application of a fraction of such available amounts (a) the numerator of which is equal to the amount due to the respective Owners, and (b) the denominator of which is equal to the total amount due to all Owners to whom such payment is owing.

Actual Payments of Principal .... Due to a number of factors, including actual shipments of cigarettes in the United States and the actual level of payments received by the Settling States (including the State) under the MSA, the amount available to pay the Series 2007 Bonds may fluctuate from year to year. The Corporation is only obligated to make Turbo Redemptions to the extent that Revenues are available for such purpose in the Turbo Redemption Account. A failure by the Corporation to pay the Accreted Value of a Series 2007 Bond on its applicable Maturity Date will constitute an Event of Default under the Indenture.

Optional Redemption	The Series 2007 Bonds are subject to redemption at the Corporation's option at any time, in whole or in part, on and after June 1, 2017, at a redemption price of 100% of the Accreted Value thereof, without premium. Fifteen days' notice shall be given to holders of the Series 2007 Bonds to be redeemed prior to maturity. The Corporation may select the dates, amounts, rates and maturities of Series 2007 Bonds for optional redemption at its sole discretion. On and after any date of redemption, interest will cease to accrete on any Series 2007 Bonds called for redemption.
Extraordinary Prepayment	If an Event of Default has occurred, on each Distribution Date, Outstanding Senior Bonds will be prepaid from available funds on deposit in the Debt Service Reserve Account, the Lump Sum Prepayment Account and the Extraordinary Prepayment Account, at a price equal to the principal amount or Accreted Value thereof, without premium (any such prepayment, an "**Extraordinary Prepayment**"). Any such prepayment shall be made by Series in accordance with the Payment Priorities and Pro-Rata within each Series. If an event of default has previously occurred with respect to the 2002 Indenture Bonds, however, no payments of Residual Pledged TSRs will be made to the Trustee until the 2002 Indenture Bonds have been paid in full.
Lump Sum Prepayment	The Bonds are subject to prepayment at any time at the principal amount or Accreted Value thereof, plus accrued interest, if any, to the prepayment date, upon receipt by the Trustee of a lump sum payment received as a payment from a PM which results in, or is due to, a release of that PM from all or a portion of its future obligations under the MSA (a "**Lump Sum Payment**"). Each Lump Sum Payment shall be allocated to the prepayment of Outstanding Senior Bonds. Any such prepayment shall be made by Series in accordance with the Payment Priorities and Pro-Rata within each Series.
Bond Structuring Assumptions and Methodology	The Series 2007 Bonds were structured on the basis of forecasts, which themselves are based on assumptions, as described herein. Among these are a forecast of United States cigarette consumption contained in the Global Insight Cigarette Consumption Report, and the application of certain adjustments and offsets to payments to be made by the PMs pursuant to the MSA, and a forecast of the Accounts and all earnings on amounts on deposit in the Accounts established under the Indenture. In addition, such forecasts were used to project amounts expected to be available for redemption of the Series 2007 Bonds from Turbo Redemptions and the resulting expected average lives of the Series 2007 Bonds. No assurance can be given, however, that events will occur in accordance with such assumptions and forecasts. Any deviations from such assumptions and forecasts could materially and adversely affect the payment of the Series 2007 Bonds. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.
Distributions and Priorities	Any Residual Pledged TSRs received by the Corporation will be promptly (and in no event later than five Business Days after receipt) deposited in the Revenue Account. Except as otherwise specified in the Indenture, the Trustee will deposit all Revenues in the Revenue Account. The term "**Fiscal Year**" means each 12 month period ending each June 30. As used herein, the term "**Deposit Date**" means the date of actual receipt by the Trustee of any Residual Pledged TSRs. As soon as possible following each deposit of Residual Pledged TSRs to the Revenue Account, the Trustee will withdraw Revenues on deposit in the Revenue Account and transfer such amounts in priority as follows: (1) to the Operating Account, an amount specified in an Officer's Certificate (or certificate of an authorized officer of the Corporation,

as appropriate), plus the amount necessary to provide for Priority Payments and any penalties, fines or other payments required to be made to the United States of America under the arbitrage or rebate provisions of the Code, in each case for the current Fiscal Year and for the first full six months of the following Fiscal Year (provided, however, that the aggregate of the amounts transferred to the Operating Account pursuant to this clause (1) in any Fiscal Year shall not exceed the 2007 Operating Cap);

(2) to the Debt Service Account, an amount sufficient to cause the amount therein to equal interest (including interest at the stated rate on the Principal of Outstanding Bonds and on overdue interest, if any) due on the next succeeding Distribution Date and, in the case of Parity Payments and interest due at variable rates on Bonds, to deposit in separate subaccounts within the Debt Service Account, Bond interest and Parity Payments due during the current Fiscal Year including such Distribution Date, together with any unpaid interest and other Parity Payments due on prior Distribution Dates;

(3) unless an Event of Default has occurred and is continuing, to the Debt Service Account, an amount sufficient to cause the amount therein (exclusive of the amount on deposit therein under clause (2) above) to equal the Principal due during the current Fiscal Year;

(4) unless an Event of Default has occurred and is continuing, to the Debt Service Reserve Account, and amount sufficient to cause the amounts therein to equal the Debt Service Reserve Requirement, if any;

(5) unless an Event of Default has occurred and is continuing, to the Debt Service Account the amount which, together with amounts deposited pursuant to clause (2) above but exclusive of the amounts deposited therein pursuant to clause (3) above, will be sufficient to cause the amount on deposit therein to equal interest (including interest at the stated rate on the Principal of Outstanding Bonds) and Parity Payments, in each case, due (a) during the current Fiscal Year and (b) if the Deposit Date is during the period from January 1 through June 30 of any year, during the first full six months of the next Fiscal Year, assuming that Principal of the Bonds will be paid in the amounts deposited pursuant to clause (3) above and Turbo Redemptions will be paid pursuant to clause (9) below;

(6) if an Event of Default has occurred and is continuing, to the Extraordinary Prepayment Account, all amounts remaining in the Revenue Account;

(7) to the Lump Sum Prepayment Account, the amount of any Lump Sum Payment;

(8) to the Operating Account, an amount specified by an Officer's Certificate (or certificate of an authorized officer of the Corporation, as appropriate) to pay for any Operating Expenses in excess of the 2007 Operating Cap; and

(9) to the Turbo Redemption Account, the amount remaining in the Revenue Account.

Except as otherwise provided in the Indenture and unless an Event of Default has occurred, investment earnings on the Accounts shall be deposited in the Revenue Account no later than the Business Day immediately preceding each Distribution Date. If an Event of Default has occurred and is continuing any such investment earnings shall be deposited in the Debt Service Account.

On each Distribution Date the Trustee will apply amounts in the various Accounts in the following order of priority:

(1) from the Debt Service Account, the Lump Sum Prepayment Account, the Turbo Redemption Account and the Debt Service Reserve Account, in that order, to pay interest on the Outstanding Bonds (including interest on overdue interest, if any) and Parity Payments due on such Distribution Date, plus any unpaid interest and Parity Payments due on prior Distribution Dates;

(2) unless an Event of Default has occurred and is continuing, from the Debt Service Account, the Lump Sum Prepayment Account, the Turbo Redemption Account and the Debt Service Reserve Account, in that order, to pay in order of Maturity Dates the Principal due on such Distribution Date;

(3) if an Event of Default has occurred, from the Debt Service Reserve Account, the Lump Sum Prepayment Account and the Extraordinary Prepayment Account, to pay Extraordinary Prepayments;

(4) from the Lump Sum Prepayment Account, to redeem Bonds pursuant to a Lump Sum Prepayment;

(5) from the Accounts therefor, in the amounts and to the accounts specified by Series Supplement for payments on Subordinate Bonds, if applicable, termination and certain other payments on swaps, term-out and subordinate payments with respect to credit enhancement and any other subordinate payments specified by the Indenture (collectively, the "**Junior Payments**"); and

(6) from the Turbo Redemption Account, to redeem Bonds.

Events of Default.............................. "**Event of Default**" means any one of the events set forth below:

(i) the failure to pay Principal of or interest on the Senior Bonds when due;

(ii) the Corporation fails to observe or perform any other provision of the Indenture which failure is not remedied within 30 days after written notice thereof is given to the Corporation by the Trustee or to the Corporation and the Trustee by the holders of at least 25% of the Principal amount of the Senior Bonds then Outstanding;

(iii) bankruptcy, reorganization, arrangement or insolvency proceedings, or other proceedings for relief under any bankruptcy or similar law or laws for the relief of debtors, are instituted by or against the Corporation and, if instituted against the Corporation, are not dismissed within 60 days after such institution;

(iv) the State fails to observe or perform any covenant described below under "SECURITY FOR THE SERIES 2007 BONDS-Non-Impairment Pledge of the State", which failure is not remedied within 30 days after written notice thereof is given to the Corporation, the State and the Trust Fund by the Trustee or to the Corporation and the Trustee by Holders of not less than 25% of the principal amount Outstanding of the Senior Bonds then Outstanding;

(v) the State fails to pay promptly to the Corporation or the Trustee any Residual Pledged TSRs received by it; or

(vi) the State consents to or acquiesces in an amendment or modification of the MSA, or the Consent Decree is amended or modified, in each

case, so as to materially reduce the amount of TSRs payable to the State under the MSA or to materially delay any date of payment of a material amount thereof.

Upon the occurrence of an Event of Default, neither the Trustee nor the Holders shall have the right to sell or foreclose on the collateral pledged to the Trustee under the Indenture.

Additional Bonds and Additional Obligations .... The Corporation may only issue additional Series of Bonds ("**Additional Bonds**") or bonds, notes or other obligations ("**Additional Obligations**") under the 2002 Indenture (as amended, supplemented or restated from time to time) or any other indenture or agreement providing for the issuance of Additional Obligations that are to be secured by a claim on the 2002 Tobacco Assets prior to the 2002 Residual Certificate or the Series 2007 Bonds (each a "**Senior Indenture**") only upon receipt by the Trustee of (i) a Rating Confirmation from each Rating Agency then rating the Outstanding Bonds under the Indenture and (ii) a certificate of the Corporation that as a result of the issuance of such Additional Bonds or Additional Obligations, the weighted average life of each Bond then Outstanding under the Indenture, projected in years from such Bond's date of issuance, will not exceed the sum of (x) the weighted average life of each such Outstanding Bond issued under the Indenture as projected at the time such Bond was issued and set forth in the applicable Series Supplement relating thereto (with respect to the Series 2007 Bonds, such expected weighted average lives are set forth in the Turbo Defeasance Schedule attached to the Series 2007 Supplement) and (y) one. In calculating the weighted average life of each of the Outstanding Bonds for the purpose of the certificate required by clause (ii) of the preceding sentence, the Corporation shall take into consideration (1) the amount of Turbo Redemptions of such Bonds that have been paid prior to and including to the date of issuance of the Additional Bonds or Additional Obligations and (2) the amount of Turbo Redemptions projected by the Corporation to be paid on each Distribution Date subsequent to the issuance of such Additional Bonds or Additional Obligations based upon the amount of TSRs then expected to be received by the Corporation and available for payment of Turbo Redemptions of each outstanding bond under the Senior Indenture. In determining compliance with clause (ii) of this paragraph, the Corporation may rely conclusively on a certification of a financial advisor or an underwriting firm, who may in turn rely on a report of a nationally recognized firm of econometric experts on matters related to projected or forecasted cigarette consumption. See "THE SERIES 2007 BONDS — Additional Bonds and Additional Obligations."

Covenants .... Pursuant to the Act, the State has covenanted, among other things, that it will not limit or alter rights vested in the Corporation to fulfill the terms of any agreements made with holders of the Bonds, or otherwise take any action that materially and adversely effects the rights of the Bondholders until all Bonds are entirely paid or defeased. The Corporation has covenanted not to impair the exclusion of interest on the Series 2007 Bonds from gross income for federal income tax purposes. See Appendix D -"SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - The Indenture" for a summary of the covenants made by the Corporation and Appendix D -"SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - The Purchase Agreement" for a summary of the covenants made by the State.

Continuing Disclosure Undertaking...................................... The Corporation has agreed to provide, or cause to be provided, to each nationally recognized municipal securities information repository and any public or private repository or entity designated by the State as a repository for purposes of Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission certain annual financial information and operating data and, in

	a timely manner, notices of certain material events. See "CONTINUING DISCLOSURE UNDERTAKING" herein.
Ratings..	The ratings of the Series 2007 Bonds address the ability of the Corporation to pay the Accreted Value of such Series 2007 Bonds on their respective Maturity Dates as set forth on the inside cover page of this Offering Circular. Neither projections of Turbo Redemption payments of the Series 2007 Bonds nor any principal amounts used for structuring purposes, other than amounts due on the Maturity Dates for the Series 2007 Bonds, have been rated by the Rating Agency. A rating is not a recommendation to buy, sell or hold securities, and such rating is subject to revision or withdrawal at any time. Owners of the Series 2007 Bonds bear the reinvestment risk from faster than expected amortization, as well as the extension risk from slower than expected amortization of the Series 2007 Bonds. See "RATINGS" herein.
Legal Considerations	Reference is made to "LEGAL CONSIDERATIONS" for a description of certain legal issues relevant to an investment in the Series 2007 Bonds. Neither the State nor the Corporation can be a debtor under any chapter of the United States Bankruptcy Code, nor could the State or the Corporation become a debtor under any chapter of such Bankruptcy Code without an amendment thereto.
Risk Factors	Reference is made to "RISK FACTORS" for a description of certain considerations relevant to an investment in the Series 2007 Bonds.
Tax Matters..	In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Series 2007 Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "**Code**"), and (ii) interest on the Series 2007 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In addition, in the opinion of Bond Counsel to the Corporation, pursuant to the provisions of the Tobacco Settlement Financing Corporation Act, income on the Series 2007 Bonds, including any profit made on the sale thereof, is free from State personal income taxes. See "TAX MATTERS" herein.
Availability of Documents.................	Included herein are brief summaries of certain documents and reports, which summaries do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statements of the contents thereof. Copies of the Indenture and the Purchase Agreement may be obtained by written request from the Trustee at 10 Orms Street, Suite 325, Providence, Rhode Island 02904. Any statements in this Offering Circular involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Offering Circular is not to be construed as a contract or agreement among the Corporation, the State and the purchasers or Bondholders.

$197,005,742.20
Tobacco Settlement Financing Corporation
Tobacco Settlement Asset-Backed, Series 2007

RISK FACTORS

The Series 2007 Bonds differ from many other tax-exempt securities in a number of respects. Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2007 Bonds as well as other information contained in this Offering Circular. The following discussion of risks is not meant to be a complete list of the risks associated with the purchase of the Series 2007 Bonds and the order of presentation does not necessarily reflect the relative importance of the various risks. Potential purchasers of the Series 2007 Bonds are advised to consider the following factors, among others, and to review the other information in this Offering Circular in evaluating the Series 2007 Bonds. Any one or more of the risks discussed, and others, could lead to a decrease in the market value and/or the liquidity of the Series 2007 Bonds or, in certain circumstances, could lead to a complete loss of a Bondholder's investment. There can be no assurance that other risk factors will not become material in the future.

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation

General Overview. Certain smokers, consumer groups, cigarette importers, cigarette wholesalers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have instituted lawsuits against various PMs, certain of the Settling States and other public entities challenging the MSA and/or the Qualifying Statutes and related legislation. One or more of the lawsuits, several of which remain pending, allege, among other things, that the MSA and/or the Qualifying Statutes and related legislation are void or unenforceable under the Commerce Clause and certain other provisions of the U.S. Constitution and the federal antitrust laws, as described below under "*–Grand River, Freedom Holdings and Related Cases*" and "*–Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" in this subsection. In addition, some of the lawsuits allege that the MSA and/or related state legislation are void or unenforceable under the federal civil rights laws, state constitutions, consumer protection laws, and unfair competition laws. Certain of these lawsuits seek, and, if ultimately successful, could result in, a determination that the MSA and/or the Qualifying Statutes and related legislation are void or unenforceable. Certain of the lawsuits further seek, among other things, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA. In addition, class action lawsuits have been filed in several federal and state courts alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco-related diseases should be paid directly to Medicaid recipients. In the case of *Cutting Edge Enterprises Inc. v. National Association of Attorneys General*, in an action in federal court in the Southern District of New York a PM seeks to cause the National Association of Attorneys General and the attorneys general of several states (not including the State) to list the PM's brands on their respective web sites, alleging that their refusal to do so violates federal antitrust laws, the Commerce Clause, and laws prohibiting tortious interference with business relations. Oral argument on a motion to dismiss was heard on April 20, 2006, and a decision is pending. To date, challenges to the MSA or related state legislation have not been ultimately successful, although three such challenges (the *Grand River* and *Freedom Holdings* cases in federal court in New York, and the *Xcaliber* case in federal court in Louisiana, all of which are discussed below) have survived initial appellate review of motions to dismiss. Moreover, these three cases and the *A.B. Coker* case in federal court in Louisiana (discussed below) are the only cases challenging the MSA or related legislation that have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact based on extrinsic evidence as to the operation and impact of the MSA and the related statutes. In *Grand River* and *Freedom Holdings*, certain decisions by the U.S. Court of Appeals for the Second Circuit have created heightened uncertainty as a result of that court's interpretation of federal antitrust immunity and Commerce Clause doctrines as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by other courts, which have rejected challenges to the MSA and related statutes. Prior decisions rejecting such challenges have concluded that the MSA and related statutes do not violate the Commerce Clause of the U.S. Constitution and are protected from antitrust challenges based on established antitrust immunity doctrines. In addition, proceedings are pending or on appeal in certain other cases, including two challenges by certain NPMs in federal court in Louisiana (*Xcaliber* and *A.B. Coker*), alleging, *inter alia*, that the Louisiana Allocable Share Release Amendment violates the rights of free speech, due process of law, and equal protection of the laws guaranteed under the U.S. Constitution and the Louisiana Constitution. On March 1, 2006,

the U.S. Court of Appeals for the Fifth Circuit vacated the district court's dismissal of the plaintiffs' complaint in one of the *Xcaliber* cases and remanded the case for reconsideration. See "*–Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" in this subsection. The MSA and related state legislation may also continue to be challenged in the future. A determination that the MSA or related state legislation is void or unenforceable would have a material adverse effect on the payments by the PMs under the MSA and the amount or the timing of receipt of Residual Pledged TSRs available to the Corporation to make payments with respect to the Series 2007 Bonds, including payments of Turbo Redemptions, interest on or principal or Accreted Value of the Series 2007 Bonds, could lead to a decrease in the market value and/or the liquidity of the Series 2007 Bonds and, in certain circumstances, could lead to a complete loss of a Bondholder's investment. See "LEGAL CONSIDERATIONS" herein.

Qualifying Statute and Related Legislation. Under the MSA's NPM Adjustment, downward adjustments may be made to the Annual Payments and Strategic Contribution Payments payable by a PM if the PM experiences a loss of market share in the United States to NPMs as a result of the PM's participation in the MSA. See "− Other Potential Payment Decreases Under the Terms of the MSA − NPM Adjustment" herein and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT − MSA Provisions Relating to Model/Qualifying Statutes" herein. A Settling State may avoid the effect of this adjustment by adopting and diligently enforcing a Qualifying Statute, as hereinafter described. The State has adopted the Model Statute, which by definition is a Qualifying Statute under the MSA. The Model Statute, in its original form, required an NPM to make escrow deposits approximately in the amount that the NPM would have had to pay to all of the states had it been a PM and further authorized the NPM to obtain from the applicable Settling State the release of the amount by which the escrow deposit in that state exceeded that state's allocable share of the total payments that the NPM would have made as a PM. Legislation has been enacted in at least 44 of the Settling States, including the State, amending the Qualifying Statutes in those states by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain under the statute to the excess above the total payment that the NPM would have paid had it been a PM (each an "**Allocable Share Release Amendment**"). A majority of the PMs, including all OPMs, have indicated in writing that the State's Model Statute, as amended by an Allocable Share Release Amendment, will continue to constitute a Qualifying Statute within the meaning of the MSA. In addition, at least 44 Settling States (including the State) and the District of Columbia have passed legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making required escrow payments under the states' respective Qualifying Statutes. Pursuant to the State's Qualifying Statute and Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold directly or indirectly in the State is required to certify annually that it is either (a) a PM and is in full compliance with the terms of the MSA or (b) an NPM and is in full compliance with the State's Qualifying Statute. The Qualifying Statutes and related legislation, like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the United States Constitution and/or state constitutions and are preempted by federal antitrust laws. The lawsuits seek, among other things, injunctions against the enforcement of the Qualifying Statutes and related legislation. To date such challenges have not been ultimately successful, although the enforcement of Allocable Share Release Amendments has been preliminarily enjoined in New York and certain other states. Appeals are also possible in certain cases. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Pending challenges to the Qualifying Statutes and related legislation are described below under "*– Grand River, Freedom Holdings and Related Cases" and "– Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" in this subsection.

A determination that a Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA itself; such a determination could, however, have an adverse effect on payments to be made under the MSA if one or more NPMs were to gain market share. See "− Other Potential Payment Decreases Under the Terms of the MSA – NPM Adjustment," "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Relating to Model/Qualifying Statutes," and "LEGAL CONSIDERATIONS" herein.

A determination that an Allocable Share Release Amendment is unenforceable would not constitute a breach of the MSA but could permit NPMs to exploit differences among states, target sales in states without Allocable Share Release Amendments, and thereby potentially increase their market share at the expense of the PMs. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Relating to Model/Qualifying Statutes" herein.

A determination that the State's Complementary Legislation is unenforceable would not constitute a breach of the MSA or affect the enforceability of the State's Qualifying Statute; such a determination could, however, make enforcement of the State's Qualifying Statute against NPMs more difficult for the State. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT − MSA Provisions Relating to Model/Qualifying Statutes" herein.

Grand River, Freedom Holdings and Related Cases. Among the pending challenges to the MSA and/or related state legislation are two lawsuits referred to herein as *Grand River* and *Freedom Holdings*, both of which are pending in the United States District Court for the Southern District of New York. The *Grand River* case is pending against the attorneys general of 31 states (but not the State) and alleges, among other things, that (a) the MSA creates an unlawful output cartel under federal antitrust law and state legislation enacted pursuant to the MSA mandates or authorizes such cartel and is thus preempted by federal law and that (b) the MSA and related statutes are invalid or unenforceable under the Commerce Clause and other provisions of the United States Constitution. The plaintiffs in *Grand River* seek to enjoin the enforcement of the Qualifying Statutes and Complementary Legislation by the Grand River Challenged States (defined below). The *Freedom Holdings* case is pending against the attorney general and the commissioner of taxation and finance of the State of New York and is based on the same purported claims as the *Grand River* case (including, as discussed below, a Commerce Clause claim asserted by the plaintiffs in their Second Supplemental and Amended Complaint following a Second Circuit ruling on the issue in the *Grand River* case). The plaintiffs in *Freedom Holdings* seek to enjoin the enforcement of New York's Qualifying Statute and Complementary Legislation. These suits have survived appellate review of motions to dismiss for failure to state a claim upon which relief can be granted and are in the discovery phase of litigation in preparation for the development of a factual record to support possible findings of fact that may be used by the court in its decision as to the pending claims. To date, *Grand River* and *Freedom Holdings*, along with *Xcaliber v. Ieyoub* and *A.B. Coker v. Foti* (both discussed below), are the only cases challenging the MSA or related legislation that have survived initial appellate review of motions to dismiss. Moreover, these cases are the only cases challenging the MSA or related legislation that have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact based on extrinsic evidence as to the operation and impact of the MSA and the related state legislation.

On July 1, 2002, *Grand River Enterprises Six Nations Ltd. v. Pryor* ("**Grand River**") was filed in the United States District Court of the Southern District of New York by certain NPMs against current and former attorneys general of 31 states (not including the State) (the "**Grand River Challenged States**"). The plaintiffs seek to enjoin the enforcement of the Grand River Challenged States' Qualifying Statutes and Complementary Legislation, alleging that such Qualifying Statutes and Complementary Legislation violate the plaintiffs' constitutional rights under the Commerce Clause and other provisions of the United States Constitution and also that such Qualifying Statutes and Complementary Legislation conflict with and are therefore preempted by the federal antitrust laws. In September 2003, the District Court held that it lacked personal jurisdiction over the non-New York attorneys general and dismissed the plaintiffs' complaint against them. In addition, the District Court dismissed the plaintiffs' complaint against the New York attorney general, finding that the plaintiffs had failed to state a claim upon which relief could be granted. After the Second Circuit's decision in *Freedom Holdings* (discussed below), however, the District Court granted the plaintiffs' motion in *Grand River* to reinstate, against the New York attorney general only, that portion of the complaint alleging that New York's Qualifying Statute and New York's Complementary Legislation conflict with antitrust laws and are preempted by federal law.

The plaintiffs appealed the dismissal of their other claims to the Second Circuit. On September 28, 2005, the Second Circuit reinstated portions of the Commerce Clause challenge and reinstated the non-New York attorneys general as defendants, finding that a federal court in New York could exercise personal jurisdiction over them, and affirmed the dismissal of certain remaining claims, including the claim that the Qualifying Statute and related legislation violated the Indian Commerce Clause of the United States Constitution. The case was remanded to the District Court. On May 31, 2006, the District Court denied *Grand River*'s motion for a preliminary injunction seeking to bar defendants from: (1) enforcing their states' Allocable Share Release Amendments; (2) denying *Grand River*'s application to become a party to the Master Settlement Agreement; and (3) banning sales in the defendants' states of *Grand River*-produced cigarettes. The District Court held that *Grand River* failed to show either a likelihood of irreparable injury absent an injunction or a likelihood of success on the merits of its claims. On June 7, 2006, *Grand River* filed an appeal of this decision before the Second Circuit. Separately, *Grand River* also filed a motion for an injunction pending appeal, which the District Court denied on June 29, 2006. On March 6, 2007, the Second Circuit denied *Grand River*'s appeal, solely on the basis that the District Court had not abused its discretion in finding that plaintiff *Grand River* had failed to show a likelihood of irreparable injury.

On October 12, 2005, the defendants filed a petition with the Second Circuit for rehearing with regard to the Second Circuit's ruling on the issue of personal jurisdiction. The plaintiffs filed a petition with the Second Circuit for rehearing on the Indian Commerce Clause ruling. On January 3, 2006, the Second Circuit denied all parties' petitions for rehearing. On April 18, 2006 the non-New York defendants filed a petition for certiorari review with the U.S. Supreme Court challenging the Second's Circuit ruling on the issue of personal jurisdiction. See *King v. Grand River Enterprises Six Nations, Ltd.* On October 10, 2006, the U.S. Supreme Court denied the defendants' petition for certiorari.

With regard to the Commerce Clause challenge, the Second Circuit in *Grand River* noted that because it was reviewing a motion to dismiss, it was required to accept as true the material facts alleged in the complaint and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit held that although each state's Qualifying Statute and Complementary Legislation apply to cigarette sales within such state, the plaintiffs sufficiently stated a possible claim that these statutes together create a national or "interstate" regulatory policy and thereby exert "extraterritorial control" over out-of-state transactions in contravention of the Commerce Clause. The Second Circuit acknowledged that in *Freedom Holdings* (discussed below) it had ruled that plaintiffs failed to state a claim that the State's Complementary Legislation had violated the Commerce Clause, but explained that it did so because plaintiffs there had not sufficiently alleged an extraterritorial effect of that legislation. To date, *A.B. Coker* (discussed below), *Grand River*, and, as a technical matter, *Freedom Holdings* (pursuant to the grant of a motion to amend the complaint in that matter to include a Commerce Clause claim), are the only cases in which a Commerce Clause challenge to the MSA and related statutes has not been the subject of a summary dismissal. However, other such challenges are currently pending in various jurisdictions. An adverse ruling on Commerce Clause grounds could potentially lead to invalidation of the MSA and the Qualifying Statutes in their entirety and result in the complete loss of a Bondholder's outstanding investment.

With regard to the reinstatement of the non-New York defendants, the Second Circuit explained that where an out of state defendant has "transacted business" in the State of New York and there is "substantial nexus" between that transaction and the litigation in question, the federal courts in the state can obtain jurisdiction over the defendants. The Second Circuit concluded that by negotiating the MSA in New York, the attorneys general "transacted business" for the purpose of conferring jurisdiction in federal courts in New York. The Court also held that there was "substantial nexus" between the MSA negotiations and the lawsuit, because although the challenged statutes are discrete acts of each state, they were integral to the operation of the MSA and were negotiated as such.

Grand River remains pending before the U.S. District Court for the Southern District of New York, wherein the defendants filed an answer to the complaint on October 25, 2006. The District Court has ruled that the pre-trial discovery period will conclude in March 2008. Any decision by the Second Circuit in this case would not be subject to appeal as of right to the U.S. Supreme Court. No assurance can be given: (1) that the Supreme Court would choose to hear and determine any appeal relating to the validity or enforceability of MSA or related legislation in this or any other case; or (2) as to the outcome of the certiorari or any appeal, even if heard by the Supreme Court. A Supreme Court decision to affirm or to decline to review a Second Circuit ruling that is adverse to the defendants in *Grand River* or other similar case, challenging validity or enforceability of MSA or related legislation, could result in the complete cessation of the Residual Pledged TSRs available to make payments on the Series 2007 Bonds. Moreover, even if ultimately reversed by the Supreme Court, a Second Circuit decision adverse to the defendants in *Grand River* could, unless stayed pending appeal at the discretion of the court: (1) result in the complete cessation of the Residual Pledged TSRs available to make payments on the Series 2007 Bonds; or (2) have a material adverse effect on the secondary market for the Series 2007 Bonds and, as a result, lead to a decrease in the market value and/or the liquidity of, the Series 2007 Bonds, during the pendency of the appeal.

On April 16, 2002, in *Freedom Holdings, Inc. v. Spitzer* ("**Freedom Holdings**"), certain cigarette importers filed an action against the attorney general of New York and the Commissioner of Taxation and Finance of the State of New York (the "**New York State Defendants**"), challenging New York's Complementary Legislation, alleging in their initial complaint that New York's Complementary Legislation enforces a market-sharing and price-fixing cartel, and allows the OPMs to charge supra-competitive prices for their cigarettes. Plaintiffs also alleged that New York's Complementary Legislation violates the Commerce Clause of the United States Constitution and establishes an output cartel in violation of federal antitrust law. The initial complaint also alleged that the legislation is selectively enforced in violation of the Equal Protection Clause of the United States Constitution. The Southern District dismissed the action on May 14, 2002.

In its *Freedom Holdings* decision, the Southern District applied two United States Supreme Court doctrines known as the "state action" immunity doctrine (based on a United States Supreme Court case known as "***Parker***") and the First Amendment based immunity doctrine (based on two United States Supreme Court cases known collectively as Noerr-Pennington ("**NP**")). The applicability of the *Parker* immunity doctrine requires two levels of analysis. Where a state confers authority on private parties to engage in conduct that would otherwise be per se violative of antitrust laws, cases subsequent to *Parker* (most notably a United States Supreme Court case known as "***MidCal***") have required both a clear articulation of state policy and active supervision by the state of the otherwise anticompetitive conduct for *Parker* immunity to apply. When a state is acting unilaterally, in its capacity as the sovereign, however, no *MidCal* analysis is required and *Parker* immunity applies directly. *NP* immunity applies to conduct that is protected by the First Amendment, most particularly conduct that constitutes petitioning activity directed at courts or governmental bodies. The Southern District held, among other things, that New York's

Complementary Legislation was protected from antitrust challenge by both direct *Parker* immunity and *NP* immunity.

The plaintiffs in *Freedom Holdings* appealed and on January 6, 2004, the Second Circuit partially reversed the decision of the Southern District. In its reversal, the Second Circuit noted, because it was reviewing a motion to dismiss, that it was required to accept as true the material facts alleged in the complaint and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit affirmed the Southern District's dismissal of that portion of the complaint that alleged a Commerce Clause violation. The Second Circuit reversed the dismissal of the plaintiffs' Equal Protection claim, based on uncertainty both as to the basis for the district court's ruling and the allegations of the complaint. The Second Circuit remanded the case to allow the plaintiffs to amend their complaint to correct deficiencies in the pleadings. The Second Circuit held, however, that the plaintiffs had alleged facts sufficient to state a claim that New York's Complementary Legislation conflicts with federal antitrust law, and that based on the facts alleged, the legislation was not protected from an antitrust challenge based on either of the *Parker* or NP immunity doctrines. The Second Circuit determined, on the record before it, that a *MidCal* analysis was required and, on that record and solely for the purpose of reviewing the Southern District's dismissal of the complaint, found insufficient active supervision and insufficient articulation of state policy to support a conclusion that there was antitrust immunity under *Parker* and *MidCal*. On March 25, 2004, the Second Circuit denied the New York State Defendants' petition for a rehearing.

In April 2004, the plaintiffs in *Freedom Holdings* filed an amended complaint, which was supplemented in November 2004 and included requests for: (1) a declaratory judgment that the operation of the MSA, New York's Qualifying Statute, and New York's Complementary Legislation implements an illegal *per se* output cartel in violation of the federal antitrust laws and are thus preempted by federal antitrust law; and (2) injunctive relief enjoining the enforcement of New York's Qualifying Statute and New York's Complementary Legislation. The amended complaint did not seek an injunction enjoining the enforcement or administration of the MSA, was limited only to claims under the federal antitrust laws, and did not allege that the MSA, New York State's Qualifying Statute, or Complementary Legislation violates the Commerce Clause or the Equal Protection Clause of the U.S. Constitution.

On September 14, 2004, the Southern District denied the plaintiffs' motion for a preliminary injunction enjoining New York, during the pendency of the action, from enforcing the MSA, New York's Qualifying Statute and New York's Complementary Legislation. The Southern District held that, based on the evidence presented by the parties, the plaintiffs had failed to establish a likelihood of success on the merits of their claims (1) that New York's Qualifying Statute and New York's Complementary Legislation authorized or mandated a per se violation of the federal antitrust laws or (2) that the MSA, New York's Qualifying Statute and New York's Complementary Legislation would not be entitled to *Parker* antitrust immunity under a *MidCal* analysis. The Southern District also determined that the plaintiffs had failed to make a showing of irreparable harm sufficient to justify preliminary injunctive relief. The Southern District, however, granted the plaintiffs' motion to enjoin New York from enforcing its Allocable Share Release Amendment, holding that the plaintiffs had established a likelihood of success on their claim that New York's Allocable Share Release Amendment conflicts with the federal antitrust laws and that its enforcement would cause plaintiffs and other NPMs irreparable harm. The plaintiffs appealed the Southern District's denial of their motion for a preliminary injunction as to New York's Qualifying Statute and New York's Complementary Legislation. The plaintiffs did not appeal the denial of their motion for a preliminary injunction to enjoin the enforcement of the MSA and supplemented their amended complaint to state that they do not seek a permanent injunction to enjoin the enforcement of the MSA. The New York State Defendants did not appeal the granting of the plaintiffs' motion to enjoin enforcement of New York's Allocable Share Release Amendment. On May 18, 2005, the Second Circuit affirmed the Southern District's denial of the plaintiffs' request for a preliminary injunction. The Second Circuit held that the plaintiffs failed to satisfy the irreparable harm requirement for a preliminary injunction. The Second Circuit made no determination as to the likelihood of the plaintiffs' ultimate success on the merits. On November 1, 2005, the Southern District denied, without prejudice and upon agreement of the parties, plaintiffs' motion for partial summary judgment which sought a determination that the State's Allocable Share Release Amendment violates federal antitrust law. On December 28, 2005, the Southern District denied the plaintiffs' motion to file an amended complaint to add a Commerce Clause claim similar to the plaintiffs' claims in *Grand River*, as described above. In its decision, however, the Southern District granted the plaintiffs leave to renew their motion to amend upon the condition that the plaintiffs show what additional discovery would be required to support such additional claims.

On February 6, 2006, the Southern District granted plaintiffs' renewed motion for leave to assert a claim under the Commerce Clause. On February 10, 2006, plaintiffs filed a Second Supplemental and Amended Complaint. The plaintiffs now seek (1) a declaratory judgment that the operation of the MSA, New York's Qualifying Statute and New York's Complementary Legislation implements an illegal per se output cartel in

violation of the federal antitrust laws and is preempted thereby (2) a declaratory judgment that the New York Qualifying Statute and Complementary Legislation, together with the Qualifying Statutes and Complementary Legislation of other states, regulates interstate commerce in violation of the Commerce Clause of the United States Constitution and (3) an injunction permanently enjoining the enforcement of New York's Qualifying Statute and New York's Complementary Legislation. The amended complaint does not seek to enjoin the enforcement or administration of the MSA. On July 12, 2006, defendants filed a motion to dismiss the Second Supplemental and Amended Complaint. A hearing took place on December 11, 2006 to resolve certain discovery issues. A final decision by Judge Alvin K. Hellerstein of the Southern District remains pending in *Freedom Holdings*.

Possibility of Conflict Among Federal Courts. Certain decisions by the United States Court of Appeals for the Second Circuit in *Freedom Holdings* have created heightened uncertainty as a result of the court's interpretation of federal antitrust law immunity doctrines, as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by the United States Court of Appeals for the Third Circuit (*A.D. Bedell Wholesale Co. v. Philip Morris, Inc.* and *Mariana v. Fisher*) and other courts which have rejected challenges to the MSA and related statutes. Prior decisions rejecting such challenges have concluded that the MSA and related statutes are protected from an antitrust challenge based on the *Parker* or *NP* doctrines.

An adverse decision by the Second Circuit in *Grand River* regarding the enforceability of the MSA and/or related statutes under federal antitrust law or the Commerce Clause of the U.S. Constitution would be controlling law not only within the Second Circuit but would be binding in each of the *Grand River* Challenged States, (not including the State), at least as to the *Grand River* plaintiffs and possibly as to other potential plaintiffs as well.

In addition, an adverse decision by the Second Circuit in *Freedom Holdings* regarding the enforceability of the MSA and related statutes under federal antitrust law or the Commerce Clause of the United States Constitution would be controlling law only within the Second Circuit from which no appeal as of right to the United States Supreme Court would exist. If, however, the Second Circuit were to make a final determination in *Freedom Holdings* that (a) the MSA constitutes a per se federal antitrust violation, not immunized by the *NP* or *Parker* doctrines, or that New York's Qualifying Statute and Complementary Legislation authorize or mandate such a per se violation, or (b) New York's Qualifying Statute and New York's Complementary Legislation operate with the Qualifying Statutes and Complementary Legislation of other states to regulate interstate commerce in violation of the Commerce Clause of the United States Constitution, such determination could be considered to be in conflict with decisions rendered by other federal courts, which have come to different conclusions on these issues. The existence of a conflict as to the rulings of different federal courts on these issues, especially between Circuit Courts of Appeals, is one factor that the United States Supreme Court may take into account when deciding whether to exercise its discretion in agreeing to hear an appeal. No assurance can be given that the United States Supreme Court would choose to hear and determine any appeal relating to the substantive merits of *Freedom Holdings*. Any decision by the United States Supreme Court on the substantive merits of *Freedom Holdings* would be binding everywhere in the United States, including in Rhode Island.

Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation. In addition to *Freedom Holdings* and *Grand River*, other cases remain pending in federal courts that challenge the MSA, the Qualifying Statute, the Complementary Legislation and/or the Allocable Share Release Amendment in California, Louisiana, Oklahoma, Kansas, Kentucky, Tennessee and Arkansas. The issues raised in *Freedom Holdings* or *Grand River* are also raised in many of these other cases, as briefly described below, by way of example only, and not as an exclusive or complete list.

On March 28, 2005, the United States District Court for the Northern District of California in the California case, *Sanders v. Lockyer*, dismissed an antitrust challenge to the MSA and California's Qualifying Statute and Complementary Legislation brought by a class of California consumers against the State and the OPMs. The District Court, expressly unpersuaded by *Freedom Holdings*, found the MSA to be the sovereign act of the State and further found California's Qualifying Statute and Complementary Legislation to be direct legislative activity entitled to *Parker* immunity without the need for any additional *MidCal* analysis. The District Court also found the MSA and California's Qualifying Statute and Complementary Legislation to be entitled to *NP* immunity. The plaintiffs have appealed the dismissal to the Ninth Circuit Court of Appeals. Briefing in the case is complete, and oral argument on the appeal took place on February 15, 2007. A decision by the Ninth Circuit remains pending.

On August 13, 1999, in *PTI, Inc v. Philip Morris Inc.*, certain cigarette importers and cigarette distributors filed an action in the United States District Court for the Central District of California against the PMs and all of the state officials involved in the negotiation of the MSA and those charged with the enforcement of the California Qualifying Statute and Complementary Legislation as enacted by the respective states (collectively, the "**State Defendants**"). The plaintiffs therein sought to enjoin the passage or enforcement, as the case may be, of the California Qualifying Statute and Complementary Legislation. The complaint alleged, among other things, that the

passage, implementation and/or enforcement of the California Qualifying Statute would be preempted by federal antitrust laws and violate certain provisions of the federal constitution, including the Interstate Compact Clause, the prohibition on Bills of Attainder, the Commerce Clause, the Import-Export Clause, the Supremacy Clause, the First Amendment, the Equal Protection Clause, and the Due Process Clause. On May 25, 2000, the District Court found that jurisdiction did not exist over the non-California State Defendants, and dismissed with prejudice all federal antitrust and constitutional claims against the PMs and the California State Defendants based on the merits. Like the *Sanders* Court, the *PTI* Court found antitrust immunity under both the *NP* and *Parker* doctrines. With respect to the Commerce Clause challenge, the District Court found that neither the California Qualifying Statute nor the Complementary Legislation was discriminatory on its face and applied equally to in-state, out-of-state and foreign manufacturers. In addition, the Court found that the alleged burden imposed on interstate commerce by the California Qualifying Statute did not clearly exceed the putative local benefits of discouraging cigarette consumption. The *PTI* Court's decision was not appealed and is final.

Two cases are currently pending in Louisiana that challenge the MSA, Qualifying Statutes and related legislation. In *Xcaliber International Limited, LLC v. Ieyoub*, certain NPMs have challenged the state's Allocable Share Release Amendment on both federal and state constitutional grounds. In March 2006, the Fifth Circuit Court of Appeals vacated the District Court's earlier dismissal of the action and remanded the case for further proceedings to review the plaintiffs' allegations that the Louisiana Allocable Share Release Amendment violates the rights of free speech, due process of law and equal protection of the laws guaranteed under the United States Constitution and the Louisiana Constitution. On July 5, 2006, the plaintiff filed an Amended Complaint, which is now pending before U.S. District Court for the Eastern District of Louisiana. The Amended Complaint also alleges that the Allocable Share Release Amendment violates federal antitrust laws. On July 19, 2006, defendant filed a motion to dismiss certain claims of the Amended Complaint, which the court denied on October 18, 2006. On October 30, 2006, the defendant filed its answer to the Amended Complaint. A settlement conference was held on February 5, 2007. A final pretrial conference is set for September 6, 2007, with a bench trial to follow on September 24, 2007. In *A.B. Coker v. Foti*, filed in August 2005, certain NPMs and cigarette distributors brought an action in a federal district court in Louisiana, seeking, among other relief: (1) a declaration that the MSA and Louisiana's Qualifying Statute and Complementary Legislation are invalid as violations of various federal laws; and (2) an injunction barring the enforcement of the MSA and Louisiana's Qualifying Statute and Complementary Legislation. On November 2, 2005, the state defendant filed a motion to dismiss the complaint for lack of jurisdiction. On November 9, 2006, the U.S. District Court for the Western District of Louisiana granted in part and denied in part the defendant's motion to dismiss. The court allowed the case to proceed on claims that the MSA and Louisiana's Complementary Legislation are violations of the Commerce Clause, Due Process Clause, First Amendment, and the Federal Cigarette Labeling and Advertising Act. The court dismissed the claims that alleged violation of the Tenth Amendment. On December 12, 2006, the state defendant filed its answer to the complaint. The judge has ordered all dispositive motions due by January 14, 2008. A trial date will be set thereafter.

In the Oklahoma case, *Xcaliber International Limited, LLC v. Edmondson*, certain NPMs have challenged Oklahoma's enforcement of its Allocable Share Release Amendment under federal antitrust laws. On May 20, 2005, the District Court granted summary judgment in favor of defendant, holding that the Oklahoma Allocable Share Release Amendment constituted unilateral state action that is directly protected from preemption by the *Parker* immunity doctrine. The plaintiffs have requested that the District Court reconsider its summary judgment order and appealed the order to the U.S. Court of Appeals for the Tenth Circuit. On August 31, 2005, the District Court denied the motion to reconsider. On October 28, 2005, the Tenth Circuit referred the case for mediation conferencing. Mediation conferencing was subsequently terminated, and appellate briefing was completed in February 2006. Oral argument on the appeal was held on September 25, 2006 and a decision remains pending.

In the Kentucky case, *Tritent International Corp. v. Commonwealth of Kentucky*, the plaintiffs seek a declaratory judgment that Kentucky's Qualifying Statute and Complementary Legislation conflict with federal antitrust laws and certain provisions of the U.S. Constitution. On September 8, 2005, the District Court granted Kentucky's motion to dismiss the complaint, and on October 24, 2005, the District Court denied the plaintiffs' subsequent motion for reconsideration. The plaintiffs appealed the dismissal to the Sixth Circuit Court of Appeals. Oral argument occurred on September 20, 2006, and on October 30, 2006, the Sixth Circuit affirmed the District Court's dismissal. On November 13, 2006, the plaintiffs filed a petition for en banc rehearing, which petition was denied in February 2007.

Similarly, in the Tennessee case, *S&M Brands, Inc. v. Summers*, the plaintiffs seek a declaratory judgment that the Tennessee Qualifying Statute (including the Allocable Share Release Amendment) and Complementary Legislation also conflict with federal antitrust laws and certain provisions of the U.S. Constitution. On June 1, 2005, the Sixth Circuit affirmed the District Court's denial of plaintiffs' motion for a preliminary injunction with respect to the enforcement of Tennessee's Allocable Share Release Amendment. On October 6, 2005, the District Court

granted Tennessee's motion to dismiss the complaint except that portion of the complaint that alleges that the state's retroactive enforcement of the state's Allocable Share Release Provision violates plaintiff's constitutional rights, which issue was not raised by the state in its motion and was therefore not addressed by the court. In its opinion, the District Court expressly rejected the Second Circuit's reasoning in sustaining antitrust challenges in the *Freedom Holdings* case and the Third Circuit's rationale for denying state action immunity in the *Bedell* and *Mariana* cases. Instead, *S&M Brands* followed the *Sanders* and *PTI* line of cases and held that Qualifying Statute and Complementary Legislation are direct state action, entitled to *Parker* immunity without the need for *MidCal* analysis. By decision filed November 28, 2005, the District Court held that the state's retroactive application of its Allocable Share Release Amendment, which was effective as of April 20, 2004, to 2003 cigarette sales was unconstitutional. On December 12, 2005, the District Court entered a final judgment dismissing the claims seeking a declaration that the Tennessee Qualifying Statute violated Federal antitrust laws and certain provisions of the U.S. Constitution. On January 3, 2006, plaintiffs filed a notice of appeal of that judgment. On June 9, 2006, plaintiffs filed a notice of appeal of the October 6, 2005 judgment. On April 19, 2007, the Sixth Circuit Court of Appeals affirmed the District Court's December 12, 2005 final judgment of dismissal. Plaintiff's appeal of the District Court's November 25, 2005 decision remains pending before the Sixth Circuit Court of Appeals.

Similar cases were brought in Arkansas. In three cases in the U.S. District Court for the Western District of Arkansas (*Grand River Enterprises Six Nations Ltd. v. Beebe, International Tobacco Partners Ltd. v. Beebe,* and *Dos Santos v. Beebe*), the plaintiffs sought to enjoin, preliminarily and permanently, Arkansas's enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws and certain provisions of the U.S. Constitution and the Arkansas Constitution. In *International Tobacco Partners Ltd.*, the plaintiffs also sought a declaratory judgment that the MSA and Arkansas's Qualifying Statute and Complementary Legislation are preempted by federal antitrust laws and certain provisions of the U.S. Constitution. The District Court preliminarily enjoined, as against the plaintiffs only, the enforcement of Arkansas's Allocable Share Release Amendment. On August 8, 2005, the court ordered Arkansas to reimburse certain amounts it withheld pursuant to the Allocable Share Release Amendment to International Tobacco Partners Ltd. On March 6, 2006, the District Court issued orders in all three cases: (1) denying Arkansas's motion to dismiss the complaint with respect to the plaintiffs' claim that the retroactive application of the Allocable Share Release Amendment violates the plaintiffs' right to due process of law under the Fourteenth Amendment of the U.S. Constitution; and (2) granting Arkansas's motion to dismiss the complaint in all other respects. Both the *Dos Santos* and *International Tobacco Partners Ltd.* cases have been settled by the parties, and orders dismissing those cases have been entered. On March 14, 2006, the District Court in *Grand River v. Beebe* denied the plaintiffs' motion to preliminarily enjoin the Allocable Share Release Amendment. On April 12, 2006, the plaintiffs filed an appeal to the U.S. Court of Appeals for the Eighth Circuit. On December 4, 2006, the Eighth Circuit affirmed the District Court's decision to deny an injunction.

Two cases are currently pending in Kansas. In the first case filed, *Xcaliber International Limited, LLC v. Kline*, the plaintiffs seek to enjoin, preliminarily and permanently, Kansas's enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws, expressly based on the same facts that were before the District Court in the *Freedom Holdings* case in New York. The complaint challenges only the Allocable Share Amendment but purports to reserve the right to challenge the Kansas Qualifying Statute in its entirety. On February 7, 2006, the District Court granted the state's motion for summary judgment and dismissed the case on its merits and denied the plaintiffs' motion to supplement the record with additional facts. On February 16, 2006, the plaintiffs appealed to the Court of Appeals for the Tenth Circuit. On March 8, 2006, the Tenth Circuit granted *Xcaliber*'s motion to consolidate this case with *Xcaliber v. Edmondson* (described above) for oral argument, and oral argument was held in September 2006. In the second case, *International Tobacco Partners Ltd. v. Kline*, the plaintiff seeks a declaratory judgment that the Allocable Share Release Amendment is preempted by federal antitrust laws and certain provisions of the U.S. Constitution and preliminary and permanent injunctions against the enforcement of the Allocable Share Release Amendment. On January 30, 2006, the plaintiff amended the complaint, which now seeks to enjoin the enforcement of Kansas's Complementary Legislation and Kansas's Qualifying Statute in their entirety. Although the complaint asserts that the MSA is also preempted by federal antitrust laws and certain provisions of the U.S. Constitution, it does not specifically seek to enjoin the enforcement thereof. Both parties filed motions for summary judgment, which were dismissed by the court. Kansas filed a motion to dismiss on February 28, 2006. On April 24, 2006, plaintiff filed a new motion for summary judgment. On February 8, 2007, the court granted Kansas' motion and dismissed the case. On March 9, 2007, the plaintiff appealed this dismissal.

The plaintiffs in *Freedom Holdings* filed a motion with the federal Judicial Panel on Multidistrict Litigation (the "**MDL Panel**") requesting that the Tennessee, Kentucky and Oklahoma cases described above, together with *Grand River*, be transferred to the Southern District of New York for coordinated and consolidated pretrial

proceedings with *Freedom Holdings*. On June 16, 2005, the MDL Panel denied this motion. The MDL Panel's denial of this motion is not subject to appeal.

If there is an adverse ruling in one or more of the cases discussed above, it could have a material adverse effect on: (1) the amount of Residual Pledged TSRs available to the Corporation to make payments with respect to the Series 2007 Bonds, including Turbo Redemption payments; or (2) the secondary market for the Series 2007 Bonds and, as a result, lead to a decrease in the market value and/or the liquidity of the Series 2007 Bonds, which could result in the complete loss of a Bondholder's investment. For a description of the opinions of Bond Counsel addressing such matters, see "LEGAL CONSIDERATIONS − MSA Enforceability" and "LEGAL CONSIDERATIONS – Qualifying Statute Constitutionality" herein.

Litigation Seeking Monetary Relief from Tobacco Industry Participants

The tobacco industry has been the target of litigation for many years. Both individual and class action lawsuits have been brought by or on behalf of smokers alleging that smoking has been injurious to their health, and by non-smokers alleging harm from environmental tobacco smoke (**"ETS"**), also known as "secondhand smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of May 1, 2007, there were 10 cases on appeal in which verdicts were returned against Philip Morris, including: (1) a $74 billion punitive damages judgment against Philip Morris in the *Engle* class action, which has been overturned on appeal by the Florida Supreme Court; and (2) a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. On December 15, 2005, however, the Illinois Supreme Court reversed the judgment against Philip Morris in *Price* and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission, and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the U.S. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. In January 2006, the plaintiffs filed a motion asking the court to reconsider its decision in *Price*. On May 5, 2006, the Supreme Court of Illinois denied this motion. In October 2006, plaintiffs filed a petition for certiorari with the U.S. Supreme Court. On November 27, 2006, the U.S. Supreme Court denied plaintiff's petition for certiorari. The trial court then entered an order of dismissal in December 2006. In January 2007, the plaintiff filed a motion to vacate the dismissal, which motion is pending. It has been reported that on May 2, 2007 the state trial court judge in the *Price* case asked the Illinois Fifth District Appellate Court whether he has the authority to reopen the *Price* case, citing possible new evidence presented in a case pending before the U.S. Supreme Court. It has also been reported that on May 17, 2007, Philip Morris petitioned the Illinois Supreme Court for an order that would prevent the trial court judge from reopening the *Price* case.

The MSA does not release PMs from liability in either individual or class action cases. Healthcare cost recovery cases have also been brought by governmental and non-governmental healthcare providers seeking, among other things, reimbursement for healthcare expenditures incurred in connection with the treatment of medical conditions allegedly caused by smoking. The PMs are also exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims of the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Pending claims related to tobacco products generally fall within four categories: (i) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants on U.S. airlines alleging injury from exposure to ETS in aircraft cabins, (ii) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (iii) health care cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for health care expenditures allegedly caused by cigarette smoking and/or disgorgement of profits, and (iv) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act. A February 2007 California Supreme Court decision (*Grisham v. Philip Morris*) regarding a statute of limitations issue in an individual case has held that the plaintiff

need not have filed suit when she realized she was addicted, thus permitting her lawsuit to go forward after a lower court had held her claim to be time-barred. This decision could lead to an increase in individual lawsuits in California.

The ultimate outcome of these and any other pending or future lawsuits is uncertain. Verdicts of substantial magnitude that are enforceable as to one or more PMs, if they occur, could encourage commencement of additional litigation, or could negatively affect perceptions of potential triers of fact with respect to the tobacco industry, possibly to the detriment of pending litigation. An unfavorable outcome or settlement or one or more adverse judgments could result in a decision by the affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption beyond what is forecast in the Global Insight Cigarette Consumption Report. In addition, the financial condition of any or all of the PM defendants could be materially and adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected PM's ability to make payments under the MSA, and have a material adverse effect on: (1) the amount of Residual Pledged TSRs available to the Corporation to make payments with respect to the Series 2007 Bonds, including Turbo Redemption payments; or (2) the secondary market for the Series 2007 Bonds and, as a result, lead to a decrease in the market value and/or the liquidity of the Series 2007 Bonds. For a detailed discussion of tobacco industry litigation and related matters, see "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY – Civil Litigation" and "LEGAL CONSIDERATIONS."

Decline in Cigarette Consumption Materially Beyond Forecasted Levels May Adversely Affect Payments

Smoking Trends. As discussed in the Global Insight Cigarette Consumption Report, cigarette consumption in the United States has declined since its peak in 1981 of 640 billion cigarettes to an estimated 373 billion cigarettes in 2006. Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) has been declining since 1964. The Global Insight Cigarette Consumption Report forecasts a continued decline in total cigarette consumption at an average annual rate of 1.81% to 163 billion cigarettes in 2052 under the Global Insight Base Case Forecast (as defined herein), which represents a decline in per capita consumption at an average rate of 2.52% per year. These consumption declines are based on historical trends, which may not be indicative of future trends, as well as other factors which may vary significantly from those assumed or forecasted by Global Insight.

On March 8, 2006, the National Association of Attorneys General and the American Legacy Foundation jointly announced that cigarette consumption in 2005 had fallen to 378 billion cigarettes. The Global Insight 2005 estimate of 381 billion cigarettes is slightly higher. For a more detailed discussion of the Global Insight methodology, see "– GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" herein and APPENDIX A "– GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached hereto.

According to the Global Insight Cigarette Consumption Report, the pharmaceutical industry is seeking approval from the U.S. Food and Drug Administration (the "**FDA**") for two new smoking cessation products possibly more effective than those now in existence, such as gum and patch nicotine replacement products, and other smoking cessation products such as NicoBloc or Zyban. The FDA has approved Varenicline, a Pfizer product, to be marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. Tests indicate that it is more effective as a cessation aid then Zyban. Pfizer has introduced Chantix with a novel marketing program, GETQUIT, an integrated consumer support system which emphasizes personalized treatment advice with regular phone and email contact. On May 14, 2005, Cytos Biotechnology AG, announced that it had successfully completed Phase II testing of a virus-based vaccine, which is genetically engineered to cause an immune system response against nicotine and its effects. The company now plans to begin Phase III trials. Nabi Biopharmaceuticals is in Phase IIB clinical trials for NicVAX, a vaccine to prevent and treat nicotine addiction. It triggers antibodies that bind with nicotine molecules. On March 9, 2006, NicVAX received Fast Track Designation from the FDA, which is intended to expedite its review process. The company expects to move to Phase III trials in the second half of 2007. The Xenova Group is set to begin Phase II testing of its similar vaccine, Ta-Nic. Positive results were also reported in July 2006 by Somaxon Pharmaceuticals from a pilot Phase II study of Nalmefene. Nalmefene has been used for over 10 years for the reversal of opioid drug effects. The company is seeking to develop it as a treatment for impulse control disorders. Global Insight expects that products such as these will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. One SPM has also introduced a cigarette with reportedly little or no nicotine. Future FDA regulation could also include regulation of nicotine content in cigarettes to non-addictive levels. Such new products or similar products, if successful, or such FDA regulation, if enacted, could have a material adverse effect on cigarette consumption.

Smokeless Tobacco Products. Smokeless tobacco products have been available for centuries. As cigarette consumption expanded in the last century, the use of smokeless products declined. Chewing tobacco and snuff are the most significant components. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and can be spit-free. According to the Global Insight Consumption Report, chewing tobacco and dry snuff consumption has been declining in the U.S. in this decade, but moist snuff consumption has increased at an annual rate of more than 5% since 2002, and by 10.4% in 2006, when over 5 million consumers purchased 1.1 billion cans. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST Inc., the largest producer of moist smokeless tobacco, is explicitly targeting adult smoker conversion in its growth strategy. The industry is responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. In 2006, the three largest U.S. cigarette manufacturers entered the market. Philip Morris introduced a snuff product, Taboka, Reynolds American acquired Conwood Company, L.P., the nation's second largest smokeless-tobacco manufacturer, and introduced Camel Snus, and Lorillard entered into an agreement with Swedish Match North America to develop a smokeless tobacco product in the United States.

Advocates of the use of snuff as part of a tobacco harm reduction strategy point to Sweden, where 'snus,' a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men. The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY–Regulatory Issues–*Smokeless Tobacco Products*" herein.

A decline in the overall consumption of cigarettes beyond the levels forecasted in the Global Insight Cigarette Consumption Report could have a material adverse effect on the payments by PMs under the MSA and the amounts of Residual Pledged TSRs available to the Corporation to make payments with respect to the Series 2007 Bonds, including Turbo Redemptions payments.

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet, and charge state employees who smoke higher health insurance premiums than non-smoking state employees. Five states, Alabama, Georgia, Idaho, Kentucky and West Virginia, charge higher health insurance premiums to smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to state employees who do not smoke. Several large corporations, including Meijer Inc., Gannett Co., American Financial Group Inc., PepsiCo Inc., and Northwest Airlines, are now charging smokers higher health insurance premiums. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the FDA, amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire-safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non-face-to-face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress, which would provide the FDA with broad authority to regulate tobacco products. A bi-partisan group of lawmakers, Massachusetts Senator Edward M. Kennedy, Texas Senator John Cornyn, California Representative Henry Waxman and Virginia Representative Tom Davis, on February 15, 2007 introduced the Family Smoking Prevention and Tobacco Control Act, legislation aimed at placing tobacco products under the authority of the FDA. The bill would give the FDA broad regulatory authority over the sale, distribution, and advertising of tobacco products. Such legislation would, among other anticipated changes, permit the FDA to strengthen warning labels, reduce nicotine levels in tobacco products, police false or misleading advertising and marketing aimed at children and would require manufacturers to provide the FDA with lists of ingredients and additives in their products, including nicotine. Philip Morris has indicated its strong support for this legislation. It has been recently reported that various states, including

the State, have requested the Alcohol Tax and Trade Bureau to categorize "little cigars" as another form of cigarettes that require federal regulation. No assurance can be given that future federal or state legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes.

Cigarettes are also currently subject to substantial excise taxes in the U.S. The federal excise tax has remained constant, at $0.39 per pack of 20 cigarettes, since 2002. This March the U.S. Senate included a $0.61 increase in the federal excise tax in an amendment to its proposed budget for the 2008 fiscal year, which begins October 1, 2007. The amendment was designed to provide funding for the State Children's Health Insurance Program. House and Senate leaders have indicated that the excise tax is just one of many funding options for the program. If enacted the federal excise tax would equal $1.00 per pack. According to Global Insight's Consumption Report, should the federal excise tax increase to $1.00 per pack, the resulting price increase, would, according to its model, lead to a sharper, one-time, consumption decline of 4.3%, or 15.5 billion cigarettes, by 2009. The difference with Global Insight's Base Case forecast would be somewhat lower over the longer term, because forecast assumptions incorporate the likelihood of significant excise tax increases over time.

All states, the District of Columbia, and the Commonwealth of Puerto Rico currently impose taxes at levels ranging from $0.07 per pack in South Carolina to $2.575 per pack in New Jersey. In addition, certain municipalities also impose an excise tax on cigarettes ranging up to $1.50 per pack in New York City and $2.68 per pack in Chicago, which includes the Cook County tax of $2.00 per pack. According to the Global Insight Cigarette Consumption Report, excise tax increases were enacted in 20 states and in New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee," which has the same effect on consumer prices. Global Insight's Consumption Report considers any such fees as equivalent to excise taxes. In 2006, Texas passed a budget that raised the state excise tax by $1.00 in January 2007. In 2006, Hawaii, New Jersey, North Carolina, and Vermont enacted legislation which raises excise taxes, Arizona, Iowa, South Dakota and Texas have increased excise taxes in 2007 and Indiana and Tennessee have each passed legislation in May to increase excise taxes. These actions will increase the average state excise tax to $1.065 per pack. It is expected that other states will also enact increases in 2007 and in future years. At least eleven states (California, Connecticut, Delaware, Maine, Maryland, Michigan, Mississippi, New Hampshire, Oregon, Pennsylvania and Wisconsin), and New York City are now considering excise tax increases. After California voters rejected a ballot initiative on November 7, 2006 that would have raised the tax from $0.87 to $3.47 per pack, California lawmakers introduced three new smoking related bills that would: (a) raise the average tax by $1.90 per pack; (b) impose a fine of $100 on anyone smoking in a car with a child under the age of 18 present; and (c) ban smoking in state parks and on beaches.

As mentioned above, at least one state, Minnesota (a Previously-Settled State), currently imposes a 75-cent "health impact fee" on tobacco manufacturers for each pack of cigarettes sold. The purpose of this fee is to recover the state's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld by the Minnesota Supreme Court as not in violation of Minnesota's settlement with the tobacco companies. On February 20, 2007, the U.S. Supreme Court declined to hear Philip Morris' appeal of that decision. See "–Other Potential Payment Decreases Under the Terms of the MSA–*NPM Adjustment*" herein.

According to the Global Insight Cigarette Consumption Report, all of the states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. The most comprehensive bans have been enacted since 1998 in 26 states and a number of large cities. In 1998, California imposed a comprehensive smoking ban for all indoor workplaces, including restaurants and bars. Delaware followed suit in 2002, and in 2003, Connecticut, Maine, New York, and Florida passed similar comprehensive bans, as did the cities of Boston and Dallas. Since then, Arizona, Arkansas, Colorado, the District of Columbia, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Ohio, Rhode Island, Tennessee, Utah, Vermont, Washington, and Puerto Rico established similar bans, as did the cities of Baltimore, Chicago, Houston, and Philadelphia. The New Mexico, Washington State and Chicago restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. It is expected that these restrictions will continue to proliferate. For example, in June 2007, at least 7 states are considering legislation which would enact comprehensive bans.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of April 2, 2007, there were 2,572 municipalities with indoor smoking restrictions. Of these, 455 local governments required workplaces to be 100% smoke-free, and 100% smoke-free conditions were required for restaurants by 403 governments, and for bars by 296. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In

1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars. These numbers grew to 49 for restaurants and 32 for bars in 1998, and doubled again by 2001, to 100 and 74, respectively.

The first extensive outdoor smoking restrictions were instituted in March 2006 in Calabasas, California. The California municipalities of Belmont, Beverly Hills, Dublin, Emeryville and Santa Monica have also established extensive outdoor restrictions. Burbank is expected to follow suit, and in June 2007 an Oakland City Councilmember proposed an outdoor ban. In the past year, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties have banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. The beach restrictions may soon become statewide. Nassau County, New York and Volusia County, Florida are also considering park and beach bans. At least 43 colleges nationwide now prohibit smoking everywhere on campus. California and Nevada have banned smoking in state prisons. Arkansas, Louisiana, and Texas now prohibit smoking in a car where there are children present, and similar legislation has been proposed in Arizona, California, Connecticut, Illinois, Indiana, Iowa, Kansas, Massachusetts, Montana, New Jersey, New York, Oregon, Rhode Island, South Carolina, Utah, West Virginia, and in Rockland County, NY and Bangor, Maine.

In June 2006, the Office of The Surgeon General released a report, "The Health Consequences of Involuntary Exposure to Tobacco Smoke." It is a comprehensive review of health effects of involuntary exposure to tobacco smoke. It concludes definitively that secondhand smoke causes disease and adverse respiratory effects. It also concludes that policies creating completely smoke-free environments are the most economical and efficient approaches to providing protection to non-smokers. The report is expected to strengthen arguments in favor of further smoking restrictions across the country. Further, the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant in 2006.

The attorneys general of the Settling States, including the Attorney General of the State, have obtained agreements from Philip Morris, Reynolds Tobacco and B&W that they will remove product advertisements from various magazines that are circulated in schools for educational purposes.

No assurance can be given that future federal or state legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes. Excise tax increases and other legislative or regulatory measures could severely increase the cost of cigarettes, limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes. As a result of these types of initiatives and other measures, the overall consumption of cigarettes nationwide may decrease materially more than forecasted in the Global Insight Cigarette Consumption Report and thereby could have a material adverse effect on: (1) the amounts available to make payments with respect to the Series 2007 Bonds, including Turbo Redemptions payments; or (2) the secondary market for the Series 2007 Bonds and, as a result, lead to a decrease in the market value and/or the liquidity of the Series 2007 Bonds. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY – Regulatory Issues" herein.

Other Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments. The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which could be material. Such adjustments, offsets and recalculations could reduce the Residual Pledged TSRs available to the Corporation below the respective amounts required to pay the Series 2007 Bonds. Both the Settling States and one or more of the PMs are disputing or have disputed the calculations of some of the Initial Payments for the years 2000 through 2003, and some Annual Payments for the years 2000 through 2007. No assurance can be given as to the magnitude of the adjustments that may result upon resolution of those disputes. Any such adjustments could trigger the Offset for Miscalculated or Disputed Payments. For additional information regarding the MSA and the payment adjustments, see "– NPM Adjustment" in this subsection and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" herein.

The assumptions used to project the source of the payments on the Series 2007 Bonds ("**Revenues**") are based on the premise that certain adjustments will occur as set forth under "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein. Actual adjustments could be materially different from what has been assumed and described herein.

Growth of NPM Market Share and Other Factors. The assumptions used to project Revenues and structure the Series 2007 Bonds contemplate declining consumption of cigarettes in the United States combined with a static relative market share of 5.6%* for the NPMs. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein. Should the forecasted decline in consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments and Strategic Contribution Payments by the PMs due to application of the Volume Adjustment, even for Settling States (including the State) that have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and are thus exempt from the NPM Adjustment. One SPM has introduced a cigarette with reportedly no nicotine. If consumers used the product to quit smoking, it could reduce the size of the cigarette market. The capital costs required to establish a profitable cigarette manufacturing facility are relatively low and new cigarette manufacturers, whether SPMs or NPMs, are less likely than OPMs to be subject to frequent litigation.

The Model Statute in its original form had required each NPM to make escrow deposits approximately in the amount that the NPM would have had to pay had it been a PM, but entitled the NPM to a release, from each Settling State in which the NPM had made an escrow deposit, of the amount by which the escrow deposit exceeds that Settling State's allocable share of the total payments that the NPM would have been required to make had it been a PM. At least 44 Settling States, including the State, have enacted, and other states are considering enacting, legislation that amends this provision in their Model/Qualifying Statutes, by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain to the excess above the total payment that the NPM would have paid had it been a PM (so called "**Allocable Share Release Legislation**"). The National Association of Attorneys General ("**NAAG**") has endorsed these legislative efforts. A majority of the PMs, including all OPMs, have indicated their agreement in writing that in the event a Settling State enacts legislation substantially in the form of the Allocable Share Release Legislation, such Settling State's previously enacted Qualifying Statute will continue to constitute a Qualifying Statute within the meaning of the MSA. Following a challenge by NPMs, the District Court for the Southern District of New York in September 2004 enjoined New York from enforcing its Allocable Share Release Legislation. NPMs are also currently challenging Allocable Share Release Legislation in the states of California, Arkansas, Kansas, Kentucky, Louisiana, Oklahoma and Tennessee. It is possible that NPMs will challenge such legislation in other states. See "–Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein. To the extent either (i) that other states do not enact or enforce Allocable Share Release Legislation or (ii) that a state's Allocable Share Release Legislation is invalidated, NPMs could concentrate sales in such states to take advantage of the absence of Allocable Share Release Legislation by limiting the amount of its escrow payment obligations to only a fraction of the payment it would have been required to make had it been a PM. Because the price of cigarettes affects consumption, NPM cost advantage is one of the factors that has resulted and could continue to result in increases in market share for the NPMs.

A significant loss of market share by PMs to NPMs could have a material adverse effect on the payments by PMs under the MSA and the amounts of Residual Pledged TSRs available to make payments with respect to the Series 2007 Bonds, including Turbo Redemptions payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" and "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" herein.

NPM Adjustment

Description of the NPM Adjustment. The NPM Adjustment, measured by domestic sales of cigarettes by NPMs, operates in certain circumstances to reduce the payments of the PMs under the MSA in the event of losses in market share to NPMs during a calendar year as a result of the MSA. Three conditions must be met in order to trigger an NPM Adjustment for one or more Settling States: (1) a Market Share Loss (as defined in the MSA) for the applicable year must exist, which means that the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997 (a condition that has existed in every year since 2000), (2) a nationally recognized firm of economic consultants must determine that the disadvantages

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* The aggregate market share of NPMs utilized in the Cash Flow Assumptions may differ materially from the market share information utilized by the MSA Auditor when calculating the NPM adjustments.

experienced as a result of the provisions of the MSA were a significant factor contributing to the market share loss for the year in question, and (3) the Settling States in question must be found to not have diligently enforced their Qualifying Statutes.[*] The Settling States and the PMs selected The Brattle Group in May 2004 as the current economic consultants responsible for making the significant factor determinations.

Application of the NPM Adjustment. The entire NPM Adjustment is ultimately applied to a subsequent year's Annual Payment and Strategic Contribution Fund Payment due to those Settling States: (i) that have been proven to have not diligently enforced their Qualifying Statutes throughout the year; or (2) that have enacted a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate market share is between 0% and 16⅔% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs would be decreased by three times the percentage decrease in the PMs' actual aggregate market share. If, however, the PMs' market share loss is greater than 16⅔%, then the increase in the NPM Adjustment in excess of 50% (three times 16⅔%) is determined by formula.[†]

The MSA provides that in no event shall the amount of any NPM Adjustment applied to any Settling State in any given year exceed the amount of Annual Payments and Strategic Contribution Payments to be received by such Settling State in such year.

Regardless of how the NPM Adjustment is calculated, it is always subtracted from the total Annual Payments and Strategic Contribution Payments due from the PMs and then ultimately allocated on a Pro Rata (as defined in the MSA) basis only among those Settling States that have been found (i) to have not diligently enforced their Qualifying Statutes or (ii) to have enacted a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction.[‡] However, the practical effect of a decision by a PM to claim an NPM Adjustment for a given year and pay its portion of the amount of such claimed NPM Adjustment into the Disputed Payments Account, or withhold payment of such amount, would be to reduce the payments to all Settling States on a Pro Rata basis until, for any particular Settling State, a resolution is reached regarding the diligent enforcement dispute for such state for such year or until, for all Settling States, a global settlement is reached for all such disputes for such year. If the PMs make a claim for an NPM Adjustment for any particular year and the State is determined to be one of a few states (or the only state) not to have diligently enforced its Qualifying Statute in such year, the amount of the NPM Adjustment applied to the State in the year following such determination could be as great as the amount of Annual Payments and Strategic Contribution Payments that would otherwise have been received by the State in such year and would have a material adverse effect on the amounts of Residual Pledged TSRs available to make payments with respect to the Series 2007 Bonds, including Turbo Redemptions payments.

Settlement of Calendar 1999 through 2002 NPM Adjustment Claims. In June 2003, the OPMs and the Settling States settled all NPM Adjustment claims for the years 1999 through 2002, subject, however, under limited circumstances, to the reinstatement of an OPM's right to an NPM Adjustment for the years 2001 and 2002. In connection therewith, the OPMs and the Settling States agreed prospectively that OPMs claiming an NPM Adjustment for any year will not make such a deposit into the Disputed Payments Account or withhold payment

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[*] The NPM Adjustment does not apply at all if the number of cigarettes shipped in or to the United States in the year prior to the year in which the payment is due by all manufacturers that were PMs prior to December 7, 1998 exceeds the number of cigarettes shipped in or to the United States by all such PMs in 1997.

[†] If the aggregate market share loss from the Base Aggregate Participating Manufacturer Share is greater than 16⅔%, the NPM Adjustment will be calculated as follows:

NPM Adjustment = 50% +
[50% / (Base Aggregate Participating Manufacturer Market Share - 16⅔%)]
x [market share loss - 16⅔%]

[‡] If a court of competent jurisdiction declares a Settling States' Model Statute to be invalid or unenforceable, then the NPM Adjustment for such state is limited to no more, on a yearly basis, than 65% of the amount of such state's allocated payment.

with respect thereto unless and until the selected economic consultants determine that the disadvantages of the MSA were a significant factor contributing to the market share loss giving rise to the alleged NPM Adjustment. If the selected economic consultants make such a "significant factor" determination regarding a year for which one or more OPMs have claimed an NPM Adjustment, such OPMs may either make a deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" herein.

The State has indicated that the 2005 Annual Payments by the OPMs were made without a diversion of any portion thereof into the Disputed Payments Account for the Settling States. According to the State, however, it has been reported that eleven SPMs paid approximately $84 million of their 2005 Annual Payments into the Disputed Payments Account for the Settling States as a result of alleged disputes, including disputes related to NPM Adjustments. Unlike the OPMs, the SPMs had not agreed, as part of their settlement of calendar 1999 through 2002 NPM Adjustment Claims, to await the finding of a significant factor determination before taking such action. Of this $84 million, approximately $44 million represented payments by six SPMs relating to cigarettes sold in 2003. Following litigation brought by the State of New York challenging such actions, the six SPMs released such $44 million to the Settling States. Such release of money, however, does not represent final settlement of any alleged disputes. In addition, more than $18 million due from various SPMs was withheld on April 15, 2005.

Significant Factor Determination for Calendar Year 2003. On March 27, 2006, The Brattle Group made its final determination, which final determination is publicly available, that the disadvantages experienced as a result of the MSA were a significant factor contributing to the Market Share Loss for calendar year 2003. The MSA Auditor had previously determined that the Market Share Loss in 2003 was 5.95%, reflecting the difference between the PMs' 99.58% 1997 market share and their 91.63% 2003 market share less 2%. Of the total 7.95% differential, The Brattle Group determined that 3% to 3.5% was attributable to the MSA and then compared 3% to 3.5% to 7.95% in making its significant factor determination. In a statement dated March 28, 2006, the Attorneys General of Iowa and Idaho, the co-chairs of the NAAG Tobacco Committee, stated, among other things, that the Settling States believe it would not be appropriate for a PM to withhold any portion of the April 2006 Annual Payment. According to the statement, the Settling States believe that the PMs must still prove to a court that the Settling States have not diligently enforced their Qualifying Statutes and also believe that every Settling State will be found to have diligently enforced its Qualifying Statute in 2003. It has been reported, however, that the general counsel of Reynolds American stated that he believes not all states were diligently enforcing their Qualifying Statutes.

Effect of Calendar 2003 NPM Adjustment Claim on 2006 Annual Payments. Philip Morris and Reynolds American believe that the size of the NPM Adjustment attributable to 2003 is approximately $1.2 billion (representing a $1.14 billion NPM Adjustment of approximately 17.85% of the 2004 Annual Payment, with interest). On March 31, 2006, Philip Morris made its full $3.4 billion payment, even though it believes that payment should eventually be subject to downward adjustment by operation of the calendar 2003 NPM Adjustment, and it intends to continue to negotiate with the Settling States' Attorneys General for, and reserved its right to claim, a reduction of its payment. Lorillard paid approximately $558 million of its 2006 Annual Payment on March 31, 2006 and deposited the balance of the 2006 Annual Payment, $108 million, into the Disputed Payments Account pending final non-appealable resolution of the diligent enforcement issue with respect to 2003. Additionally, Reynolds American paid approximately $2.016 billion of its Annual Payment obligation for 2006, of which $647 million was deposited in the Disputed Payment Account pending resolution of the diligent enforcement issue in 2003. According to the co-chairs of the NAAG Tobacco Committee, in a statement released on April 18, 2006, the Annual Payments paid by Lorillard and Reynolds American to the Settling States constitute about 82% of the amount that was due. The three SPMs from whom the largest payments were due made substantial payments. However, one of the three paid a portion of its payment to the Disputed Payments Account, and the other two each withheld a portion of the payment due from them. A majority of the Settling States have given notice to the PMs of each such Settling State's intent to commence enforcement proceedings under the MSA, compelling the PMs to make the 2006 Annual Payment without diminution for any NPM Adjustment so long as there has not yet been a final non-appealable resolution of the diligent enforcement issue for such Settling State for the year in question.

Vibo Corporation d/b/a General Tobacco, an SPM, paid $96 million of its 2006 Annual Payment in April 2006 and paid the balance, $11.5 million, in June 2006. General Tobacco reportedly maintains that it is entitled to a reduction based on the market share loss it experienced after joining the MSA, but has elected to make the full payments pending final adjudication regarding the actual final payments due.

In their April 18, 2006 statement, the co-chairs of the NAAG Tobacco Committee restated that the Settling States believe that no NPM Adjustment would be found to apply and, thus, the Settling States are entitled to receive the full payment due under the MSA. They stated that each Settling State has enacted a Qualifying Statute, that the states all believe they have diligently enforced their Qualifying Statute, and that they will ultimately receive the

money in dispute. The statement further stated that the issues of diligent enforcement are not subject to arbitration and will be litigated in the courts of each state. Many of the Settling States have initiated legal action in their state courts to ensure full payment. On September 13, 2006, Reynolds American and certain other PMs sent letters to the Settling States that had not yet objected to arbitration of the NPM Adjustment or that had not yet filed legal proceedings relating to the dispute regarding a claimed NPM Adjustment for 2003 in their respective state courts. These letters stated that unless the Settling States indicated otherwise, it would be assumed that these Settling States would not object to such arbitration. All but one of the Settling States that received these letters responded that they would not agree to submit the dispute to arbitration and would oppose any effort to compel arbitration of the dispute. PMs have filed motions in the courts of each of these Settling States (except certain of the Territories) to compel arbitration.

Altria has reported that 38 states have instituted legal proceedings in their respective state courts against the PMs. They each claim that they diligently enforced their Qualifying Statute and request that the respective court enter a declaratory order finding that the 2006 Annual Payment is not subject to a 2003 NPM Adjustment, and that the PMs are not entitled to withhold or pay into the Disputed Payments Account any portion of the 2006 Annual Payment. They also assert that in June 2003, the OPMs unconditionally released the Settling States from all claims that they may have with respect to cigarettes sold or shipped from 1999 through 2002. As previously noted, the OPMs and the Settling States entered into agreements that resolved a variety of disputes relating to cigarette sales and MSA payments from 1999 through 2002. The Settling States maintain that, since an NPM Adjustment for 2003 would be based upon cigarettes sold or shipped in 2002, the release in the June 2003 agreements bars the OPMs from claiming an NPM Adjustment for 2003.

Calendar 2004 NPM Adjustment. In April 2006, the OPMs initiated NPM Adjustment proceedings seeking a downward adjustment of their annual payments under the MSA for 2004. It has been reported that The Brattle Group rendered its final determination on February 12, 2007 to the effect that the disadvantages experienced as a result of the MSA were a "significant factor" contributing to the Market Share Loss for calendar year 2004. Each state may nonetheless avoid a downward adjustment to its share of the PMs' annual payment for 2004 if it establishes that it diligently enforced a qualifying escrow statute during the entirety of 2004. Any downward adjustment is then potentially re-allocated to states that do not establish such diligent enforcement. It has been reported that the calendar year 2004 NPM Adjustment for the OPMs is approximately $1.14 billion. There is no certainty that the PMs will ultimately receive any adjustment as a result of these proceedings. If the PMs do receive such an adjustment, the adjustment may be applied as a credit against future MSA payments and would be allocated among the PMs pursuant to the MSA's provisions for allocation of the NPM Adjustment among the PMs. On March 30, 2007, Philip Morris reported that it made its full $3.5 billion payment, which amount includes approximately $400 million that Philip Morris disputes it owes by operation of the calendar 2004 NPM Adjustment. Philip Morris stated that it hoped that its full payment will facilitate an expeditious resolution of NPM Adjustment disputes, whether by settlement or by arbitration. Reynolds American and Lorillard, on the other hand, collectively paid approximately $672 million of their aggregate 2007 annual payment into the Disputed Payments Account based on a claim of entitlement to an NPM Adjustment for 2004. Settlement discussions are currently ongoing between the Attorneys General of the Settling States and the OPMs in an attempt to effect a national settlement of both outstanding and subsequent NPM Adjustment claims, with the goal of replacing the current NPM Adjustment dispute resolution methodology with one that is more predictable and less subjective. Any such settlement in a given Settling State would have to be approved by such Settling State.

Calendar 2005 NPM Adjustment. Altria has reported that it is participating in an NPM Adjustment proceeding before The Brattle Group to determine whether the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share in 2005. Altria has reported that The Brattle Group is expected to render its final determination on the significant factor issue for 2005 some time in January 2008.

Resolution of Diligent Enforcement Disputes. As previously noted, any Settling State that adopts, maintains and diligently enforces its Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute (which is a Qualifying Statute under the MSA). No provision of the MSA, however, attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. The Rhode Island Attorney General's office has stated that the State has been and is diligently enforcing its Qualifying Statute. Furthermore, the MSA does not explicitly state which party bears the burden of proving or disproving whether a Settling State has diligently enforced its Qualifying Statute or whether any diligent enforcement dispute would be resolved in state courts or through arbitration. As of June 8, 2007, the 43 state courts (including the State) that have considered the issue of whether a diligent enforcement dispute should be resolved in state courts or through arbitration have held in favor of the arbitration process. As of June 14, 2007, 42 state courts have ordered arbitration of the 2003 NPM Adjustment. Twenty-one states have final orders compelling arbitration and 20 states have orders to compel arbitration that are at various stages of appellate review, including writs and appeals. One state court,

Louisiana, determined that state court is the proper forum for disputes regarding diligent enforcement of the Qualifying Statute. Certain of these decisions are the subject of appeals and, because the time period for taking appeals has not yet expired, further appeals can be expected. Most recently, in *State of North Dakota v. Philip Morris, Inc*., the North Dakota Supreme Court reversed the decision of the District Court for the County of Cass which had concluded that diligent enforcement disputes should be resolved in state court. The MSA provides that arbitration, if required by the MSA, will be governed by the United States Federal Arbitration Act. The decision of an arbitration panel under the Federal Arbitration Act may only be overturned under limited circumstances, including a showing of a manifest disregard of the law by the panel. At the present time, there are hearings pending in many other states regarding whether arbitration is the appropriate forum for these disputes. The Attorney General of the State believes that the court in each Settling State that retains continuing jurisdiction over the MSA should make the determination as to diligent enforcement of such state's Qualifying Statute. Regardless of the forum in which a diligent enforcement dispute is heard, no assurance can be given as to how long it will take to resolve such a dispute with finality.

In October 2006, the OPMs filed a motion in the Superior Court of the State to enforce the arbitration provision of the MSA and compel arbitration concerning the 2003 NPM Adjustment. Certain SPMs sought joinder. The State did not oppose joinder of the SPMs. On March 17, 2007, a Superior Court Justice issued a decision granting the motion. On May 3, 2007, the Superior Court entered the order granting the motion. On May 14, 2007, the State filed a motion for reconsideration, which is still pending.

Effect of Complementary Legislation. At least 44 of the Settling States, including the State, and the District of Columbia have passed, and various states are considering, legislation (often termed **"Complementary Legislation"**) to further ensure that NPMs are making required escrow payments under the Qualifying Statutes. Under the State's Qualifying Statute and the Complementary Legislation, every tobacco product manufacturer which sells a “Unit Sold” as defined by the MSA in the State is required to certify annually that it is an NPM and that it is in full compliance with the State's Qualifying Statute. A distributor may not affix or cause to be affixed, stamps to individual packages of cigarettes to be sold or distributed in the State by a distributor licensed in the State if the attorney general has notified the distributor that the tobacco product manufacturer of those cigarettes has: (i) failed to become a participating manufacturer as defined in Section 23-71-3(1) of the General Laws of the State; and (ii) failed to create a qualified escrow fund and make the required deposits in the escrow funds pursuant to Section 23-71-3(2)(i) of the General Laws of the State for any cigarettes the distributor sold or distributed for that tobacco product manufacturer in the State. A distributor who violates this section is subject to suspension or revocation of its license pursuant to Section 44-20-8 of the General Laws of the State.

All of the OPMs and other PMs have provided written assurances that the Settling States have no duty to enact Complementary Legislation, that the failure to enact such a legislation will not be used in determining whether a state has diligently enforced its Qualifying Statute pursuant to the terms of the MSA, and that the diligent enforcement obligations under the MSA shall not apply to the Complementary Legislation. In addition, the written assurances contain an agreement that the Complementary Legislation will not constitute an amendment to a Settling State's Qualifying Statute. However, a determination that a state's Complementary Legislation is invalid may make enforcement of its Qualifying Statute more difficult, which could lead to an increase in the market share of NPMs, resulting in a reduction of Annual Payments and Strategic Contribution Payments under the MSA. The New York Qualifying Statute and Complementary Legislation, along with similar legislation in thirty other states, have been challenged in New York State by a group of NPMs on various constitutional grounds, including claims based on preemption by the federal antitrust laws. See "–Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–MSA Provisions Relating to Model/Qualifying Statutes".

Conclusion. Future NPM Adjustment claims remain possible for calendar year 2005 and all future years. Philip Morris, Reynolds American, and Lorillard have filed an NPM Adjustment claim for the year 2004. The Brattle Group has not made any final "significant factor" determinations for any year other than 2003 and 2004. In addition, the "diligent enforcement" exemption afforded a Settling State is based on actual enforcement efforts for the calendar year preceding each Annual Payment, and could be disputed by a PM even after the final resolution of a diligent enforcement dispute related to a prior year. If the other preconditions to an NPM Adjustment exist for a given year, disputes regarding diligent enforcement for such year may be expected if the market share of the NPMs results in an NPM Adjustment that, absent the protection of the Qualifying Statutes, would apply.

Future NPM Adjustments could be as large as, or larger than, the reported potential $1.2 billion calendar 2003 NPM Adjustment and $1.14 billion calendar 2004 NPM Adjustment. Although a Settling State that diligently enforces its Qualifying Statute is exempt from the NPM Adjustment, many procedural uncertainties, as described above, still remain regarding the resolution of a dispute regarding diligent enforcement. A decision by the PMs to

pay the amount of a claimed NPM Adjustment into the Disputed Payments Account or to withhold payment of such an amount pending the resolution of the dispute could lead to a decrease in the market value and/or the liquidity of the Series 2007 Bonds and would have a material adverse effect on the amounts available to the Corporation to make Turbo Redemptions and other payments on the Series 2007 Bonds during such period. Should a PM be determined with finality to be entitled to an NPM Adjustment in a future year due to non-diligent enforcement of the Qualifying Statute by the State, the application of the NPM Adjustment could lead to a decrease in the market value and/or the liquidity of the Series 2007 Bonds and would also have a material adverse effect on the amounts available to the Corporation to pay Turbo Redemptions or Accreted Value of the Series 2007 Bonds. Settlement discussions are currently ongoing between the Attorneys General of the Settling States and the OPMs in an attempt to effect a national settlement of both outstanding and subsequent NPM Adjustment claims, with the goal of replacing the current NPM Adjustment dispute resolution methodology with one that is more predictable and less subjective. Any such settlement in a given Settling State would have to be approved by such Settling State. See "Disputed or Recalculated Payments" below. The structuring assumptions for the Series 2007 Bonds do not include any NPM Adjustments, nor do they include withholdings or Disputed Payment Account deposits relating to PM claims of entitlement to NPM Adjustments. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

Disputed or Recalculated Payments and Disputes under the Terms of the MSA. Miscalculations or recalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA, such as those described above under "NPM Adjustment," have resulted and could in the future result in offsets to, or delays in disbursements of, payments to the Settling States pending resolution of the disputed item in accordance with the provisions of the MSA. By way of example, on August 30, 2004, one of the SPMs (Liggett) announced that it had notified the attorneys general of 46 states that it intended to initiate proceedings against the attorneys general for violating the terms of the MSA. It alleged that the attorneys general violated its rights and the MSA by extending unauthorized favorable financial terms to Miami-based Vibo Corporation d/b/a General Tobacco when, on August 19, 2004, the attorneys general entered into an agreement with General Tobacco allowing it to become an SPM. General Tobacco imports discount cigarettes manufactured in Colombia, South America. In the notice sent to the attorneys general, Liggett indicated that it would seek to enforce the terms of the MSA, void the agreement with General Tobacco and enjoin the Settling States and NAAG from listing General Tobacco as a PM on their websites. On August 18, 2005, Liggett and an additional four SPMs filed a motion to enforce the MSA in Kentucky. The Commonwealth of Kentucky filed its opposition, and the SPMs replied. General Tobacco intervened in the case and filed its opposition to the other SPMs' motion. The SPMs replied, and a hearing was held on the issue on November 8, 2005. On January 26, 2006 the court upheld the agreement by which General Tobacco became an SPM. An appeal was filed to the Kentucky Court of Appeals on February 14, 2006, and oral argument was heard in March 2007.

Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments may result in the application of an offset against subsequent Annual Payments or Strategic Contribution Payments. The diversion of disputed payments to the Disputed Payments Account, the withholding of all or a portion of any disputed amounts or the application of offsets against future payments could all have a material adverse effect on: (1) the payments by the PMs under the MSA and amounts available to the Corporation to make payments with respect to the Series 2007 Bonds, including Turbo Redemptions payments; or (2) the secondary market for the Series 2007 Bonds and, as a result, lead to a decrease in the market value and/or the liquidity of the Series 2007 Bonds. The structuring assumptions for the Series 2007 Bonds do not factor in an offset for miscalculated or disputed payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Adjustments to Payments–*Offset for Miscalculated or Disputed Payments*" herein.

On June 3, 2005, the State of California filed an application in San Diego County Superior Court for an enforcement order against Bekenton USA, Inc. ("**Bekenton**"), to compel Bekenton to comply with its full payment obligations under the MSA. On June 29, 2005, Bekenton filed a motion to file a suit, alleging that the State of California breached the Most Favored Nation ("**MFN**") provisions of the MSA by allowing three other SPMs (Farmer's Tobacco Co., General Tobacco, and Premier Manufacturing Incorporated) to join the MSA under more favorable terms. In a tentative ruling dated November 1, 2005, the Superior Court granted Bekenton's motion to file suit based on this allegation. In its initial complaint, Bekenton had further alleged that (a) the state's agreements with Farmer's Tobacco, General Tobacco and Premier (the "**Three Agreements**"), which required them to make certain back payments (as required by the MSA) as a precondition to joining the MSA, permitted such back payments to be made on an extended time frame and (b) this time frame effectively "relieved" Farmer's Tobacco, General Tobacco and Premier of certain payment obligations as PMs. Bekenton claimed that it was entitled to a similar relief under another clause of the MFN (the "**Relief Clause**"), which requires that if any PM is relieved of a payment obligation, such relief becomes applicable to all of the PMs. In the November 1, 2005 tentative ruling, the Superior Court

denied Bekenton's motion to file suit under the Relief Clause, ruling that (1) because the Three Agreements were preconditions to allowing Farmer's Tobacco, General Tobacco and Premier to become PMs, these companies were not "**PMs**" for purposes of the Relief Clause and (2) even if Farmer's Tobacco, General Tobacco and Premier are PMs for purposes of the Relief Clause, the payment schedules in the Three Agreements did not relieve them of any obligations. On March 15, 2006, the Superior Court adopted the November 1, 2005 tentative ruling as its final order.

Bekenton is involved in similar disputes in Kentucky and Iowa. In the Kentucky case, Bekenton failed to make its full MSA payment of approximately $7.7 million in April 2005, and, instead, paid only $198,000, less than 3% of the total payment due. The State of Kentucky commenced an action against Bekenton in which Bekenton claimed that under the Relief Clause it was entitled to reduce its payment as a consequence of Kentucky's agreement with General Tobacco, which was similar to the agreement described above between the State of California and General Tobacco. On April 14, 2006, the court dismissed Bekenton's claim for a reduction, holding that the Relief Clause was not applicable since the General Tobacco agreement did not relieve General Tobacco of any payment obligations.

In the Iowa case, the State of Iowa sought to de-list Bekenton as a PM for failing to comply with the MSA payment provisions and to prohibit Bekenton from doing business in Iowa for failing to comply with the escrow payment provisions of the Iowa Qualifying Statute. On August 11, 2005 an Iowa state court, finding that the MSA itself provides procedures for the resolution of disputes regarding MSA payments and that such procedures should be followed in this case, enjoined Iowa from "de-listing" Bekenton, permitting Bekenton to continue selling cigarettes in Iowa.

In 2005, Bekenton filed for bankruptcy relief.

"Nicotine-Free" Cigarettes. The MSA contemplates that the manufacturers of cigarettes will be either a PM or an NPM. The term "**cigarette**" is defined in the MSA to mean any product that contains tobacco and nicotine, is intended to be burned and is likely to be offered to, or purchased by, consumers as a cigarette and includes "roll-your-own" tobacco. Should a manufacturer develop a "nicotine-free" tobacco product (intended to be burned and is likely to be offered to, or purchased by, consumers as a cigarette), such manufacturer would not be a manufacturer for purposes of the MSA. Sales of such a product could cause a reduction in Annual Payments and Strategic Contribution Payments. In addition, if consumers used the product to quit smoking, it could reduce the size of the market. The capital costs required to establish a profitable cigarette manufacturing facility are relatively low and new cigarette manufacturers are less likely to be subject to frequent litigation than OPMs. Furthermore, the Qualifying Statutes would not cover a manufacturer of such "nicotine-free" products and such manufacturer would not be required to make escrow deposits in the same manner as the NPMs are so required. Vector Group has introduced QUEST, a tobacco product that is reportedly nicotine-free.

Other Risks Relating to the MSA and Related Statutes

Severability. Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any non-severable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. If, however, any OPM does not agree to the substitute terms, the MSA terminates in all Settling States affected by the court's ruling. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Severability" herein.

Amendments, Waivers and Termination. As a settlement agreement between the PMs and the Settling States, the MSA is subject to amendment in accordance with its terms, and may be terminated upon consent of the parties thereto. Parties to the MSA, including the State, may waive the performance provisions of the MSA. The Corporation is not a party to the MSA and as such does not have the right to challenge any such amendment, waiver or termination. While the economic interests of the State and the Bondholders are expected to be the same in many circumstances, no assurance can be given that such an amendment, waiver or termination of the MSA would not have a material adverse effect on the Corporation's ability to make payments to the Bondholders. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Amendments and Waivers" herein.

Reliance on State Enforcement of the MSA and State Impairment. The State may not convey and has not conveyed to the Corporation or the Bondholders any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Failure to do so may have a material adverse effect on the Bondholders. It is possible that the State could attempt to claim some or all of the TSRs for itself or otherwise interfere with the security for the Series 2007 Bonds. In that event, the Bondholders, the Trustee or the Corporation may assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims. See "LEGAL CONSIDERATIONS" herein.

Bankruptcy of a PM May Delay, Reduce, or Eliminate Payments of TSRs

The primary source of payment for the Series 2007 Bonds is the Residual Pledged TSRs that are paid by the PMs. Therefore, if one or more PMs were to become a debtor in a case under Title 11 of the U.S. Code (the "**Bankruptcy Code**"), there could be delays in or reductions or elimination of payments on the Series 2007 Bonds, and Bondholders and Beneficial Owners of the Series 2007 Bonds could incur losses on their investments. Philip Morris, by way of example, prior to the resolution of the dispute in the *Price* case in Illinois in the spring of 2003 over the size of the required appeal bond, had publicly stated that it would not have been possible for it to post the $12 billion bond initially ordered by the trial judge. Philip Morris also publicly stated at that time that there was a risk that immediate enforcement of the judgment would force a bankruptcy. In addition, on May 13, 2003, Alliance Tobacco Corporation, one of the SPMs, filed for bankruptcy in the Western District of Kentucky and, in September 2004, its plan of reorganization was confirmed. As part of the confirmed plan, Alliance Tobacco Corporation effectively ceased its operations in September 2004. In addition to Bekenton, Cutting Edge, Liberty Brands LLC, M/s. Dhanraj International and Carolina Tobacco Company (manufacturer for House of Prince) have also filed for bankruptcy relief.

In the event of the bankruptcy of a PM, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the Corporation, the Trustee, the Bondholders, or the Beneficial Owners of the Series 2007 Bonds to collect any TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of TSRs. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it. Furthermore, payments previously made to the Bondholders or the Beneficial Owners of the Series 2007 Bonds could be avoided as preferential payments, so that the Bondholders and the Beneficial Owners of the Series 2007 Bonds would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection of the State, the Corporation, the Trustee, the Bondholders, or the Beneficial Owners of the Series 2007 Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy, such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions or elimination of payments to the Bondholders or the Beneficial Owners of the Series 2007 Bonds. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS" herein.

Uncertainty as to Timing of Turbo Redemption

No assurance can be given as to the timing of amortization of the Series 2007 Bonds. A certain level of payments due under the MSA has been forecast based on various assumptions, including among others, domestic cigarette consumption levels as set forth in the Global Insight Base Case Consumption Forecast and adjustments to the payments by the PMs as required by the terms of the MSA. These assumptions, which were used to schedule Principal and Accreted Value of the Series 2007 Bonds, as well as provide expectations of Turbo Redemptions of the Series 2007 Bonds from Revenues are discussed in "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS." Actual results could and likely will vary from such assumptions. Such variance could be material and could affect the level of payments due under the MSA. Any material reduction would impair the Revenues available for Turbo Redemptions of the Series 2007 Bonds and extend the average life of the Series 2007 Bonds. On the other hand, material increases would generate more Revenues for Turbo Redemptions and shorten the average life of the Series 2007 Bonds. In addition, future increases in the rate of inflation above 3% per annum, in the absence of other factors, would materially shorten the average lives of the Series 2007 Bonds. No assurance can be given that these assumptions will be realized.

The ratings of the Series 2007 Bonds address the ability of the Corporation to pay the Accreted Value of such Series 2007 Bonds on their respective Maturity Dates. Owners of the Series 2007 Bonds bear the reinvestment risk from faster than expected amortization, as well as the extension risk from slower than expected amortization of the Series 2007 Bonds.

Subordinate Nature of the Series 2007 Bonds

The Trustee is only entitled to receive payments of Residual Pledged TSRs on and after the date on which there are no 2002 Indenture Bonds outstanding under the 2002 Indenture. Accordingly, the Series 2007 Bonds are structurally subordinate to the full payment of all 2002 Indenture Bonds issued under the 2002 Indenture. If the 2002 Indenture Bonds are not paid in accordance with their terms or there is a default or event of default with

respect to the 2002 Indenture Bonds, Holders of the Series 2007 Bonds may suffer a complete loss of their investment and have no remedy for the loss.

The Residual Pledged TSRs were projected assuming the Global Insight Base Case Consumption Forecast and assuming that all other events occur as assumed by the Collection Methodology and Assumptions and the Structuring Assumptions. The Residual Pledged TSRs may actually come in substantially below projections, thus potentially reducing the value of and the yield on the Series 2007 Bonds.

No Current Interest

The Series 2007 Bonds do not pay any current interest. All interest accrues until both principal and accrued interest are paid. The lack of current interest payments may affect liquidity or cause price volatility. See Appendix G– "TABLE OF ACCRETED VALUES" attached hereto.

Limited Resources of the Corporation

The Series 2007 Bonds are neither general nor moral obligations of the State and are not secured by a pledge of the full faith and credit of the State and holders of the Series 2007 Bonds may not require the levy or imposition of taxes. The assets of the Corporation (other than the Residual Pledged TSRs) are not pledged to the payment of, nor are they security for, the Series 2007 Bonds. The Corporation's only source of funds for payments on the Series 2007 Bonds are the Residual Pledged TSRs and amounts on deposit in pledged funds and accounts pursuant to the Indenture. The proceeds of the Series 2007 Bonds will not be available to pay debt service on the Series 2007 Bonds. The Corporation has no taxing power and no assets other than the assets available to the Bondholders acquired pursuant to the Purchase Agreement.

Limited Remedies

The Trustee is limited under the terms of the Purchase Agreement and the Indenture to enforcing the terms of such agreements and to receiving the Residual Pledged TSRs and applying them in accordance with the Indenture. If an Event of Default occurs, the Trustee cannot sell, or foreclose on, the Residual Pledged TSRs or its rights under the Purchase Agreement or the Indenture. The Corporation is not a party to the MSA, and neither the State nor the Corporation has made any representation or warranty that the MSA is enforceable. Remedies under the Purchase Agreement do not include the repurchase of the Residual Pledged TSRs under any circumstances, including unenforceability of the MSA or breach of any representation of warranty.

Limited Liquidity of the Series 2007 Bonds; Price Volatility

There is currently a limited secondary market for securities such as the Series 2007 Bonds. The Underwriters are under no obligation to make a secondary market. There can be no assurance that a secondary market for the Series 2007 Bonds will develop, or if a secondary market does develop, that it will provide Bondholders with liquidity or that it will continue for the life of the Series 2007 Bonds. Tobacco settlement securitization bonds generally have also exhibited greater price volatility than traditional municipal bonds. Any purchaser of the Series 2007 Bonds must be prepared to hold such securities for an indefinite period of time or until final redemption of such securities.

Limitation on Transferability

The Series 2007C Bonds are being reoffered only to Qualified Institutional Buyers as such term is defined in Rule 144A under the Securities Act of 1933. Upon purchase of any of the Series 2007C Bonds, a purchaser will be deemed to have represented that it is a Qualified Institutional Buyer and that it has a holding in Series 2007C Bonds in an amount equal to at least $100,000 in aggregate purchase price.

Limited Nature of Ratings; Reduction, Suspension or Withdrawal of a Rating

Ratings assigned to the Series 2007 Bonds by the Rating Agency will reflect such Rating Agency's assessment of the likelihood that owners of such Series 2007 Bonds will receive payments of the Accreted Value on such Series 2007 Bonds when due. Any such rating will not address the likelihood of payments from the Turbo Redemption Account or the expected average life of such Series 2007 Bonds. A rating of such Series 2007 Bonds will not be a recommendation to purchase, hold or sell such Series 2007 Bonds and such rating will not address the marketability of such Series 2007 Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by a Rating Agency if in such Rating Agency's judgment circumstances so warrant based on factors prevailing at the time. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market or the market price of such Series 2007 Bonds. No request has been made and no rating has been assigned to the Series 2007C Bonds. See "RATINGS."

S&P currently indicates that its ratings on all tobacco settlement securitizations have a "negative outlook." See "RATINGS" herein.

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal issues that could affect the Series 2007 Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the Residual Pledged TSRs to be reduced or eliminated. References in the discussion to various opinions are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions.

Bankruptcy of a PM

Because the only significant source of payment for the Series 2007 Bonds is the Residual Pledged TSRs that are paid by the PMs, if one or more PMs were to become a debtor in a case under the Bankruptcy Code, there could be delays or reductions in or elimination of payments on the Series 2007 Bonds. See "RISK FACTORS – Bankruptcy of a PM May Delay, Reduce, or Eliminate TSRs" herein.

In the bankruptcy of a PM, the automatic stay provisions of the Bankruptcy Code could prevent (unless approval of the bankruptcy court was obtained) any action by the State, the Corporation, the Trustee, the Bondholders, or the Beneficial Owners to collect any Residual Pledged TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying Residual Pledged TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of Residual Pledged TSRs. Bond Counsel will render an opinion to the Rating Agency that, subject to all the assumptions, qualifications, and limitations set forth therein, if a PM were to become the debtor in a case under the Bankruptcy Code, and the matter were properly briefed and presented to a federal court with jurisdiction over such bankruptcy case, the court, exercising reasonable judgment after full consideration of all relevant factors, would hold that the MSA is an "executory contract" under Section 365 of the Bankruptcy Code. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Bond Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that a particular court would not hold that the MSA is not an executory contract, thus resulting in delays or reductions in, or elimination of, payments on the Series 2007 Bonds.

If the MSA is an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it, thus resulting in delays or reductions in, or elimination of, payments on the Series 2007 Bonds.

Furthermore, payments previously made to the holders of the Series 2007 Bonds or the Beneficial Owners could be avoided as preferential payments, so that the Bondholders and the Beneficial Owners would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection, of the State, the Corporation, the Trustee, the Bondholders, and the Beneficial Owners. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy, such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions in, or elimination of, payments on the Series 2007 Bonds.

MSA Enforceability

Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. However, if any OPM does not agree to the substitute terms, the MSA would terminate in all Settling States affected by the court's ruling. Even if substitute terms are agreed upon, payments under such terms may be less than payments under the MSA and could reduce the amount of Residual Pledged TSRs available to make payments on the Series 2007 Bonds.

Certain cigarette manufacturers, cigarette importers, cigarette distributors, Native American tribes and smokers' rights organizations have filed actions against some, and in certain cases all, of the signatories to the MSA alleging, among other things, that the MSA violates provisions of the U.S. Constitution, federal antitrust laws, federal civil rights laws, state constitutions, state consumer protection laws and unfair competition laws, which

actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any money under the MSA and barring the PMs from collecting cigarette price increases related to the MSA or a determination that the MSA is void or unenforceable. To date, such challenges have not been ultimately successful, although two cases have survived pre-trial motions and have proceeded to a stage of litigation where the ultimate outcome may be determined in part by findings of fact based on extrinsic evidence as to the operation and impact of the MSA and appeals are pending or still possible in certain other cases. The terms of the MSA are currently being challenged and may continue to be challenged in the future.

A determination by a court that a nonseverable provision of the MSA is void or voidable would, in the absence of an agreement to a substitute term as described above, result in the termination of the MSA in any Settling States affected by the court's ruling. Accordingly, in the event of an adverse court ruling, Bondholders could incur a complete loss of their investment. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

In rendering the opinions described below, Bond Counsel considered the claims asserted in the federal and state actions described above under the caption "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" that it believes are representative of the legal theories that an opponent of the MSA would advance in an attempt to invalidate the MSA. Subject to the assumptions and qualifications set forth below, Bond Counsel will render an opinion to the Rating Agency that, subject to all the assumptions, qualifications and limitations set forth therein, and although there can be no assurances that a court applying existing legal principles would not hold otherwise, a court applying existing legal principles to the facts would find the MSA to be a valid and enforceable agreement under federal and State law among the Settling States and the tobacco companies who are parties thereto.

Qualifying Statute Constitutionality

The Qualifying Statutes and related legislation, like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the federal and state constitutions or are preempted by federal antitrust laws. The lawsuits seek, among other things, injunctions against the enforcement of the Qualifying Statutes and related legislation. To date such challenges have not been ultimately successful, although the enforcement of Allocable Share Release Amendments has been preliminarily enjoined in New York and certain other states. Appeals are pending or still possible in certain cases. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Although a determination that the Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA, such a determination could have an adverse effect on payments to be made under the MSA if an NPM were to gain market share in the future and there occurred the requisite impact on the market share of PMs under the MSA. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

In rendering the opinions described below, Bond Counsel considered the claims asserted in the federal and state actions described above under the caption "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" that it believes are representative of the legal theories that an opponent of the Qualifying Statute would advance in an attempt to invalidate the Qualifying Statute. Subject to the assumptions and qualifications set forth below, Bond Counsel will render an opinion to the State that, subject to all the facts, assumptions and qualifications set forth therein, and although there can be no assurance that a court applying existing legal principles would not hold otherwise, if the matter were properly briefed and presented to a court, that a court applying existing legal principles to the facts would find the State's Qualifying Statute to be constitutional and enforceable and not violative of the antitrust laws in all material respects under federal and State law. In rendering its opinion, Bond Counsel will rely upon a letter dated June 17, 2002 from counsel to the OPMs confirming that the OPMs would not dispute that the State's Qualifying Statute constitutes a "model statute" under the MSA.

Limitations on Opinions of Counsel; No Assurance as to Outcome of Litigation

A court's decision regarding the matters upon which a lawyer is opining would be based on such court's own analysis and interpretation of the factual evidence before it and of applicable legal principles. Thus, if a court reached a result different from that expressed in an opinion, such as that the MSA is void or voidable or that the State's Qualifying Statute is unenforceable, it would not necessarily constitute reversible error or be inconsistent with that opinion. An opinion of counsel is not a prediction of what a particular court (including any appellate court) that reached the issue on the merits would hold, but, instead, is the opinion of such counsel as to the proper result to be reached by a court applying existing legal rules to the facts as properly found after appropriate briefing and argument and, in addition, is not a guarantee, warranty or representation, but rather reflects the informed

professional judgment of such counsel as to specific questions of law. Opinions of counsel are not binding on any court or party to a court proceeding. The descriptions of the opinions set forth herein are summaries, do not purport to be complete and are qualified in their entirely by the opinions themselves.

No Assurance as to the Outcome of Litigation

With respect to all matters of litigation that have been brought and may in the future be brought against the PMs, or involving the enforceability of the MSA or constitutionality of the State's Qualifying Statute or the enforcement of the right to the Residual Pledged TSRs or otherwise filed in connection with the tobacco industry, the outcome of such litigation, in general, cannot be determined with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and (ii) on the courts, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation and any such adverse outcome could have a material and adverse impact on the amounts of Residual Pledged TSRs available to make payments on the Series 2007 Bonds.

Corporation Not Eligible to Declare Bankruptcy

Bond Counsel will render an opinion to the Corporation that the Corporation cannot be a debtor under any chapter of the United States Bankruptcy Code without an amendment thereto.

THE CORPORATION

The Tobacco Settlement Financing Corporation is a public corporation of the State established under and pursuant to the Act. The Corporation has a legal existence distinct from the State and is not a department of the State.

The directors of the Corporation are:

Name	Principal Occupation
Robert E. Cusack	President and Chief Investment Officer, Preferred Asset Management
James Thorsen, CFA	Principal, State Street Global Advisors
Rosemary Booth Gallogly	Executive Director/ State Budget Officer, State of Rhode Island
Andrew Reilly	Managing Director, Thomas Keenan Ventures, Inc.

The officers of the Corporation are:

Name	Title
Rosemary Booth Gallogly	Chairperson
James Thorsen, CFA	Vice Chairperson
Robert E. Cusack	Secretary

SOURCES AND USES OF FUNDS

The Corporation will apply the proceeds of the Series 2007 Bonds (i) to pay the cash portion of the purchase price for the Residual Tobacco Assets, and (ii) to pay certain costs of issuance of the Series 2007 Bonds.

Sources of Funds

Initial Principal Amount of Series 2007 Bonds	$197,005,742.20
Total Sources	$197,005,742.20

Uses of Funds

Payment of Purchase Price of Residual Tobacco Assets	$195,000,000.00
Underwriters' Discount	938,686.55
Costs of Issuance*	1,067,055.65
Total Uses	$197,005,742.20

*Includes fees of the financial advisors for the State and Bond Counsel, Global Insight, the Rating Agency, certain auditing, verification agent fees and printing and other miscellaneous expenses.

THE SERIES 2007 BONDS

The following summary describes certain terms of the Series 2007 Bonds. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Series 2007 Bonds. Terms used herein and not previously defined have the meanings ascribed to them in the Indenture. Copies of the Indenture and the Purchase Agreement may be obtained upon written request to the Trustee.

The Series 2007 Bonds will initially be represented by one or more bond certificates registered in the name of The Depository Trust Company or its nominee ("**DTC**"), New York, New York. DTC will act as securities depository for the Series 2007 Bonds. Except under the limited circumstances described herein, no Beneficial Owner (as hereinafter defined) of the Series 2007 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Series 2007 Bonds. See Appendix F – "BOOK–ENTRY ONLY SYSTEM" herein.

Payments on the Series 2007 Bonds

Payments of Accreted Value. The Accreted Value of the Series 2007 Bonds will be paid on the maturity dates as set forth on the inside front cover of this Offering Circular or upon prior redemption. "**Accreted Value**" means an amount equal to the initial principal amount of such Bonds, plus interest accrued thereon from its date of issuance, compounded on each December 1 and June 1, commencing on December 1, 2007 through and including the Maturity Date or earlier redemption date of such Bond at the interest rate for such Bond, as set forth in the Series Supplement therefor and in accordance with the Accreted Value Table attached thereto; provided, however, that the Corporation shall calculate or cause to be calculated the Accreted Value on any date other than each December 1 and June 1 by straight line interpolation of the Accreted Values as of the immediately preceding and succeeding December 1 and June 1. See Appendix G – "TABLE OF ACCRETED VALUES" attached hereto.

Failure by the Corporation to pay the Accreted Value at maturity on any Series 2007 Bonds will constitute an Event of Default under the Indenture. Failure to make Turbo Redemption payments on the Series 2007 Bonds will not constitute an Event of Default. See "SECURITY FOR THE SERIES 2007 BONDS – Flow of Funds" herein.

Turbo Redemption

The Series 2007 Bonds are subject to mandatory redemption in whole or in part prior to their stated maturity, from amounts on deposit in the Turbo Redemption Account on any Distribution Date, at a redemption price of 100% of the Accreted Value thereof and without premium. Any redemption of the Series 2007 Bonds from the Turbo Redemption Account pursuant to the Indenture shall be made by Series in accordance with the Payment Priorities and pro rata within each Series of Bonds. For purposes of defeasance, such Bonds shall have the assumed

redemptions schedule set forth in Appendix H – "DEFEASANCE TURBO SCHEDULES" herein. Monies in the Turbo Redemption Account may not be applied to purchase Series 2007 Bonds on the open market. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

"**Payment Priorities**" means, subject to the issuance of Additional Bonds which may be payable prior to the Series described below, payment of the Bonds in the following order of priority: (1) first, the Series 2007A Bonds until they are Fully Paid (as defined in the Indenture); (2) second, the Series 2007B Bonds until they are Fully Paid; and (3) third, the Series 2007C Bonds until they are Fully Paid.

"**Distribution Date**" means each December 1 and June 1.

Extraordinary Prepayment

If an Event of Default has occurred, on each Distribution Date, Outstanding Senior Bonds will be prepaid from available funds on deposit in the Debt Service Reserve Account, the Lump Sum Prepayment Account and the Extraordinary Prepayment Account, at a price equal to the principal amount or Accreted Value thereof, without premium (any such prepayment, an "**Extraordinary Prepayment**"). Any such prepayment shall be made by Series in accordance with the Payment Priorities and Pro-Rata within each Series.

Lump Sum Prepayment

The Bonds are subject to prepayment at any time at the principal amount or Accreted Value thereof, plus accrued interest, if any, to the prepayment date, upon receipt by the Trustee of a lump sum payment received as a payment from a PM which results in, or is due to, a release of that PM from all or a portion of its future obligations under the MSA (a "**Lump Sum Payment**"). Each Lump Sum Payment shall be allocated to the prepayment of Outstanding Senior Bonds. Any such prepayment shall be made by Series in accordance with the Payment Priorities and Pro-Rata within each Series.

Optional Redemption

The Series 2007 Bonds are subject to redemption at the Corporation's option at any time, in whole or in part, on and after June 1, 2017, at a redemption price of 100% of the Accreted Value thereof, without premium. Fifteen days' notice shall be given to holders of the Series 2007 Bonds to be redeemed prior to maturity. The Corporation may select the dates, amounts, rates and maturities of Series 2007 Bonds for optional redemption at its sole discretion. On and after any date of redemption, interest will cease to accrete on any Series 2007 Bonds called for redemption.

Partial Redemption

If less than all the Outstanding Series 2007 Bonds are to be redeemed, the particular Series 2007 Bonds to be redeemed or prepaid shall, except as otherwise specified in the Indenture, be selected by the Trustee by such method as it shall deem fair and appropriate, and the Trustee may provide for the selection for redemption or prepayment of portions (equal to any authorized denominations) of the Accreted Value of Series 2007 Bonds of a denomination larger than the minimum authorized denomination.

Additional Bonds and Additional Obligations

The Corporation may only issue additional Series of Bonds ("**Additional Bonds**")under the Indenture or bonds, notes or other obligations ("**Additional Obligations**") under the 2002 Indenture (as amended, supplemented or restated from time to time) or any other indenture or agreement providing for the issuance of Additional Obligations that are to be secured by a claim on the 2002 Tobacco Assets prior to the 2002 Residual Certificate or the Series 2007 Bonds (each a "**Senior Indenture**") only upon receipt by the Trustee of (i) a Rating Confirmation from each Rating Agency then rating the Outstanding Bonds under the Indenture and (ii) a certificate of the Corporation that as a result of the issuance of such Additional Bonds or Additional Obligations, the weighted average life of each Bond then Outstanding under the Indenture, projected in years from such Bond's date of issuance, will not exceed the sum of (x) the weighted average life of each such Outstanding Bond issued under the Indenture as projected at the time such Bond was issued and set forth in the applicable Series Supplement relating thereto (with respect to the Series 2007 Bonds, such expected weighted average lives are set forth in the Turbo Defeasance Schedule attached to the Series 2007 Supplement) and (y) one. In calculating the weighted average life of each of the Outstanding Bonds for the purpose of the certificate required by clause (ii) of the preceding sentence, the Corporation shall take into consideration (1) the amount of Turbo Redemptions of such Bonds that have been paid prior to and including to the date of issuance of the Additional Bonds or Additional Obligations and (2) the amount of Turbo Redemptions projected by the Corporation to be paid on each Distribution Date subsequent to the issuance of such Additional Bonds or Additional Obligations based upon the amount of TSRs then expected to be

received by the Corporation and available for payment of Turbo Redemptions of each outstanding bond under the Senior Indenture. In determining compliance with clause (ii) of this paragraph, the Corporation may rely conclusively on a certification of a financial advisor or an underwriting firm, who may in turn rely on a report of a nationally recognized firm of econometric experts on matters related to projected or forecasted cigarette consumption.

SECURITY FOR THE SERIES 2007 BONDS

General

Pursuant to the Act and the Purchase Agreement, the State will sell to the Corporation, on the Closing Date, the Residual Tobacco Assets.

The Bonds will be secured by and payable solely from (a) the Revenues, (b) all rights to receive the Revenues and the proceeds of such rights, (c) all Accounts established under the Indenture and assets thereof, including money, contract rights, general intangibles or other personal property, held by the Trustee under the Indenture, (d) subject to the following sentence, all rights and interest of the Corporation under the Purchase Agreement, including the representations, warranties and covenants of the Trust Fund and the State in the Purchase Agreement and (e) any and all other property of every kind and nature from time to time hereafter, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture (collectively, the "**Collateral**"). Except as specifically provided in the Indenture, such assignment and pledge does not include: (i) the rights of the Corporation to the receipt of the 2002 Tobacco Assets under the 2002 Indenture and the 2002 Purchase Agreement before the 2002 Indenture Bonds are deemed paid under the 2002 Indenture, (ii) the rights of the Corporation pursuant to provisions for consent or other action by the Corporation, notice to the Corporation, indemnity or the filing of documents with the Corporation, or otherwise for its benefit and not for that of the Beneficiaries, or (iii) any right or power reserved to the Corporation pursuant to the Act or other law; nor does this assignment and pledge preclude the Corporation's enforcement of its rights under and pursuant to the Purchase Agreement for the benefit of the Beneficiaries as provided in the Indenture. Unless otherwise specified in the Series Supplement applicable thereto, the proceeds of any Bonds do not constitute any portion of the Residual Pledged TSRs, are not pledged to the holders of such Bonds and are not subject to the lien of the Indenture. The Corporation will implement, protect and defend this assignment and pledge by all appropriate legal action, the cost thereof to be an Operating Expense.

The Trustee is only entitled to receive payments of Residual Pledged TSRs on and after the date on which there are no 2002 Indenture Bonds outstanding under the 2002 Indenture. Accordingly, the Series 2007 Bonds are structurally subordinate to the payment in full of all 2002 Indenture Bond issued under the 2002 Indenture. If the 2002 Indenture Bonds are not paid in accordance with their terms or there is a default or event of default with respect to the 2002 Indenture Bonds, Holders of the Series 2007 Bonds may suffer a complete loss of their investment and have no remedy for the loss.

The Series 2007B Bonds are subordinate to the Series 2007A Bonds, and Holders of the Series 2007B Bonds are not entitled to receive any payment, including any Extraordinary Prepayment, until all Holders of Series 2007A Bonds and any other Bonds senior to the Series 2007B Bonds issued under the Indenture have been fully paid, regardless of the occurrence of an Event of Default. The Series 2007C Bonds are subordinate to the Series 2007B Bonds, and Holders of the Series 2007C Bonds are not entitled to receive any payment, including any Extraordinary Prepayment, until Holders of all Series 2007B Bonds and any other Bonds senior to the Series 2007C Bonds issued under the Indenture have been fully paid, regardless of the occurrence of an Event of Default.

The Series 2007 Bonds are payable as to Accreted Value solely out of the assets of the Corporation pledged for such purpose; neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the Accreted Value on the Series 2007 Bonds; the Series 2007 Bonds do not constitute an indebtedness of the State or any political subdivision of the State; the Series 2007 Bonds are secured solely by and are payable solely from the tobacco receipts sold to the Corporation and other monies of the Corporation pledged under the Indenture; the Series 2007 Bonds do not constitute a general, legal, or moral obligation of the State or any political subdivision thereof and the State has no obligation or intention to satisfy any deficiency or default of any payment of the Series 2007 Bonds. The Corporation has no taxing power.

Payment by MSA Escrow Agent to Trustee

The MSA Escrow Agent will disburse the Residual Pledged TSRs directly to the Trustee. The disbursement of TSRs is required to be made to the Trustee by the MSA Escrow Agent 10 business days after the MSA Escrow Agent receives the related Annual Payments and Strategic Contribution Payments from the PMs.

Accounts

All of the following funds and accounts will be established and held by the Trustee for the benefit of the holders of the Bonds. All money on deposit in the following accounts will be invested in Eligible Investments as defined in the Indenture.

Revenue Account. Under the Indenture, the Trustee will establish and hold a segregated trust account (the "**Revenue Account**") into which the Trustee will deposit all Revenues. Funds on deposit in the Revenue Account will be transferred to various other accounts under the Indenture and applied to certain other purposes as described below.

Debt Service Account. Under the Indenture, the Trustee will establish and hold a segregated trust account (the "**Debt Service Account**") into which the Trustee will deposit amounts transferred from the Revenue Account in respect of interest on and Principal of the Senior Bonds and from which the Trustee will make payments on the Senior Bonds in accordance with the priority of payments as described below under "Flow of Funds."

Debt Service Reserve Account. Under the Indenture, the Trustee will establish and hold a segregated trust account (the **"Debt Service Reserve Account"**). The **"Debt Service Reserve Requirement"** for the Series 2007 Bonds is zero.

Extraordinary Prepayment Account. Under the Indenture, the Trustee will establish and hold a segregated trust account (the "**Extraordinary Prepayment Account**") into which the Trustee will deposit, following the occurrence of any Event of Default, all future Revenues after the payment of certain expenses, all current and preceding due interest on the Senior Bonds and current and past due Principal. The Trustee will make Extraordinary Prepayments on the Senior Bonds from the Extraordinary Prepayment Account.

Lump Sum Prepayment Account. Under the Indenture, the Trustee will establish and hold a segregated trust account (the "**Lump Sum Prepayment Account**") into which the Trustee will deposit any Lump Sum Payments. The Trustee will make Lump Sum Prepayments of the Senior Bonds from the Lump Sum Prepayment Account.

Turbo Redemption Account. Under the Indenture, the Trustee will establish and hold a segregated trust account (the "**Turbo Redemption Account**") into which the Trustee will deposit certain amounts transferred from the Revenue Account as described below. The Trustee will make Turbo Redemption Payments from the Turbo Redemption Account.

Operating Account. Under the Indenture, the Trustee will establish and hold a segregated trust account (the "**Operating Account**") into which the Trustee will deposit certain amounts transferred from the Revenue Account as described below. The Indenture will pay Operating Expenses from the Operating Account, subject to the 2007 Operating Cap.

"**2007 Operating Cap**" means $347,782 in the Fiscal Year ending June 30, 2007, inflated in each following Fiscal Year by the Inflation Adjustment Percentage (as defined in the MSA) applicable pursuant to the MSA to the calendar year ending in such Fiscal Year, plus arbitrage rebate and penalties specified by officer's certificate of the Corporation.

"**Operating Expenses**" means all expenses incurred by the Corporation, including but not limited to arbitrage rebate and penalties, salaries, administrative expenses, insurance premiums, advisory, auditing and legal expenses, fees and expenses incurred for professional consultants and fiduciaries, and all Operating Expenses so identified in the Indenture.

Flow of Funds

Any Residual Pledged TSRs received by the Corporation will be promptly (and in no event later than five Business Days after receipt) deposited in the Revenue Account. Except as otherwise specified in the Indenture, the Trustee will deposit all Revenues in the Revenue Account.

The term "**Fiscal Year**" means each period from July 1 through the following June 30.

As used herein, the term "**Deposit Date**" means the date of actual receipt by the Trustee of any Residual Pledged TSRs.

As soon as possible following each deposit of Residual Pledged TSRs to the Revenue Account, the Trustee will withdraw Revenues on deposit in the Revenue Account and transfer such amounts in priority as follows:

(1) to the Operating Account, an amount specified in an Officer's Certificate (or certificate of an authorized officer of the Corporation, as appropriate), plus the amount necessary to provide for Priority Payments

and any penalties, fines or other payments required to be made to the United States of America under the arbitrage or rebate provisions of the Code, in each case for the current Fiscal Year and for the first full six months of the following Fiscal Year (provided, however, that the aggregate of the amounts transferred to the Operating Account pursuant to this clause (1) in any Fiscal Year shall not exceed the 2007 Operating Cap);

(2) to the Debt Service Account, an amount sufficient to cause the amount therein to equal interest (including interest at the stated rate on the Principal of Outstanding Bonds and on overdue interest, if any) due on the next succeeding Distribution Date and, in the case of Parity Payments and interest due at variable rates on Bonds, to deposit in separate subaccounts within the Debt Service Account, Bond interest and Parity Payments due during the current Fiscal Year including such Distribution Date, together with any unpaid interest and other Parity Payments due on prior Distribution Dates;

(3) unless an Event of Default has occurred and is continuing, to the Debt Service Account, an amount sufficient to cause the amount therein (exclusive of the amount on deposit therein under clause (2) above) to equal the Principal due during the current Fiscal Year;

(4) unless an Event of Default has occurred and is continuing, to the Debt Service Reserve Account, and amount sufficient to cause the amounts therein to equal the Debt Service Reserve Requirement, if any;

(5) unless an Event of Default has occurred and is continuing, to the Debt Service Account the amount which, together with amounts deposited pursuant to clause (2) above but exclusive of the amounts deposited therein pursuant to clause (3) above, will be sufficient to cause the amount on deposit therein to equal interest (including interest at the stated rate on the Principal of Outstanding Bonds) and Parity Payments, in each case, due (a) during the current Fiscal Year and (b) if the Deposit Date is during the period from January 1 through June 30 of any year, during the first full six months of the next Fiscal Year, assuming that Principal of the Bonds will be paid in the amounts deposited pursuant to clause (3) above and Turbo Redemptions will be paid pursuant to clause (9) below;

(6) if an Event of Default has occurred and is continuing, to the Extraordinary Prepayment Account, all amounts remaining in the Revenue Account;

(7) to the Lump Sum Prepayment Account, the amount of any Lump Sum Payment;

(8) to the Operating Account, an amount specified by an Officer's Certificate (or certificate of an authorized officer of the Corporation, as appropriate) to pay for any Operating Expenses in excess of the 2007 Operating Cap; and

(9) to the Turbo Redemption Account, the amount remaining in the Revenue Account.

Except as otherwise provided in the Indenture and unless an Event of Default has occurred, investment earnings on the Accounts shall be deposited in the Revenue Account no later than the Business Day immediately preceding each Distribution Date. If an Event of Default has occurred and is continuing any such investment earnings shall be deposited in the Debt Service Account.

On each Distribution Date the Trustee will apply amounts in the various Accounts in the following order of priority:

(1) from the Debt Service Account, the Lump Sum Prepayment Account, the Turbo Redemption Account and the Debt Service Reserve Account, in that order, to pay interest on the Outstanding Bonds (including interest on overdue interest, if any) and Parity Payments due on such Distribution Date, plus any unpaid interest and Parity Payments due on prior Distribution Dates;

(2) unless an Event of Default has occurred and is continuing, from the Debt Service Account, the Lump Sum Prepayment Account, the Turbo Redemption Account and the Debt Service Reserve Account, in that order, to pay in order of Maturity Dates the Principal due on such Distribution Date;

(3) if an Event of Default has occurred, from the Debt Service Reserve Account, the Lump Sum Prepayment Account and the Extraordinary Prepayment Account, to pay Extraordinary Prepayments;

(4) from the Lump Sum Prepayment Account, to redeem Bonds pursuant to a Lump Sum Prepayment;

(5) from the Accounts therefor, to make Junior Payments; and

(6) from the Turbo Redemption Account, to redeem Bonds.

Events of Default

"***Event of Default***" means any one of the events set forth below:

(i) the failure to pay Principal of or interest on the Senior Bonds when due;

(ii) the Corporation fails to observe or perform any other provision of the Indenture which failure is not remedied within 30 days after written notice thereof is given to the Corporation by the Trustee or to the Corporation and the Trustee by the holders of at least 25% of the Principal Amount of the Senior Bonds then Outstanding;

(iii) bankruptcy, reorganization, arrangement or insolvency proceedings, or other proceedings for relief under any bankruptcy or similar law or laws for the relief of debtors, are instituted by or against the Corporation and, if instituted against the Corporation, are not dismissed within 60 days after such institution;

(iv) the State fails to observe or perform any covenant described below under "Non-Impairment Pledge of the State", which failure is not remedied within 30 days after written notice thereof is given to the Corporation and the State by the Trustee or to the Corporation and the Trustee by holders of not less than 25% of the principal amount Outstanding of the Senior Bonds then Outstanding;

(v) the State fails to pay promptly to the Corporation or the Trustee any Residual Pledged TSRs received by it; or

(vi) the State consents to or acquiesces in an amendment or modification of the MSA or the Consent Decree is amended or modified, in each case, so as to materially reduce the amount of TSRs payable to the State under the MSA or to materially delay any date of payment of a material amount thereof.

Upon the occurrence of an Event of Default, neither the Trustee nor the Holders shall have the right to sell or foreclose on the collateral pledged to the Trustee under the Indenture.

Non-Impairment Pledge of the State

Pursuant to the Act, the Purchase Agreement and the Indenture, the Corporation has, in the opinion of Bond Counsel, validly included the pledge and agreement of the State that the State will (i) continue to diligently enforce the Qualifying Statute against all tobacco product manufacturers selling tobacco products in the State that are not signatories to the MSA, (ii) enforce the State's rights to receive the payments to be made to the State pursuant to the MSA to the full extent permitted by the terms of the MSA, (iii) not amend the MSA in any way that would materially impair the rights of the holders of Bonds, (iv) not limit or alter rights vested in the Corporation to fulfill agreements made with holders of the Bonds, or (v) not in any way impair the rights and remedies of the holders of the Bonds until the Bonds, together with the interest thereon, with interest on any unpaid installments of interest, and all costs and expenses in connection with any action or proceedings by or on behalf of the holders of the Bonds are fully met and discharged.

Defeasance

When (i) there is held by or for the account of the Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities as will provide sufficient funds to pay or redeem all or any portion of the Outstanding Bonds in accordance with their terms and all or any portion of the obligations to Beneficiaries (including parties to Swap Contracts and Ancillary Contracts (the holders of said Bonds and such Beneficiaries herein called the "**Defeased Beneficiaries**") (to be verified by a nationally recognized firm of independent certified public accountants), (ii) any required notice of redemption shall have been duly given in accordance with the Indenture or irrevocable written instructions to give notice shall have been given to the Trustee, and (iii) all the rights of the Fiduciary under the Indenture have been provided for, then upon written notice from the Corporation to the Trustee, such Defeased Beneficiaries shall cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien of the Indenture, the security interests created by the Indenture with respect to such Defeased Beneficiaries (except in such funds and investments) shall terminate, and the State, the Corporation and the Trustee shall execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created under the Indenture and to make the Residual Pledged TSRs payable to the order of the holder of the Remainder Certificate. Upon such defeasance, the funds and investments required to pay or redeem the Bonds and other obligations to such Defeased Beneficiaries shall be

irrevocably set aside for that purpose, subject, however, to the terms of the Indenture regarding unclaimed money, and money held for defeasance shall be invested only as provided in the Indenture and applied by the Trustee and other Paying Agents, if any, to the retirement of the Bonds and such other obligations. Upon defeasance of all Outstanding Bonds and Beneficiaries, any funds or property held by the Trustee and not required for payment or redemption of the Bonds and such other obligations to Beneficiaries and Fiduciaries in full shall be distributed to the order of the State.

Subject to the requirements of the Code, when the Corporation shall have determined to retire and defease all or any portion of the Series 2007 Bonds, the Corporation shall establish a defeasance escrow which (i) redeems on the earliest possible date any Series 2007 Bonds that were projected to be redeemed from the Turbo Redemption Schedule included as part of Series Supplement therefor but, as of the date of such redemption, have not been paid or redeemed and (ii) thereafter, redeems Series 2007 Bonds in accordance with the applicable Projected Turbo Redemption Schedule.

THE 2002 INDENTURE BONDS

The following summary describes certain terms of the 2002 Indenture Bonds. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the 2002 Indenture and the 2002 Indenture Bonds. Terms used herein and not previously defined have the meanings ascribed to them in the 2002 Indenture. Copies of the 2002 Indenture and the 2002 Purchase Agreement may be obtained upon written request to the 2002 Indenture Trustee.

Payments of Interest

Interest on the principal balance of the 2002 Indenture Bonds will be payable on June 1 and December 1 of each year. Failure to pay the full amount of interest payable on any Distribution Date is an Event of Default.

For each Distribution Date, payments will be made to holders of the 2002 Indenture Bonds of record (the "**2002 Indenture Bondholders**") as of the Record Date.

Payments of Principal

Principal on 2002 Indenture Bonds will be paid as follows:

The "**Principal**" of a 2002 Indenture Bond must be paid on the Maturity Date thereof in order to avoid an Event of Default as described herein. The principal amount of the Outstanding 2002 Indenture Bonds are set forth in the following tables.

2002A Indenture Bonds

Year of Maturity (June 1)	Principal Amount Outstanding
2023	$109,770,000
2032	168,260,000
2042	371,700,000

2002B Indenture Bonds

Year of Maturity (June 1)	Principal Amount Outstanding
2012	$13,425,000

A failure by the Corporation to pay the Principal of a 2002 Indenture Bond on its respective Maturity Date will constitute an Event of Default under the Indenture and, to the extent of available Revenues, will result in the Extraordinary Prepayment of the 2002 Indenture Bonds on each subsequent Distribution Date as described herein.

Extraordinary Prepayment

If an Event of Default has occurred and is continuing under the 2002 Indenture, amounts on deposit in the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account will be applied on each Distribution Date in the following order: *first,* to pay interest on overdue interest on the 2002 Indenture Bonds (to the extent legally permissible) pro rata without regard to their order of maturity; *second,* to pay overdue interest on the 2002 Indenture Bonds then due pro rata without regard to their order at maturity; *third,* to pay interest on the 2002 Indenture Bonds then due pro rata without regard to their order of maturity; and *fourth,* to prepay the 2002 Indenture Bonds pro rata without regard to their order of maturity, at the principal amount thereof without premium. See "SECURITY FOR THE 2002 INDENTURE BONDS – Flow of Funds."

Lump Sum Prepayment

The 2002 Indenture Bonds are subject to mandatory prepayment, in whole or in part, prior to their stated Maturity Dates from amounts on deposit in the Lump Sum Prepayment Account on any date at the prepayment price of 100% of the principal amount thereof, together with accrued interest thereon to the prepayment date, without premium. Any prepayments of 2002 Indenture Bonds from Lump Sum Prepayments will be applied to prepay the 2002 Indenture Bonds in direct order of maturity.

Turbo Redemption

The 2002 Indenture Bonds are subject to mandatory redemption in whole or in part prior to their stated Maturity Dates from amounts on deposit in the Turbo Redemption Account on each Distribution Date at the redemption price of 100% of the principal amount thereof together with interest accrued thereon to the date fixed for redemption without premium, provided, however, that any such redemption shall be in a minimum aggregate amount of $50,000. The 2002 Indenture Bonds are subject to Turbo Redemption in order of maturity.

Optional Redemption

The 2002A Indenture Bonds are subject to redemption at the Corporation's option at any time on or after June 1, 2012, in whole or in part, at a redemption price of 100% of the principal amount thereof, plus accrued interest to the date of redemption. The 2000B Indenture Bonds are not subject to optional redemption prior to maturity.

Mandatory Clean-Up Redemption

The 2002 Indenture Bonds are subject to mandatory redemption on any Distribution Date in whole at a redemption price of 100% of the principal amount being redeemed plus accrued interest to the redemption date at any time that the available cash amounts consisting of amounts accumulated in the Collection Account and amounts on deposit in the Debt Service Reserve Account, exceed the aggregate principal amount of, and accrued interest on, all Outstanding 2002 Indenture Bonds.

SECURITY FOR THE 2002 INDENTURE BONDS

General

Pursuant to the Act, the State has transferred to the Corporation certain of the State's future right, title and interest under the MSA, including the 2002 Tobacco Assets. **"2002 Tobacco Assets"** are (i) the Annual Payments and Strategic Contribution Payments and subsequent adjustments thereto which are scheduled to be received by the State on or after January 1, 2004 pursuant to and under the MSA, (ii) all amounts received by the State under the MSA on and after January 1, 2004 consisting of adjustments to Initial Payments and Annual Payments made to the State under the MSA prior to January 1, 2004, and (iii) the total Partial Lump Sum Payments and Final Lump Sum Payments received prior to January 1, 2004 (less the positive difference between (a) $53,410,000 and (b) the amount of the Initial Payment due on January 10, 2003 and the Annual Payment due on April 15, 2003, if and to the extent either or both of such payment was actually made.

The 2002 Indenture Bonds are payable as to Principal, redemption price and interest solely out of the assets of the Corporation pledged for such purpose; neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the Principal, redemption price of or the interest on the 2002 Indenture Bonds; the 2002 Indenture Bonds do not constitute an indebtedness of the State or any political subdivision of the State; the 2002 Indenture Bonds are secured solely by and are payable solely from the tobacco receipts sold to the Corporation and other monies of the Corporation pledged under the Indenture; the 2002 Indenture Bonds do not constitute a general, legal, or moral obligation of the

State or any political subdivision thereof and the State has no obligation or intention to satisfy any deficiency or default of any payment of the 2002 Indenture Bonds. The Corporation has no taxing power.

Payment by MSA Escrow Agent to 2002 Indenture Trustee

The MSA Escrow Agent will disburse the 2002 Tobacco Assets directly to the 2002 Indenture Trustee. The disbursement of 2002 Tobacco Assets is required to be made to the 2002 Indenture Trustee by the MSA Escrow Agent 10 business days after the MSA Escrow Agent receives the related the Annual Payments and Strategic Contribution Payments from the PMs.

Accounts

All of the following accounts have been established and are held by the 2002 Indenture Trustee for the benefit of the 2002 Indenture Bondholders. All money on deposit in the following accounts will be invested in Eligible Investments as defined in the 2002 Indenture.

Collection Account. Under the 2002 Indenture, the 2002 Indenture Trustee established and holds a segregated trust account (the **"Collection Account"**) into which the 2002 Indenture Trustee deposits all Revenues. Funds on deposit in the Collection Account are transferred to various other accounts under the 2002 Indenture and applied to certain other purposes as described below.

Operating Account. Under the 2002 Indenture, the 2002 Indenture Trustee established and holds a segregated trust account (the "**Operating Account**") into which the 2002 Indenture Trustee deposited (i) $600,000 from the proceeds of the 2002 Indenture Bonds to be applied to the payment of operating expenses of the Corporation until April 15, 2004 and (ii) amounts transferred from the Collection Account to pay Operating Expenses of the Corporation.

Debt Service Account. Under the 2002 Indenture, the 2002 Indenture Trustee established and holds within the Bond Fund a segregated trust account (the **"Debt Service Account"**) into which the 2002 Indenture Trustee deposits amounts transferred from the Collection Account in respect of interest and Principal payments on the 2002 Indenture Bonds and from which the 2002 Indenture Trustee will make payments on the 2002 Indenture Bonds in accordance with the priority of payments as described below under **"**Flow of Funds."

Debt Service Reserve Account. Under the 2002 Indenture, the 2002 Indenture Trustee established and holds within the Bond Fund a segregated trust account (the **"Debt Service Reserve Account"**) funded on the Closing Date of the 2002 Indenture Bonds from the proceeds of the 2002 Indenture Bonds in the amount of $51,309,843.75 (the **"Debt Service Reserve Requirement"**). Except after the occurrence of an Event of Default, the balance in the Debt Service Reserve Account must be maintained, to the extent of available funds, at the requirement therefor.

Amounts in the Debt Service Reserve Account will be available to pay Principal of and interest on the 2002 Indenture Bonds to the extent Revenues are insufficient for such purpose and, after an Event of Default, Extraordinary Prepayments. Amounts in the Debt Service Reserve Account are not available to make Turbo Redemption Payments unless such amounts, together with all available Revenues, are sufficient to retire all Outstanding 2002 Indenture Bonds. Amounts withdrawn from the Debt Service Reserve Account will be replenished from Revenues as described in **"**Flow of Funds**"** below. On each Distribution Date, amounts on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement will be transferred to the Debt Service Account. All funds on deposit in the Debt Service Reserve Account will be invested in Eligible Investments as defined in the 2002 Indenture.

Extraordinary Prepayment Account. Under the 2002 Indenture, the 2002 Indenture Trustee established and holds a segregated trust account (the "**Extraordinary Prepayment Account**") into which the 2002 Indenture Trustee will deposit, following the occurrence of any Event of Default and while such Event of Default is continuing, all future Revenues after the payment of certain expenses and all current and past due interest on the 2002 Indenture Bonds. The 2002 Indenture Trustee will make Extraordinary Prepayments on the 2002 Indenture Bonds from the Extraordinary Prepayment Account.

Contingency Account. Under the 2002 Indenture, the 2002 Indenture Trustee established and holds a segregated trust account (the "**Contingency Account**") with which the 2002 Indenture Trustee deposits Revenues in an amount equal to that specified by Officer's Certificate to pay any Operating Expenses not otherwise paid from the Operating Account.

Turbo Redemption Account. Under the 2002 Indenture, the 2002 Indenture Trustee established and holds a segregated trust account (the "**Turbo Redemption Account**") into which the 2002 Indenture Trustee will deposit all

Revenues in excess of the requirements of the 2002 Indenture. At any time, the Corporation may make a deposit to the credit of the Turbo Redemption Account, from sources other than Revenues, including the proceeds of refunding obligations. The 2002 Indenture Trustee will make Turbo Redemption Payments on the 2002 Indenture Bonds from the Turbo Redemption Account.

Lump Sum Prepayment Account. Under the 2002 Indenture, the 2002 Indenture Trustee established and holds a segregated trust account (the "**Lump Sum Prepayment Account**") into which the 2002 Indenture Trustee will deposit all Lump Sum Prepayments. The 2002 Indenture Trustee will make Lump Sum Prepayments on the 2002 Indenture Bonds from the Lump Sum Prepayment Account.

Flow of Funds

The 2002 Indenture Trustee will deposit all Revenues in the Collection Account promptly (and in no event later than 5 Business Days) after receipt, except to the extent that the 2002 Indenture Trustee shall receive settlement payments that do not constitute 2002 Tobacco Assets, the 2002 Indenture Trustee shall promptly remit such amounts to or upon the order of the State.

As soon as possible following each deposit of 2002 Tobacco Assets to the Collection Account (the "**Deposit Date**"), the 2002 Indenture Trustee will withdraw Revenues on deposit in the Collection Account (after setting aside an amount sufficient to pay the 2002 Indenture Trustee's fees and expenses in amount not to exceed the Operating Cap and after any remittance to the State pursuant to the last sentence of the preceding paragraph), and transfer such amounts as follows:

(i) to the Operating Account, an amount specified in an Officer's Certificate taking into account the payment of the 2002 Indenture Trustee's fees and expense payments from the Collection Account for the next twelve months or until the next scheduled Deposit Date, whichever is the longer period, but not exceeding, when taken together with other applicable transfers, the Operating Cap for the then current Fiscal Year;

(ii) if an Event of Default has occurred and is continuing, to the Extraordinary Prepayment Account all amounts remaining in the Collection Account;

(iii) to the Debt Service Account an amount sufficient to cause the amount on deposit therein, together with the investment earnings transferred from the Debt Service Reserve Account, to equal interest due on Outstanding 2002 Indenture Bonds due on the next succeeding Distribution Date;

(iv) to the Debt Service Account an amount sufficient to cause the amount on deposit therein, (exclusive of the amount on deposit therein under clause (iii) above) to equal the Principal of Outstanding 2002 Indenture Bonds due on the next Distribution Date;

(v) to the Debt Service Reserve Account an amount sufficient to cause the amount on deposit therein to equal the Debt Service Reserve Requirement;

(vi) to the Debt Service Account an amount sufficient to cause the amount therein, exclusive of the amount on deposit therein under clauses (iii) and (iv) above, together with investment earnings transferred and anticipated to be transferred from the Debt Service Reserve Account (and, in each case, not allocated pursuant to clause (iii) above) to equal interest due on 2002 Indenture Bonds Outstanding on the second succeeding Distribution Date;

(vii) to the Lump Sum Prepayment Account, the amount of any Partial Lump Sum Payment or any Final Lump Sum Payment;

(viii) to the Contingency Account, an amount specified by an Officer's Certificate to pay for any Operating Expenses not otherwise paid from the Operating Account;

(ix) to the Turbo Redemption Account until 2002 Indenture Bonds are no longer Outstanding, the amount remaining in the Collection Account; and

(x) from and after such time that no 2002 Indenture Bonds remain Outstanding, the remaining amount shall be retained in the Collection Account and applied as required by the Indenture.

Except as otherwise provided in the Indenture, investment earnings on the Accounts shall be deposited in the Collection Account. Investment earnings on the Debt Service Reserve Account shall be deposited in the Debt Service Account as received.

On each Distribution Date, the 2002 Indenture Trustee will apply amounts in the various Accounts in the following order of priority:

(i) from the Collection Account, to the 2002 Indenture Trustee, to pay the 2002 Indenture Trustee's fees and expenses pursuant to the 2002 Indenture in an amount not to exceed the Operating Cap;

(ii) from the Operating Account, to the parties entitled thereto, to pay Operating Expenses, in an amount not to exceed, together with amounts payable under clause (i) above, the applicable Operating Cap;

(iii) unless an Event of Default has occurred and is continuing, from the Debt Service Account and the Debt Service Reserve Account, in that order, to pay interest on the Outstanding 2002 Indenture Bonds due on such Distribution Date;

(iv) unless an Event of Default has occurred and is continuing, from the Debt Service Account and the Debt Service Reserve Account, in that order, to pay the Principal of Outstanding 2002 Indenture Bonds due on such Distribution Date;

(v) unless an Event of Default has occurred and is continuing, from the Debt Service Reserve Account, any amount remaining in excess of the Debt Service Reserve Requirement, to the Debt Service Account;

(vi) if an Event of Default has occurred and is continuing, from the Extraordinary Prepayment Account, the Debt Service Account and the Debt Service Reserve Account, in that order, to pay Extraordinary Prepayments;

(vii) from the Lump Sum Prepayment Account, to pay Lump Sum Prepayments;

(viii) from the Contingency Account, to the parties entitled thereto, to pay Operating Expenses not otherwise paid from the Operating Account; and

(ix) from the Turbo Redemption Account, to make Turbo Redemption Payments of the 2002 Indenture Bonds.

After making all deposits and payments set forth above, and provided that there are no Outstanding 2002 Indenture Bonds, the 2002 Indenture Trustee shall deliver any amounts remaining in an Account to the registered owner of the 2002 Residual Certificate upon presentation of the 2002 Residual Certificate to the 2002 Indenture Trustee.

Definitions

"Distribution Date" means each June 1 and December 1.

"Final Lump Sum Payment" means a lump sum payment received by the 2002 Indenture Trustee as a final payment from a PM which results in a release of that PM from all of its future obligations under the MSA.

"Fiscal Year" means each 12 month period ending each June 30.

"Operating Cap" means $300,000 in the 2002 Fiscal Year inflated in each following Fiscal Year by the Inflation Adjustment (as defined in the MSA) plus arbitrage payments, rebate and penalties specified by Officer's Certificate.

"Operating Expenses" means operating and administrative expenses of the Corporation (including, without limitation, the cost of preparation of accounting and other reports, costs of maintenance of the ratings on the 2002 Indenture Bonds, arbitrage payments and rebate penalties, insurance premiums and costs of annual meetings or other required activities of the Corporation), fees and expenses incurred for the 2002 Indenture Trustee, any Paying Agents, professional consultants and fiduciaries, termination payments on investment contracts or investment agreements for Accounts or on forward purchase contracts for investments in Accounts, enforcement related costs with federal and state agencies incurred, as determined by the State, in order to preserve the tax-exempt status of any Bonds, and the costs related to enforcement of the Corporation's or the 2002 Indenture Trustee's enforcement rights with respect to the 2002 Indenture, the 2002 Purchase and Sale Agreement and the Corporation's tax certificate or the 2002 Indenture Bonds, and all other expenses so identified as Operating Expenses in the 2002 Indenture.

"Partial Lump Sum Payment" means a lump sum payment received by the 2002 Indenture Trustee as a payment from a PM which results in a release of that PM from a portion, but not all of its future payment obligations under the MSA.

Events of Default

"Event of Default" means any one of the events set forth below:

(i) failure to pay when due interest on any interest payment date or Principal on the applicable Maturity Date or failure to pay when due interest on and principal of any 2002 Indenture Bonds in accordance with any notice of redemption or prepayment;

(ii) failure of the Corporation to observe or perform any other provision of the 2002 Indenture which is not remedied within 60 days after written notice thereof is given to the Corporation by the 2002 Indenture Trustee or to the Corporation and the 2002 Indenture Trustee by the Holders of at least 25% in principal amount of the 2002 Indenture Bonds then Outstanding; or

(iii) a material breach by the State of its covenants summarized below under the caption "Covenants of the State," which breach is not remedied within 60 days after written notice, specifying such default and requiring the same to be remedied, shall have been given to the Corporation and the State by the 2002 Indenture Trustee or by the Holders of at least 25% in principal amount of the 2002 Indenture Bonds then Outstanding. In the case of a default specified in this clause (iii), if the default be such that it cannot be corrected within the said 60-day period, it shall not constitute an Event of Default if corrective action is instituted by the State within said 60-day period and diligently pursued until the default is corrected.

Except as specified in clause (i) above, failure to make any payment or to make provision therefor, including any Turbo Redemption Payment, does not constitute an Event of Default to the extent that such failure results from the insufficiency of available Collateral to make such payment or provision therefor.

Failure by the Corporation to comply with its continuing disclosure undertaking relating to the 2002 Indenture Bonds is not an Event of Default under the 2002 Indenture.

Covenants of the State

Pursuant to the Act, the State pledges to and agrees with the Bondholders of any 2002 Indenture Bonds issued under the 2002 Indenture that the State will not limit or alter the rights vested in the Corporation to fulfill the terms of any agreements made with the Bondholders, or otherwise take any action that materially and adversely affects the rights of the Bondholders, until the 2002 Indenture Bonds, together with the interest thereon, with interest on any unpaid installments of interest, and all costs and expenses in connection with any action or proceeding by or on behalf of Bondholders, are fully met and discharged.

Pursuant to the Act and the 2002 Purchase and Sale Agreement, the State covenants and agrees with the Corporation, and the Corporation is authorized to include such covenant and agreement in the 2002 Indenture for the benefit of the Bondholders or other parties receiving the express benefit of the security for the 2002 Indenture Bonds, that the State will (i) irrevocably direct the Escrow Agent and Independent Auditor (as such terms are defined in the MSA) to transfer all 2002 Tobacco Assets directly to the 2002 Indenture Trustee, (ii) enforce the Corporation's rights to receive the 2002 Tobacco Assets to the full extent permitted by the MSA, (iii) not amend the MSA in any manner that would materially impair the rights of the Bondholders or other parties receiving the express benefit of the security for the 2002 Indenture Bonds (**"benefited parties"**), (iv) not limit or alter the rights of the Corporation to fulfill the terms of its agreements with the Bondholders and benefited parties, (v) not in any way impair the rights and remedies of the Bondholders or benefited parties or the security for the 2002 Indenture Bonds until the 2002 Indenture Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of the Bondholders, are fully paid and discharged, (vi) not fail to enforce the Qualifying Statute, and (vii) not amend, supersede or repeal the Qualifying Statute in any way that would materially adversely affect the amount of any payment to, or materially impair the rights of, the Corporation, such owners of the 2002 Indenture Bonds or such benefited parties.

Pursuant to the Act and the Purchase Agreement, the State covenants and agrees with the Corporation, and the Corporation is authorized to include such covenant and agreement in the Indenture for the benefit of the Bondholders, that (i) the State shall take all actions as may be required by law and the MSA fully to preserve, maintain, defend, protect and confirm the interest of the Corporation in the Residual Tobacco Assets and in the proceeds thereof in all material respects, and the State will not take any material action that will adversely affect the Corporation's legal right to receive the Residual Tobacco Assets; (ii) the State will promptly pay to the 2002 Indenture Trustee any Residual Tobacco Assets received by the State; and (iii) without the prior written consent of the Corporation and the Trustee, the State will not take any action and will use its best reasonable efforts not to permit any action to be taken by others that (x) would release any person from any of such person's covenants or

obligations under the MSA or (y) would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the MSA or waive timely performance or observance under such document, in each case if the effect thereof would be materially adverse to the Bondholders or benefited parties; provided, however, that if a Rating Confirmation is received relating to such proposed action then such proposed action will be deemed not to be materially adverse to the Bondholders or benefited parties. The State shall deliver to the Corporation and to the Trustee written notice of any action described in clause (iii)(x) or (iii)(y) of the preceding sentence which it intends to take. The State shall deliver such written notice a reasonable period of time before taking any such action.

Pursuant to section 42-133-17 of the Act, nothing in the Act shall be construed as in any way modifying or limiting, and the State pledges to and agrees with the holders of any bonds issued under the Act that the State will not modify or limit, the responsibility of the Attorney General to administer, protect and discharge all duties, rights and obligations of the State under the Master Settlement Agreement and the State Qualifying Statute.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

The following is a brief summary of certain provisions of the MSA. This summary is not complete and is subject to, and qualified in its entirety by reference to, the copy of the MSA, as amended, which is attached hereto as Appendix B. Several amendments have been made to the MSA which are not included in Appendix B. Except for those amendments pursuant to which certain tobacco companies became SPMs, such amendments involve technical and administrative provisions not material to the summary below.

General

The MSA is an industry wide settlement of litigation between the Settling States and the OPMs and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for SPMs to become parties to the MSA. The three OPMs together with the SPMs are referred to as the PMs. Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions, and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

Parties to the MSA

The Settling States are all of the states, territories and the District of Columbia, except for the four states (Florida, Minnesota, Mississippi and Texas) that separately settled with the OPMs prior to the adoption of the MSA (the "**Previously Settled States**"). According to the National Association of Attorneys General ("**NAAG**"), as of May 29, 2007, 47 PMs have signed the MSA. The chart below identifies each of the PMs which was a party to the MSA as of May 29, 2007:

OPMs	SPMs	
Lorillard Tobacco Company	Bekenton, S.A.	Lignum-2, Inc.
Philip Morris, USA (formerly Philip Morris Incorporated)	Canary Islands Cigar Co.	Mac Baren Tobacco Company A/S
R.J. Reynolds Tobacco Company	Caribbean-American Tobacco Corp. (CATCORP)	Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)
	Chancellor Tobacco Company, UK Ltd.	NASCO Products Inc.
	Commonwealth Brands, Inc.	P.T. Djarum
	Cutting Edge Enterprises, Inc.	Pacific Stanford Manufacturing Corporation
	Daughters & Ryan, Inc.	Peter Stokkebye Tobaksfabrik A/S
	M/s. Dhanraj International	Planta Tabak-manufaktur Gmbh & Co.
	Eastern Company S.A.E.	Poschl Tabak GmbH & Co. KG
	Farmer's Tobacco Co. of Cynthiana, Inc.	Premier Manufacturing Incorporated
	General Jack's Incorporated	Santa Fe Natural Tobacco Company, Inc.
	General Tobacco (Vibo Corporation d/b/a General Tobacco)	Sherman's 1400 Broadway N.Y.C. Inc.
	House of Prince A/S	Societe National d'Exploitation Industrielle des Tabacs et Allumettes ("**SEITA**")
	Imperial Tobacco Limited/ITL (USA) Limited	Tabacalera del Este, S.A. ("**TABESA**")
	International Tobacco Group (Las Vegas), Inc.	Top Tobacco, LP
	Japan Tobacco International USA, Inc.	U.S. Flue Cured Tobacco Growers, Inc.
	King Maker Marketing	Vector Tobacco Inc.
	Konci G&D Management Group	Virginia Carolina Corporation, Inc.
		Von Eicken Group

OPMs	SPMs	
	(USA) Inc. Kretek International Lane Limited Liberty Brands, LLC Liggett Group, Inc.	Wind River Tobacco Company, LLC VIP Tobacco USA, LTD. (formerly Winner Sales Company) ZNF International, LLC (no current brands)

The MSA restricts PMs from transferring their tobacco product brands, cigarette product formulas and cigarette businesses (unless they are being transferred exclusively for use outside the United States) to any entity that is not a PM under the MSA, unless the transferee agrees to assume the obligations of the transferring PM under the MSA related to such brands, formulas or businesses. The MSA expressly provides that the payment obligations of each PM are not the obligation or responsibility of any affiliate of such PM and, further, that the remedies, penalties or sanctions that may be imposed or assessed in connection with a breach or violation of the MSA will only apply to the PMs and not against any other person or entity. Obligations of the SPMs, to the extent that they differ from the obligations of the OPMs, are described below under "− Subsequent Participating Manufacturers" herein.

Scope of Release

Under the MSA, the PMs and the other “Released Parties” (defined below) are released from:

- claims based on past conduct, acts or omissions (including any future damages arising therefrom) in any way relating to the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, or exposure to, or research statements or warnings regarding, tobacco products; and
- monetary claims based on future conduct, acts or omissions in any way relating to the use of or exposure to tobacco products manufactured in the ordinary course of business, including future claims for reimbursement of health care costs.

This release is binding upon each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions. The MSA is further stated to be binding on the following persons, to the full extent of the power of the signatories to the MSA to release past, present and future claims on their behalf: (i) any Settling State’s subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (ii) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in the MSA (a) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of such Settling State, as opposed solely to private or individual relief for separate and distinct injuries, or (b) to the extent that any such entity (as opposed to an individual) is seeking recovery of health care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State. All such persons or entities are referred to collectively in the MSA as “**Releasing Parties**.”

To the extent that the State’s Attorney General does not have the power or authority to bind any of the State Releasing Parties, the release of claims contemplated by the MSA may be ineffective as to the Releasing Parties and any amounts that become payable by the PMs on account of their claims, whether by way of settlement, stipulated judgment or litigated judgment, will trigger the Litigating Releasing Parties Offset. See “– Adjustments to Payments” below.

The release inures to the benefit of all PMs and their past, present and future affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, tobacco-related organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any PM or any such affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). They are referred to in the MSA individually as a “**Released Party**” and collectively as the “**Released Parties**.” However, the term “Released Parties” does not include any

person or entity (including, but not limited to, an affiliate) that is an NPM at any time after the MSA execution date, unless such person or entity becomes a PM.

Overview of Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Payments.* See "– Initial Payments," "– Annual Payments" and "– Strategic Contribution Payments" below. These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "Adjustments to Payments" and "Subsequent Participating Manufacturers" below. SPMs were not required to make Initial Payments. The OPMs have made all of the Initial Payments, and the PMs have made the Annual Payments for 2000, 2001, 2002, 2003, 2004 and 2005 (subject to certain withholdings described in "RISK FACTORS – Other Potential Payment Decreases Under the Terms of the MSA" herein). Residual Pledged TSRs do not include any payments made before the date of delivery of the Series 2007 Bonds. See "– Payments Made to Date" below. Strategic Contribution Payments are scheduled to begin April 15, 2008 and continue through April 15, 2017.

Payments required to be made by the OPMs are calculated by reference to the OPM's domestic shipments of cigarettes, with the amount of the payments adjusted annually roughly in proportion to the changes in total volume of cigarettes shipped by the OPMs in the United States in the preceding year. Payments to be made by the PMs are recalculated each year, based on the United States market share of each individual PM for the prior year, with consideration under certain circumstances, for the profitability of each OPM. The Annual Payments and Strategic Contribution Payments required to be made by the SPMs are based on increases in their shipment market share. See "− Subsequent Participating Manufacturers" below. Pursuant to an escrow agreement (the "**MSA Escrow Agreement**") established in conjunction with the MSA, remaining Annual Payments and Strategic Contribution Payments are to be made to Citibank, N.A., as escrow agent (the "**MSA Escrow Agent**"), which in turn will disburse the funds to the Settling States.

Beginning with the payments due in the year 2000, Pricewaterhouse Coopers LLP (the "**MSA Auditor**") has, among other things, calculated and determined the amount of all payments owed pursuant to the MSA, the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the PMs and among the Settling States. *This information is not publicly available and, the MSA Auditor has agreed to maintain the confidentiality of all such information, except that the MSA Auditor may provide such information to PMs and the Settling States as set forth in the MSA.*

Initial Payments

Initial Payments were made only by the OPMs. In December 1998, the OPMs collectively made an up-front Initial Payment of $2.40 billion. The 2000 Initial Payment, which had a scheduled base amount of $2.47 billion, was paid in December 1999 in the approximate amount of $2.13 billion due to various adjustments. The 2001 Initial Payment, which had a scheduled base amount of $2.55 billion, was paid in December 2000 in the approximate amount of $2.04 billion after taking into account various adjustments and an earlier overpayment. The 2002 Initial Payment, which had a scheduled base amount of $2.62 billion, was paid in December 2001, in the approximate amount of $1.89 billion after taking into account various adjustments and a deposit made to the Disputed Payments Account. Approximately $204 million, which was substantially all of the money previously deposited in the Disputed Payments Account for payment to the Settling States, was distributed to the Settling States with the Annual Payment due April 15, 2002. The 2003 Initial Payment, which had a scheduled base amount of $2.70 billion, was paid in December 2002 and January 2003, in the approximate aggregate amount of $2.14 billion after taking into account various adjustments.

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* Other payments that are required to be made by the PMs, such as payments of attorneys' fees and payments to a national foundation established pursuant to the MSA, are not allocated to the states and are not available to the Bondholders, and consequently are not discussed here.

Annual Payments

The OPMs and the other PMs are required to make Annual Payments on each April 15 in perpetuity. The PMs made the first eight Annual Payments due April 15 in each of the years 2000 through 2007, the scheduled base amounts of which (before adjustments discussed below) were $4.5 billion, $5.0 billion, $6.5 billion, $6.5 billion, $8.0 billion, $8.0 billion, $8.0 billion and $8.0 billion, respectively. After application of the adjustments, the Annual Payment made (i) in April 2000 was approximately $3.5 billion, (ii) in April 2001 was approximately $4.1 billion, (iii) in April 2002 was approximately $5.2 billion, (iv) in April 2003 was approximately $5.1 billion, (v) in April 2004 was approximately $6.2 billion, (vi) in April 2005 was approximately $6.3 billion, (vii) in April 2006 was approximately $5.8 billion, and (viii) in April 2007 was approximately $6.0 billion. The scheduled base amount (before adjustments discussed below) of each Annual Payment, subject to adjustment, is set forth below:

Annual Payments

Year	Base Amount	Year	Base Amount
2000*	$4,500,000,000	2010	$8,139,000,000
2001*	5,000,000,000	2011	8,139,000,000
2002*	6,500,000,000	2012	8,139,000,000
2003*	6,500,000,000	2013	8,139,000,000
2004*	8,000,000,000	2014	8,139,000,000
2005*	8,000,000,000	2015	8,139,000,000
2006*	8,000,000,000	2016	8,139,000,000
2007*	8,000,000,000	2017	8,139,000,000
2008	8,139,000,000	2018	9,000,000,000
2009	8,139,000,000	Thereafter	9,000,000,000

The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM's Relative Market Share during the preceding calendar year. The base annual payments in the above table will be increased by at least the minimum 3% Inflation Adjustment, adjusted by the Volume Adjustment, reduced by the Previously Settled States Reduction, and further adjusted by the other adjustments described below. The SPMs are required to make Annual Payments if their respective market share increases above the higher of their respective 1998 Market Share or 125% of their 1997 Market Share. See "– Subsequent Participating Manufacturers" below.

"**Relative Market Share**" is defined as an OPM's percentage share of the number of cigarettes shipped by all OPMs in or to the 50 states, the District of Columbia and Puerto Rico (defined hereafter as the "**United States**"), as measured by the OPM's reports of shipments to Management Science Associates, Inc. (or any successor acceptable to all the OPMs and a majority of the attorneys general of the Settling States who are also members of the NAAG executive committee). The term "**cigarette**" is defined in the MSA to mean any product that contains nicotine, is intended to be burned, contains tobacco and is likely to be offered to, or purchased by, consumers as a cigarette and includes "roll-your-own" tobacco.

The base amounts shown in the table above are subject to the following adjustments applied in the following order:

- the Inflation Adjustment,
- the Volume Adjustment,
- the Previously Settled States Reduction,
- the Non-Settling States Reduction,
- the NPM Adjustment,
- the Offset for Miscalculated or Disputed Payments,

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* The 2000 through 2007 Annual Payments have been made. However, subsequent adjustments to these Annual Payments may impact subsequent Annual Payments and Strategic Contribution Payments.

- the Litigating Releasing Parties Offset, and
- the Offset for Claims-Over.

Application of these adjustments resulted in a material reduction of TSRs from the scheduled base amounts of the Annual Payments made by the PMs in April of the years 2000 through 2007, as discussed below under the heading "– Payments Made to Date."

Strategic Contribution Payments

The OPMs are also required to make Strategic Contribution Payments on April 15, 2008 and on April 15 of each year thereafter through 2017. The base amount of each Strategic Contribution Payment is $861 million. The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM's Relative Market Share during the preceding calendar year. The SPMs will be required to make Strategic Contribution Payments if their respective market share increases above the higher of their respective 1998 market share or 125% of their 1997 market share. See "− Subsequent Participating Manufacturers" below.

The base amounts of the Strategic Contribution Payments are subject to the following adjustments applied in the following order:

- the Inflation Adjustment,
- the Volume Adjustment,
- the Non-Settling States Reduction,
- the NPM Adjustment,
- the Offset for Miscalculated or Disputed Payments,
- the Litigating Releasing Parties Offset, and
- the Offset for Claims-Over.

Adjustments to Payments

The base amounts of the Initial Payments were, and the Annual Payments and Strategic Contribution Payments shown in the tables above are, subject to certain adjustments to be applied sequentially and in accordance with formulas contained in the MSA.

Inflation Adjustment. The base amounts of the Annual Payments and Strategic Contribution Payments are increased each year to account for inflation. The increase in each year will be 3% or a percentage equal to the percentage increase in the Consumer Price Index for All Urban Consumers (the "**CPI**") (or such other similar measures as may be agreed to by the Settling States and the PMs) for the preceding year, whichever is greater (the "**Inflation Adjustment**"). The inflation adjustment percentages are compounded annually on a cumulative basis beginning in 1999 and were first applied in 2000.

Volume Adjustment. Each of the Initial Payments was, and each of the Annual Payments and Strategic Contribution Payments is, increased or decreased by an adjustment which accounts for fluctuations in the number of cigarettes shipped by the OPMs in or to the United States (the "**Volume Adjustment**").

If the aggregate number of cigarettes shipped in or to the United States by the OPMs in any given year (the "**Actual Volume**") is greater than 475,656,000,000 cigarettes (the "**Base Volume**"), the base amount allocable to the OPMs is adjusted to equal the base amount (in the case of Annual Payments and Strategic Contribution Payments after application of the Inflation Adjustment) multiplied by a ratio, the numerator of which is the Actual Volume and the denominator of which is the Base Volume.

If the Actual Volume in a given year is less than the Base Volume, the base amount due from the OPMs (in the case of Annual Payments and Strategic Contribution Payments, after application of the Inflation Adjustment) is decreased by 98% of the percentage by which the Actual Volume is less than the Base Volume, multiplied by such base amount. If, however, the aggregate operating income of the OPMs from sales of cigarettes in the United States during the year (the "**Actual Operating Income**") is greater than $7,195,340,000, as adjusted for inflation in accordance with the Inflation Adjustment (the "**Base Operating Income**"), all or a portion of the volume reduction is added back (the "**Income Adjustment**"). The amount by which the Actual Operating Income of the OPMs exceeds the Base Operating Income is multiplied by the percentage of the allocable shares under the MSA represented by Settling States in which State-Specific Finality has been reached and divided by four, then added to the payment due. However, in no case will the amount added back due to the increase in operating income exceed the amount deducted due to the decrease in domestic volume. Any add-back due to an increase in Actual Operating

Income will be allocated among the OPMs on a Pro Rata basis in accordance with their respective increases in Actual Operating Income over 1997 Base Operating Income.

Previously Settled States Reduction. The base amounts of the Annual Payments (as adjusted by the Inflation Adjustment and the Volume Adjustment, if any) are subject to a reduction reflecting the four states that had settled with the OPMs prior to the adoption of the MSA (Mississippi, Florida, Texas and Minnesota) (the "**Previously Settled States Reduction**"). The Previously Settled States Reduction reduces by 12.4500000% each applicable payment on or before December 31, 2007, by 12.2373756% each applicable payment between January 1, 2008 and December 31, 2017, and by 11.0666667% each applicable payment on or after January 1, 2018. The SPMs are not entitled to any reduction pursuant to the Previously Settled States Reduction. Initial Payments were not and Strategic Contribution Payments are not subject to the Previously Settled States Reduction.

Non-Settling States Reduction. In the event that the MSA terminates as to any Settling State, the remaining Annual Payments and Strategic Contribution Payments due from the PMs shall be reduced to account for the absence of such state. This adjustment has no effect on the amounts to be collected by states which remain a party to the MSA, and the reduction is therefore not detailed.

Non-Participating Manufacturers Adjustment. The NPM Adjustment is based upon market share increases, measured by domestic sales of cigarettes by NPMs, and operates to reduce the payments of the PMs under the MSA in the event that the PMs incur losses in market share to NPMs during a calendar year as a result of the MSA. Three conditions must be met in order to trigger an NPM adjustment; (1) the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997, (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the market share loss for the year in question, and (3) the Settling States in question must be proven to not have diligently enforced their Qualifying Statutes. The "**NPM Adjustment**" is applied to the subsequent year's Annual Payment and Strategic Contribution Payment and the decrease in total funds available as a result of the NPM Adjustment is then allocated on a Pro Rata basis among those Settling States that have been found (i) to not diligently enforce their Qualifying Statutes, or (ii) to have enacted a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate market share is between 0% and 16⅔% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs would be decreased by three times the percentage decrease in the PMs' actual aggregate market share. If, however, the aggregate market share loss from the Base Aggregate Participating Manufacturer Market Share is greater than 16⅔%, the NPM Adjustment will be calculated as follows:

NPM Adjustment = 50% +
[50% / (Base Aggregate Participating Manufacturer Market Share – 16⅔%)]
x [market share loss – 16⅔%]

Regardless of how the NPM Adjustment is calculated, it is always subtracted from, and may not exceed, the total Annual Payments and Strategic Contribution Payments due from the PMs in any given year. The NPM Adjustment applies only to the Annual Payments and Strategic Contribution Payments, and does not apply at all if the number of cigarettes shipped in or to the United States in the year prior to the year in which the payment is due by all manufacturers that were PMs prior to December 7, 1998 exceeds the number of cigarettes shipped in or to the United States by all such PMs in 1997.

The NPM Adjustment is also state-specific, in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing a Qualifying Statute (as defined herein). Any Settling State that adopts and diligently enforces a Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute, which is a Qualifying Statute. The decrease in total funds available due to the NPM Adjustment is allocated on a Pro Rata basis among those Settling States that either (i) did not enact and diligently enforce the Qualifying Statute, or (ii) enacted a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. If a Settling State enacts and diligently enforces a Qualifying Statute that is the Model Statute but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment for any given year will not exceed 65% of the amount of such state's allocated payment for the subsequent year. If a Qualifying Statute that is not the Model Statute is held invalid or unenforceable, however, such state is not entitled to any protection from the NPM Adjustment. Moreover, if a state adopts a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM Adjustment. At all times, a state's protection from the NPM Adjustment is conditioned upon the diligent enforcement of its Qualifying Statute. See "RISK FACTORS – Other Potential Payment

Decreases Under the Terms of the MSA" above and "– MSA Provisions Relating to Model/Qualifying Statutes" below.

The MSA provides that if any Settling State resolves claims against any NPM that are comparable to any of the claims released in the MSA on overall terms more favorable to such NPM than the MSA does to the PMs, or relieves in any respect the obligation of any PM to make payments under the MSA, the terms of the MSA will be deemed modified to match the NPM settlement or such payment terms, but only with respect to the particular Settling State.

Offset for Miscalculated or Disputed Payments. If the MSA Auditor receives notice of a miscalculation of an Initial Payment made by an OPM, an Annual Payment made by a PM within four years or a Strategic Contribution Payment made by a PM within four years, the MSA Auditor will recalculate the payment and make provisions for rectifying the error (the "**Offset for Miscalculated or Disputed Payments**"). There are no time limits specified for recalculations although the MSA Auditor is required to determine amounts promptly. Disputes as to determinations by the MSA Auditor may be submitted to binding arbitration governed by the Federal Arbitration Act. In the event that mispayments have been made, they will be corrected through payments with interest (in the event of underpayments) or withholdings with interest (in the event of overpayments). Interest will be at the prime rate, except where a party fails to pay undisputed amounts or fails to provide necessary information readily available to it, in which case a penalty rate of prime plus 3% applies. If a PM disputes any required payment, it must determine whether any portion of the payment is undisputed and pay that amount for disbursement to the Settling States. The disputed portion is required to be paid into the Disputed Payments Account pending resolution of the dispute. Failure to pay such disputed amounts into the Disputed Payments Account can result in liability for interest at the penalty rate if the disputed amount was in fact properly due and owing. See "RISK FACTORS - *Other Potential Payment Decreases Under the Terms of the MSA*" herein.

Litigating Releasing Parties Offset. If any Releasing Party initiates litigation against a PM for any of the claims released in the MSA, the PM may be entitled to an offset against such PM's payment obligation under the MSA (the "**Litigating Releasing Parties Offset**"). A defendant PM may offset dollar-for-dollar any amount paid in settlement, stipulated judgment or litigated judgment against the amount to be collected by the applicable Settling State under the MSA only if the PM has taken all ordinary and reasonable measures to defend that action fully and only if any settlement or stipulated judgment was consented to by the state attorney general. The Litigating Releasing Parties Offset is state-specific. Any reduction in MSA payments as a result of the Litigating Releasing Parties Offset would apply only to the Settling State of the Releasing Party.

Offset for Claims-Over. If a Releasing Party pursues and collects on a released claim against an NPM or a retailer, supplier or distributor arising from the sale or distribution of tobacco products of any NPM or the supply of component parts of tobacco products to any NPM (collectively, the "**Non-Released Parties**"), and the Non-Released Party in turn successfully pursues a claim for contribution or indemnification against a Released Party (as defined herein), the Releasing Party must (i) reduce or credit against any judgment or settlement such Releasing Party obtains against the Non-Released Party the full amount of any judgment or settlement such Non-Released Party may obtain against the Released Party, and (ii) obtain from such Non-Released Party for the benefit of such Released Party a satisfaction in full of such Non-Released Party's judgment or settlement against the Released Party. In the event that such reduction or satisfaction in full does not fully relieve the Released Party of its duty to pay to the Non-Released Party, the PM is entitled to a dollar-for-dollar offset from its payment to the applicable Settling State (the "**Offset for Claims-Over**"). For purposes of the Offset for Claims-Over, any person or entity that is enumerated in the definition of Releasing Party set forth above is treated as a Releasing Party without regard to whether the applicable attorney general had the power to release claims of such person or entity. The Offset for Claims-Over is state-specific and would apply only to MSA payments owed to the Settling State of the Releasing Party.

Subsequent Participating Manufacturers

SPMs are obligated to make Annual Payments and Strategic Contribution Payments which are made at the same times as the Annual Payments and Strategic Contribution Payments to be made by OPMs. Annual Payments and Strategic Contribution Payments for SPMs are calculated differently, however, from Annual Payments and Strategic Contribution Payments for OPMs. Each SPM's payment obligation is determined according to its market share if, and only if, its "**Market Share**" (defined in the MSA to mean a manufacturer's share, expressed as a percentage, of the total number of cigarettes sold in the United States in a given year, as measured by excise taxes (or similar taxes, in the case of Puerto Rico)), for the year preceding the payment exceeds its "**Base Share**," defined as the higher of its 1998 Market Share or 125% of its 1997 Market Share. If an SPM executes the MSA after February 22, 1999, its 1997 or 1998 Market Share, as applicable, is deemed to be zero. Fourteen of the current 44 SPMs signed the MSA on or before the February 22, 1999 deadline.

For each Annual Payment and Strategic Contribution Payment, each SPM is required to pay an amount equal to the base amount of the Annual Payment and the Strategic Contribution Payment owed by the OPMs, collectively, adjusted for the Volume Adjustment described above but prior to any other adjustments, reductions or offsets, multiplied by (i) the difference between that SPM's Market Share for the preceding year and its Base Share, divided by (ii) the aggregate Market Share of the OPMs for the preceding year. Other than the application of the Volume Adjustment, payments by the SPMs are subject to the same adjustments (including the Inflation Adjustment), reductions and offsets as are the payments made by the OPMs, with the exception of the Previously Settled States Reduction.

Because the Annual Payments and Strategic Contribution Payments to be made by the SPMs are calculated in a manner different from the calculations for Annual Payments and Strategic Contribution Payments to be made by the OPMs, a change in market share between the OPMs and the SPMs could cause the amount of Annual Payments and Strategic Contribution Payments required to be made by the PMs in the aggregate to be greater or less than the amount that would be payable if their market share remained the same. In certain circumstances, an increase in the market share of the SPMs could increase the aggregate amount of Annual Payments and Strategic Contribution Payments because the Annual Payments and Strategic Contribution Payments to be made by the SPMs are not adjusted for the Previously Settled States Reduction. However, in other circumstances, an increase in the market share of the SPMs could decrease the aggregate amount of Annual Payments and Strategic Contribution Payments because the SPMs are not required to make any Annual Payments or Strategic Contribution Payments unless their market share increases above their Base Share, or because of the manner in which the Inflation Adjustment is applied to each SPM's payments.

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, the PMs have made the first eight Annual Payments and the MSA Escrow Agent has disbursed to the State or the 2002 Indenture Trustee, as applicable, the State's allocable portions thereof and certain other amounts under the MSA totaling $386,415,994.54 to date. These amounts are not pledged to payment of the Series 2007 Bonds. Under the MSA, the computation of Initial Payments, Annual Payments and Strategic Contribution Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA. The sole sources of information regarding the computation and amount of such payments are the reports and accountings furnished to the Corporation by the State.

MSA Payments Made to Date

Fiscal Year	Type of Payment	Actual Payment
1999/2000	Upfront and Initial Payment	$33.2 million
2000	Annual Payment	25.6 million
2001	Initial Payment	15.7 million
2001	Annual Payment	29.3 million
2002	Initial Payment	14.0 million
2002	Annual Payment	38.3 million
2003	Initial Payment	15.4 million
2003	Annual Payment	37.4 million
2004	Annual Payment	45.1 million
2005	Annual Payment	45.8 million
2006	Annual Payment	42.1 million
2007	Annual Payment	44.0 million
	Non-Allocable Tax Refunds	0.5 million

Both the Settling States and one or more of the PMs are disputing or have disputed the calculations of some of the Initial Payments for the years 2000 through 2003, and some Annual Payments for the years 2000 through 2007. In addition, subsequent revisions in the information delivered to the MSA Auditor (on which the MSA Auditor's calculations of the Initial and Annual Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

"Most Favored Nation" Provisions

In the event that any non-foreign governmental entity other than the federal government should reach a settlement of released claims with PMs that provides more favorable terms to the governmental entity than does the MSA to the Settling States, the terms of the MSA will be modified to match those of the more favorable settlement. Only the non-economic terms may be considered for comparison.

In the event that any Settling State should reach a settlement of released claims with NPMs that provides more favorable terms to the NPMs than the MSA does to the PMs, or relieves in any respect the obligation of any PM to make payments under the MSA, the terms of the MSA will be deemed modified to match the NPM settlement or such payment terms, but only with respect to the particular Settling State. In no event will the adjustments discussed in this paragraph modify the MSA with regard to other Settling States. See "RISK FACTORS – Disputed or Recalculated Payments and Disputes under the Terms of the MSA" herein.

State-Specific Finality and Final Approval

The MSA provides that payments could not be disbursed to the individual Settling States until the occurrence of each of two events: State-Specific Finality and Final Approval.

"**State-Specific Finality**" means, with respect to an individual Settling State, that (i) such state has settled its pending or potential litigation against the tobacco companies with a consent decree, which decree has been approved and entered by a court within the Settling State, and (ii) the time for all appeals against the consent decree has expired. All Settling States have achieved State Specific Finality.

"**Final Approval**" marked the approval of the MSA by the Settling States and means the earlier of (i) the date on which at least 80% of the Settling States, both in terms of number and dollar volume entitlement to the proceeds of the MSA, have reached State-Specific Finality, or (ii) June 30, 2000. Final Approval was achieved on November 12, 1999.

Disbursement of Funds from Escrow

The MSA Auditor makes all calculations necessary to determine the amounts to be paid by each PM, as well as the amounts to be disbursed to each of the Settling States. Not less than 40 days prior to the date on which any payment is due, the MSA Auditor must provide copies of the disbursement calculations to all parties to the MSA, who must within 30 days prior to the date on which such payment is due advise the other parties if it questions or challenges the calculations. The final calculation is due from the MSA Auditor not less than 15 days prior to the payment due date. The calculation is subject to further adjustments if previously missing information is received. In the event of a challenge to the calculations, the non-challenged part of a payment shall be processed in the normal course. Challenges will be submitted to binding arbitration. The information provided by the MSA Auditor to the State with respect to calculations of amounts to be paid by PMs is confidential under the terms of the MSA and may not be disclosed to the Corporation or the Beneficial Owners.

Disbursement of the funds by the MSA Escrow Agent from the escrow accounts shall occur within ten business days of receipt of the particular funds. The MSA Escrow Agent will disburse the funds due to, or as directed by, each Settling State in accordance with instructions received from that state.

Advertising and Marketing Restrictions; Educational Programs

The MSA prohibits the PMs from certain advertising, marketing and other activities that may promote the sale of cigarettes and smokeless tobacco products ("**Tobacco Products**"). Under the MSA, the PMs are generally prohibited from targeting persons under 18 years of age within the Settling States in the advertising, promotion or marketing of Tobacco Products and from taking any action to initiate, maintain or increase smoking by underage persons within the Settling States. Specifically, the PMs may not: (i) use any cartoon characters in advertising, promoting, packaging or labeling Tobacco Products; (ii) distribute any free samples of Tobacco Products except in a restricted facility where the operator thereof is able to ensure that no underage persons are present; or (iii) provide to any underage person any item in exchange for the purchase of Tobacco Products or for the furnishing of proof-of-purchase coupons. The PMs are also prohibited from placing any new outdoor and transit advertising, and are committed to remove any existing outdoor and transit advertising for Tobacco Products in the Settling States. Other examples of prohibited activities include, subject to limited exceptions: (i) the sponsorship of any athletic, musical, artistic or other social or cultural event in exchange for the use of tobacco brand names as part of the event; (ii) the making of payments to anyone to use, display, make reference to or use as a prop any Tobacco Product or item bearing a tobacco brand name in any motion picture, television show, theatrical production, music performance, commercial film or video game; (iii) the sale or distribution in the Settling States of any non-tobacco items

containing tobacco brand names or selling messages; and (iv) the sale of packs of cigarettes containing fewer than 20 cigarettes until at least December 31, 2001.

In addition, the PMs have agreed under the MSA to provide funding for the organization and operation of a charitable foundation (the "**Foundation**") and educational programs to be operated within the Foundation. The main purpose of the Foundation will be to support programs to reduce the use of Tobacco Products by underage persons and to prevent diseases associated with the use of Tobacco Products. On March 31, 1999, and on March 31 of each subsequent year for a period of nine years thereafter, each OPM is required to pay its Relative Market Share of $25,000,000 (which is not subject to any adjustments, offsets or reductions pursuant to the MSA) to fund the Foundation. In addition, each OPM is required to pay its Relative Market Share of $250,000,000 on March 31, 1999, and $300,000,000 on March 31 of each of the subsequent four years to fund the Foundation. Furthermore, each PM may be required to pay its Relative Market Share of $300,000,000 on April 15, 2004, and on April 15 of each year thereafter in perpetuity if, during the year preceding the year when payment is due, the sum of the Market Shares of the PMs equals or exceeds 99.05%. The Foundation may also be funded by contributions made by other entities.

Remedies upon the Failure of a PM to Make a Payment

Each PM is obligated to pay when due the undisputed portions of the total amount calculated as due from it by the MSA Auditor's final calculation. Failure to pay such portion shall render the PM liable for interest thereon from the date such payment is due to (but not including) the date paid at the prime rate published from time to time by *The Wall Street Journal* or, in the event *The Wall Street Journal* is no longer published or no longer publishes such rate, an equivalent successor reference to rate determined by the MSA Auditor, plus three percentage points. In addition, any Settling State may bring an action in court to enforce the terms of the MSA. Before initiating such proceeding, the Settling State is required to provide thirty (30) days' written notice to the attorney general of each Settling State, to NAAG and to each PM of its intent to initiate proceedings.

Termination of Agreement

The MSA is terminated as to a Settling State if (i) the MSA or consent decree in that jurisdiction is disapproved by a court and the time for an appeal has expired, the appeal is dismissed or the disapproval is affirmed, or (ii) the representations and warranties of the attorney general of that jurisdiction relating to the ability to release claims are breached or not effectively given. In addition, in the event that a PM enters bankruptcy and fails to perform its financial obligations under the MSA, the Settling States, by vote of at least 75% of the Settling States, both in terms of number and of entitlement to the proceeds of the MSA, may terminate certain financial obligations of that particular manufacturer under the MSA.

The MSA provides that if it is terminated, then the statute of limitations with respect to released claims will be tolled from the date the Settling State signed the MSA until the later of the time permitted by applicable law or one year from the date of termination and the parties will jointly move for the reinstatement of the claims and actions dismissed pursuant to the MSA. The parties will return to the positions they were in prior to the execution of the MSA.

Severability

By its terms, most of the major provisions of the MSA are not severable from its other terms. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are to attempt to negotiate substitute terms. If any OPM does not agree to the substitute terms, the MSA terminates in all Settling States affected by the court's ruling.

Amendments and Waivers

The MSA may be amended by all PMs and Settling States affected by the amendment. The terms of any amendment will not be enforceable against any Settling State which is not a party to the amendment. Any waiver will be effective only against the parties to such waiver and only with respect to the breach specifically waived.

MSA Provisions Relating to Model/Qualifying Statutes

General. The MSA sets forth the schedule and calculation of payments to be made by OPMs to the Settling States. As described above, the Annual Payments and Strategic Contribution Payments are subject to, among other adjustments and reductions, the NPM Adjustment, which may reduce the amount of money that a Settling State receives pursuant to the MSA. The NPM Adjustment will reduce payments of a PM if such PM experiences certain losses of market share in the United States as a result of participation in the MSA.

Settling States may eliminate or mitigate the effect of the NPM Adjustment by taking certain actions, including the adoption and diligent enforcement of a statute, law, regulation or rule (a "**Qualifying Statute**") which eliminates the cost disadvantages that PMs experience in relation to NPMs as a result of the provisions of the MSA. "**Qualifying Statute**," as defined in Section IX(d)(2)(E) of the MSA, means a statute, regulation, law, and/or rule adopted by a Settling State that "effectively and fully neutralizes the cost disadvantages that PMs experience vis-a-vis NPMs within such Settling State as a result of the provisions of the MSA." Exhibit T to the MSA sets forth a model form of Qualifying Statute (a "**Model Statute**") that will qualify as a Qualifying Statute so long as the statute is enacted without modification or addition (except for particularized state procedural or technical requirements) and is not enacted in conjunction with any other legislative or regulatory proposal. The MSA also provides a procedure by which a Settling State may enact a statute that is not the Model Statute and receive a determination from a nationally recognized firm of economic consultants that such statute is a Qualifying Statute. See "RISK FACTORS – Other Potential Payment Decreases Under the Terms of the MSA – *NPM Adjustment*" and "– Litigation Challenging the MSA, the Qualifying Statute and Related Legislation" herein.

If a Settling State continuously has a Qualifying Statute in full force and effect and diligently enforces the provisions of such statute, the MSA states that the payments allocated to such Settling State will not be subject to a reduction due to the NPM Adjustment. Furthermore, the MSA dictates that the aggregate amount of the NPM Adjustment is to be allocated, in a Pro Rata manner, among all Settling States that do not adopt and enforce a Qualifying Statute. In addition, if the NPM Adjustment allocated to a particular Settling State exceeds its allocated payment, that excess is to be reallocated equally among the remaining Settling States that have not adopted and enforced a Qualifying Statute. Thus, Settling States that do not adopt and enforce a Qualifying Statute will receive reduced allocated payments if an NPM Adjustment is in effect. The State has enacted a Model Statute, which is a Qualifying Statute.

The MSA provides that if a Settling State enacts a Qualifying Statute that is a Model Statute and uses its best efforts to keep the Model Statute in effect, but a court invalidates the statute, then, although that state remains subject to the NPM Adjustment, the NPM Adjustment is limited to no more, on a yearly basis, than 65% of the amount of such state's allocated payment (including reallocations described above). The determination from a nationally recognized firm of economic consultants that a statute constitutes a Qualifying Statute is subject to reconsideration in certain circumstances and such statute may later be deemed not to constitute a Qualifying Statute. In the event that a Qualifying Statute that is not a Model Statute is invalidated or declared unenforceable by a court, or, upon reconsideration by a nationally recognized firm of economic consultants, is determined not to be a Qualifying Statute, the Settling State that adopted such statute will become fully subject to the NPM Adjustment. Moreover, if a state adopts a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM Adjustment. At all times, a state's protection from the NPM Adjustment is conditioned upon the diligent enforcement of its Qualifying Statute.

Summary of the Model Statute. One of the objectives of the MSA (as set forth in the Findings and Purpose section of the Model Statute) is to shift the financial burdens of cigarette smoking from the Settling States to the tobacco product manufacturers. The Model Statute provides that any tobacco manufacturer who does not join the MSA would be subject to the provisions of the Model Statute because, as provided under the MSA,

> [i]t would be contrary to the policy of the state if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the state will have an eventual source of recovery from them if they are proven to have acted culpably. It is thus in the interest of the state to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise.

Accordingly, pursuant to the Model Statute, a tobacco manufacturer that is an NPM under the MSA must deposit an amount for each cigarette it sells into an escrow account (which amount increases on a yearly basis, as set forth in the Model Statute).

The State's Qualifying Statute defines "**units sold**" as the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, during the year in question, as measured by excise taxes collected by the State on packs bearing the excise tax stamp or imprint of the State, or on roll-your-own tobacco.

The amounts deposited into the escrow accounts by the NPMs may only be used in limited circumstances. Although the NPM receives the interest or other appreciation on such funds, the principal may only be released (i) to pay a judgment or settlement on any claim of the type that would have been released by the MSA brought against such NPM by the applicable Settling State or any Releasing Party located within such state; (ii) with respect to Settling States that have enacted and have in effect Allocable Share Release Amendments (described below in the next paragraph), to the extent that the NPM establishes that the amount it was required to deposit into the escrow account was greater than the total payments that such NPM would have been required to make if it had been a PM under the MSA (as determined before certain adjustments or offsets) or, with respect to Settling States that do not have in effect such Allocable Share Release Amendments, to the extent that the NPM establishes that the amount it was required to deposit into the escrow account was greater than such state's allocable share of the total payments that such NPM would have been required to make if it had been a PM under the MSA (as determined before certain adjustments or offsets); or (iii) 25 years after the date that the funds were placed into escrow (less any amounts paid out pursuant to (i) or (ii)).

In recent years legislation has been enacted in at least 44 of the Settling States, including the State, to amend the Qualifying or Model Statutes in those states by eliminating the reference to the allocable share and limiting the possible release a NPM may obtain under a Model Statute to the excess above the total payment that the NPM would have paid for its cigarettes had it been a PM (each an "**Allocable Share Release Amendment**").

If the NPM fails to place funds into escrow as required, the attorney general of the applicable Settling State may bring a civil action on behalf of the state against the NPM. If a court finds that an NPM violated the statute, it may impose civil penalties in the following amounts: (i) an amount not to exceed 5% of the amount improperly withheld from escrow per day of the violation and in an amount not to exceed 100% of the original amount improperly withheld from escrow; (ii) in the event of a knowing violation, an amount not to exceed 15% of the amount improperly withheld from escrow per day of the violation and in an amount not to exceed 300% of the original amount improperly withheld from escrow; and (iii) in the event of a second knowing violation, the court may prohibit the NPM from selling cigarettes to consumers within such state (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed two years. NPMs include foreign tobacco manufacturers that intend to sell cigarettes in the United States that do not themselves engage in an activity in the United States but may not include the wholesalers of such cigarettes. However, enforcement of the Model Statute against such foreign manufacturers that do not do business in the United States may be difficult. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

State Qualifying Statute. The State Qualifying Statute, being Chapter 23-71 of the General Laws of the State, adopted June 29, 1999, as amended to date. By letter dated June 17, 2002, counsel to the OPMs confirmed that the OPMs will not dispute that the State Qualifying Statute constitutes a Qualifying Statute under the MSA.

CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY

*The following description of the domestic tobacco industry has been compiled from certain publicly available documents of the tobacco companies and their parent companies and certain publicly available analyses of the tobacco industry and other public sources. Certain of the companies file annual, quarterly, and certain other reports with the Securities and Exchange Commission (the "**SEC**"). Such reports are available on the SEC's website (www.sec.gov). The following information does not, nor is it intended to, provide a comprehensive description of the domestic tobacco industry, the business, legal and regulatory environment of the participants therein, or the financial performance or capability of such participants. Although the Corporation has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Corporation has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. To the extent that reports submitted to the MSA Auditor by the PMs pursuant to the requirements of the MSA provide information that is pertinent to the following discussion, including market share information, the State Attorney General has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2007 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2007 Bonds is consistent with their investment objectives.*

MSA payments are computed based in part on cigarette shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The Global Insight Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the 50 states of the United States, the District of Columbia and Puerto Rico may not match at any given point in time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

Retail market share information, based upon shipments or sales as reported by the OPMs for purposes of their filings with the SEC, may be different from Relative Market Share for purposes of the MSA and the respective obligations of the PMs to contribute to Annual Payments and Strategic Contribution Payments. The Relative Market Share information reported is confidential under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT– Overview of Payments by the Participating Manufacturers; MSA Escrow Agent," "–Annual Payments" and "–Strategic Contribution Payments" herein. Additionally, aggregate market share information, based upon shipments as reported by Loews Corporation and reflected in the chart below entitled "Manufacturers' Domestic Market Share Based on Shipments" is different from that utilized in the bond structuring assumptions. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

Industry Overview

According to publicly available documents of Loews Corporation, the parent company of Lorillard, the three leading manufacturers of tobacco products in the U.S. in 2006 collectively accounted for approximately 86.8% of the domestic cigarette retail industry when measured by shipment volume. The market for cigarettes in the U.S. divides generally into premium and discount sales, approximately 72.5% and 27.5%, respectively, measured by volume of all domestic cigarette sales for calendar year 2006, as reported by Loews Corporation.

Philip Morris USA Inc. ("**Philip Morris**"), a wholly-owned subsidiary of Altria Group, Inc. ("**Altria**"), is the largest tobacco company in the U.S. Prior to a name change on January 27, 2003, the Altria Group, Inc. was named Philip Morris Companies Inc. In its Form 10-K filed with the SEC for calendar year 2006, Altria reported that Philip Morris's domestic retail market share for calendar year 2006 was 50.3% (based on sales), which represents an increase of 0.3 share points from its reported domestic retail market share (based on sales) of 50.0% for calendar year 2005. In its Form 10-Q filed with the SEC for the three months ended March 31, 2007, Altria reported that Philip Morris' domestic retail market share for the quarter ended March 31, 2007 was 50.4% (based on sales), which is the same as its reported sales-based domestic retail market share for the comparable quarter of 2006. Philip Morris' major premium brands are Marlboro, Virginia Slims and Parliament. Its principal discount brand is Basic. Marlboro is the largest selling cigarette brand in the U.S., with approximately 40.5% of the U.S. domestic retail share for calendar year 2006, up from 40.0% from calendar year 2005, and has been the world's largest-selling cigarette brand since 1972. Philip Morris' market share information is based on data from the IRI/Capstone Total Retail Panel ("**IRI/Capstone**"), which was designed to measure market share in retail stores selling cigarettes, but was not designed to capture Internet or direct mail sales.

Reynolds American Inc. ("**Reynolds American**"), is the second largest tobacco company in the U.S. Reynolds American became the parent company of R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") on July 30, 2004, following a transaction that combined Reynolds Tobacco and the U.S. operations of Brown & Williamson Tobacco Corp. ("**B&W**"), previously the third largest tobacco company in the U.S., under the Reynolds Tobacco name. In connection with this merger, Reynolds American assumed all pre-merger liabilities, costs and expenses of B&W, including those related to the MSA and related agreements and with respect to pre-merger litigation of B&W. Reynolds American is also the parent company of Lane Limited, a manufacturer and marketer of specialty tobacco products, and Santa Fe Natural Tobacco Company, Inc., both of which are SPMs.

In its Form 10-K filed with the SEC for calendar year 2006, Reynolds American reported that its domestic retail market share for calendar year 2006 was 29.78% (measured by sales volume), which represents a decrease of 0.50 share points from the 30.28% for calendar year 2005 combined domestic retail market share of Reynolds Tobacco and B&W. In its Form 10-Q filed with the SEC for the three months ended March 31, 2007, Reynolds American reported its domestic retail market share for the quarter ended March 31, 2007 was 29.41% (measured by sales volume), which represents a decrease of 0.50 share points from the comparable quarter of 2006. Reynolds American's major premium brands are Camel, Kool, Winston and Salem. Its discount brands include Doral and Pall Mall. Reynolds American's market share information is based on IRI/Capstone data.

Lorillard, Inc. ("**Lorillard**"), a wholly-owned subsidiary of Loews Corporation, is the third largest tobacco company in the U.S. On February 6, 2002, in an initial public offering, Loews Corporation issued shares of Carolina Group stock, which is intended to reflect the economic performance of Loews Corporation's stock in Lorillard. Carolina Group is not a separate legal entity. In its Form 10-K filed with the SEC for calendar year 2006, Loews Corporation reported that Lorillard's domestic retail market share for calendar year 2006 was 9.7% (measured by shipment volume), which represents an increase of 0.5 share points from its self-reported domestic retail market share of 9.2% (measured by shipment volume) for calendar year 2005. In its Form 10-Q filed with the SEC for the three months ended March 31, 2007, Loews Corporation reported that Lorillard's domestic retail market share for the three months ended March 31, 2007 was 10.0% (measured by shipment volume), which represents an increase of 0.4 share points from the 9.6% domestic retail market share for the comparable quarter of 2006.

Lorillard's principal brands are Newport, Kent, True, Maverick, and Old Gold. Its largest selling brand is Newport, which accounted for approximately 91.8% of Lorillard's unit sales for calendar year 2006. Market share data reported by Lorillard is based on data made available by Management Science Associates, Inc. ("**MSAI**"), an independent third-party database management organization that collects wholesale shipment data.

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market for calendar year 2006 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, Inc. ("**Liggett**"), a wholly-owned subsidiary of Vector Group Ltd. ("**Vector**"). Liggett, the operating successor to the Liggett & Myers Tobacco Company, is the fourth largest tobacco company in the U.S. In its Form 10–K filed with the SEC for calendar year 2006, Vector reported that Liggett's domestic retail market share in 2006 was 2.4% (measured by shipment volume), which represents an increase of 0.2 share points from its self-reported 2005 domestic retail market share of 2.2%. All of Liggett's unit volume for 2006 was in the discount segment. Its brands include Liggett Select, Grand Prix, Eve, Pyramid and USA. In November 2001, Vector Group launched OMNI, which Vector Group claims is the first reduced-carcinogen cigarette that tastes, smokes and burns like other premium cigarettes. Additionally, Vector Group announced that it has introduced three varieties of a low nicotine cigarette in eight states, one of which is reported to be virtually nicotine free, under the brand name QUEST. Vector has determined to postpone the national launch of QUEST indefinitely. Liggett and Vector Group Ltd. are SPMs under the MSA.

Shipment Trends

The following table sets forth the approximate comparative positions of the leading producers in the U.S. domestic tobacco industry, each of which is an OPM under the MSA, based upon cigarette shipments. Individual domestic OPM shipments are as reported in the publicly available documents of the OPMs. Total industry shipments are based on data made available by MSAI, as reported in publicly available documents of Loews Corporation.

Effective in June of 2004, MSAI changed the way it reports market share information to include actual units shipped by Commonwealth Brands, Inc. ("**CBI**"), an SPM who markets deep discount brands, and implemented a new model for estimating unit sales of smaller, primarily deep discount marketers. MSAI has restated its reports to reflect these changes as of January 1, 2001. As a result of these changes, market shares for the three OPMs are lower than had been reflected under MSAI's prior methodology and market shares for CBI and other low volume companies are higher. All industry volume and market share information herein reflects MSAI's revised reporting data. Despite the effects of MSAI's new estimation model for deep discount manufacturers, Lorillard management has indicated that it continues to believe that volume and market share information for the deep discount manufacturers are understated and, correspondingly, market share information for the larger manufacturers are overstated by MSAI.

Manufacturers' Domestic Market Share Based on Shipments*

Manufacturer	2003	2004	2005	2006
Philip Morris	46.7%	47.4%	48.6%	49.2%
Reynolds American**	29.6	28.8	28.1	27.9
Lorillard	8.6	8.8	9.2	9.7
Other***	15.1	15.0	14.1	13.2

* Aggregate market share as reported by Loews Corporation (or as derived from such reports) is different from that utilized in the bond structuring assumptions and may differ from the market share information reported by the OPMs for purposes of their filings with the SEC.

** Prior to July 2004, represents the combined market share of Reynolds Tobacco and B&W.

*** The market share based on shipments of the tobacco manufacturers, other than the OPMs, has been determined by subtracting the total retail market share percentages of the OPMs as reported in publicly available documents of Loews Corporation from 100%. Results may not total 100% due to rounding.

The following table sets forth the industry's cigarette shipments in the U.S. for the four years ended December 31, 2006. The MSA payments are calculated in part on shipments by the OPMs in or to the U.S. rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)*
2003	401.2
2004	394.5
2005	381.7
2006	372.5

* As reported in SEC filings and other publicly available documents of the Loews Corporation, based on MSAI data.

The information in the foregoing tables, which has been obtained from publicly available documents but has not been independently verified, may differ materially from the amounts used by the MSA Auditor for calculating Annual Payments and Strategic Contribution Payments under the MSA.

Consumption Trends

According to the April 24, 2007 estimates of the U.S. Department of Agriculture (the "**USDA**") Economic Research Service ("**USDA-ERS**"), smokers in the U.S. consumed 371 billion cigarettes in 2006, which represents a decrease of approximately 1.3% from the previous year. USDA-ERS attributes declining cigarette use to a combination of higher consumer costs due to tax and price increases, restrictions on where people can smoke and greater awareness of the health risks associated with smoking. Annual per capita consumption (per adult over 18) has dropped from 2,445 cigarettes in 1996 to 1,654 in 2006. The following chart sets forth domestic cigarette consumption from 2001 through 2006, according to the USDA:

Years Ended December 31	U.S. Domestic Consumption (Billions of Cigarettes)*
2001	425
2002	415
2003	400
2004	388
2005	376
2006	371**

* USDA-ERS. The MSA Payments are calculated in part based on domestic industry shipments rather than consumption. The Global Insight Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the 50 states of the U.S., the District of Columbia and Puerto Rico may not match at any given time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

** Estimated.

Distribution, Competition and Raw Materials

Cigarette manufacturers sell tobacco products to wholesalers (including distributors), large retail organizations, including chain stores, and the armed services. They and their affiliates and licensees also market cigarettes and other tobacco products worldwide, directly or through export sales organizations and other entities with which they have contractual arrangements.

The market for tobacco products is highly competitive and is characterized by brand recognition and loyalty, with product quality, price, marketing and packaging constituting the significant methods of competition. Promotional activities include, in certain instances, allowances, the distribution of incentive items, price reductions and other discounts. Considerable marketing support, merchandising display and competitive pricing are generally necessary to maintain or improve a brand's market position. Increased selling prices and taxes on cigarettes have resulted in additional price sensitivity of cigarettes at the consumer level and in a proliferation of discounts and of brands in the discount segment of the market. Generally, sales of cigarettes in the discount segment are not as profitable as those in the premium segment.

The tobacco products of the cigarette manufacturers and their affiliates and licensees are advertised and promoted through various media, although television and radio advertising of cigarettes is prohibited in the U.S. The domestic tobacco manufacturers have agreed to additional marketing restrictions in the U.S. as part of the MSA and other settlement agreements. They are still permitted, however, to conduct advertising campaigns in magazines, at retail cigarette locations, in direct mail campaigns targeted at adult smokers, and in other adult media.

Grey Market

A price differential exists between cigarettes manufactured for sale abroad and cigarettes manufactured for U.S. sale. Consequently, a domestic grey market has developed in cigarettes manufactured for sale abroad, but instead diverted for domestic sales that compete with cigarettes manufactured for domestic sale. The U.S. federal government and all states, except Massachusetts, have enacted legislation prohibiting the sale and distribution of grey market cigarettes. In addition, Reynolds American has reported that it has taken legal action against certain distributors and retailers who engage in such practices.

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet, and charging state employees who smoke higher health insurance premiums than non-smoking state employees. Five states, Alabama, Georgia, Idaho, Kentucky and West Virginia, charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. Several large corporations, including Meijer Inc., Gannett Co., American Financial Group Inc., PepsiCo Inc. and Northwest Airlines, are now charging smokers higher premiums. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the U.S. Food and Drug Administration (the "**FDA**"), amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire-safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non-face-to-face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress which would provide the FDA with authority to broadly regulate tobacco products. A bi-partisan group of lawmakers, Massachusetts Senator Edward M. Kennedy, Texas Senator John Cornyn, California Representative Henry Waxman and Virginia Representative Tom Davis, on February 15, 2007 introduced the Family Smoking Prevention and Tobacco Control Act, legislation aimed at placing tobacco products under the authority of the FDA. The bill would give the FDA broad regulatory authority over the sale, distribution, and advertising of tobacco products. Such legislation would, among other anticipated changes, permit the FDA to strengthen warning labels, reduce nicotine levels in tobacco products, police false or misleading advertising and marketing aimed at children and would require manufacturers to provide the FDA with lists of ingredients and additives in their products, including nicotine. Philip Morris has indicated its strong support for this legislation.

In 1964, the Report of the Advisory Committee to the Surgeon General of the U.S. Public Health Service concluded that cigarette smoking was a health hazard of sufficient importance to warrant appropriate remedial action. Since 1966, federal law has required a warning statement on cigarette packaging. Since 1971, television and radio advertising of cigarettes has been prohibited in the U.S. Cigarette advertising in other media in the U.S. is required to include information with respect to the "tar" and nicotine yield of cigarettes, as well as a warning statement.

During the past four decades, various laws affecting the cigarette industry have been enacted. In 1984, Congress enacted the Comprehensive Smoking Education Act. Among other things, the Smoking Education Act:

- establishes an interagency committee on smoking and health that is charged with carrying out a program to inform the public of any dangers to human health presented by cigarette smoking;
- requires a series of four health warnings to be printed on cigarette packages and advertising on a rotating basis;
- increases type size and area of the warning required in cigarette advertisements; and
- requires that cigarette manufacturers provide annually, on a confidential basis, a list of ingredients added to tobacco in the manufacture of cigarettes to the Secretary of Health and Human Services.

Since the initial report in 1964, the Secretary of Health, Education and Welfare (now the Secretary of Health and Human Services) and the Surgeon General have issued a number of other reports which find the nicotine in cigarettes addictive and link cigarette smoking and exposure to cigarette smoke with certain health hazards, including various types of cancer, coronary heart disease and chronic obstructive lung disease. These reports have recommended various governmental measures to reduce the incidence of smoking. In 1992, the federal Alcohol, Drug Abuse and Mental Health Act was signed into law. This act requires states to adopt a minimum age of 18 for purchases of tobacco products and to establish a system to monitor, report and reduce the illegal sale of tobacco products to minors in order to continue receiving federal funding for mental health and drug abuse programs. Federal law prohibits smoking in scheduled passenger aircraft, and the U.S. Interstate Commerce Commission banned smoking on buses transporting passengers interstate. Certain common carriers have imposed additional restrictions on passenger smoking.

State and Local Regulation; Private Restrictions. Legislation imposing various restrictions on public smoking also has been enacted in all of the states and many local jurisdictions. A number of states have enacted legislation designating a portion of increased cigarette excise taxes to fund either anti-smoking programs, healthcare programs or cancer research. In addition, educational and research programs addressing healthcare issues related to smoking are being funded from industry payments made or to be made under the MSA.

Several states have enacted or have proposed legislation or regulations that would require cigarette manufacturers to disclose the ingredients used in the manufacture of cigarettes. In September 2003, the Massachusetts Department of Public Health ("**MDPH**") announced its intention to hold public hearings on amendments to its tobacco regulations. The proposed regulations would delete any ingredients-reporting requirement. (The U.S. Court of Appeals for the Second Circuit previously affirmed a ruling that the Massachusetts ingredient-reporting law was unconstitutional.) MDPH has proposed to inaugurate extensive changes to its regulations requiring tobacco companies to report nicotine yield rating for cigarettes according to methods prescribed by MDPH. Because MDPH withdrew its notice for a public hearing in November 2003, it is impossible to predict the final form any new regulations will take or the effect they will have on the PMs.

On May 21, 1999, the OPMs filed lawsuits in the U.S. District Court for the District of Massachusetts to enjoin implementation of certain Massachusetts attorney general regulations concerning the advertisement and display of tobacco products. The regulations went beyond those required by the MSA, and banned outdoor advertising of tobacco products within 1,000 feet of any school or playground, as well as any indoor tobacco advertising placed lower than five feet in stores within the 1,000–foot zone. The district court ruled against the industry on January 25, 2000, and the U.S. Court of Appeals for the First Circuit affirmed. The U.S. Supreme Court granted the industry's petition for writ of certiorari on January 8, 2001, and ruled in favor of RJR Tobacco and the rest of the industry on June 28, 2001. The U.S. Supreme Court found that the regulations were preempted by the Federal Cigarette Labeling and Advertising Act, which precludes states from imposing any requirement or prohibition based on smoking and health with respect to the advertising or promotion of cigarettes labeled in conformity with federal law.

In June 2000, the New York state legislature passed legislation charging New York's Office of Fire Prevention and Control ("**OFPC**") with developing standards for "fire-safe" or self-extinguishing cigarettes. On December 31, 2003, OFPC issued a final standard with accompanying regulations that requires all cigarettes offered for sale in New York State after June 28, 2004 to achieve specified test results when placed on 10 layers of filter paper in controlled laboratory conditions. Reynolds American's operating companies that sell cigarettes in New York state have provided written certification to both the OFPC and the Office of the Attorney General for New York that each of their cigarette brand styles currently sold in New York has been tested and has met the performance standards set forth in the OFPC's regulations. Design and manufacturing changes were made for cigarettes manufactured for sale in New York to comply with the standard. Similar laws have been enacted in

California, Illinois, Iowa, Kentucky, New Hampshire, Maryland, Massachusetts, Montana, New Jersey, Oregon, Utah and Vermont. A number of other states are also considering similar legislation, including Rhode Island. Varying standards from state to state could have an adverse effect on the PMs.

According to the Global Insight Cigarette Consumption Report, all of the states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. The most comprehensive bans have been enacted since 1998 in 26 states and a number of large cities. In 1998, California imposed a comprehensive smoking ban for all indoor workplaces, including restaurants and bars. Delaware followed suit in 2002, and in 2003, Connecticut, Maine, New York, and Florida passed similar comprehensive bans, as did the cities of Boston and Dallas. Since then, Arizona, Arkansas, Colorado, the District of Columbia, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Ohio, Rhode Island, Tennessee, Utah, Vermont, Washington, and Puerto Rico established similar bans, as did the cities of Baltimore, Chicago, Houston, and Philadelphia. The New Mexico, Washington State and Chicago restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. It is expected that these restrictions will continue to proliferate. For example, in June 2007, at least 7 states are considering legislation which would enact comprehensive bans.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of April 2, 2007, there were 2,572 municipalities with indoor smoking restrictions. Of these, 455 local governments required workplaces to be 100% smoke-free, and 100% smoke-free conditions were required for restaurants by 403 governments, and for bars by 296. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars. These numbers grew to 49 for restaurants and 32 for bars in 1998, and doubled again by 2001, to 100 and 74, respectively.

The first extensive outdoor smoking restrictions were instituted in March 2006 in Calabasas, California. The California municipalities of Belmont, Beverly Hills, Dublin, Emeryville and Santa Monica have also established extensive outdoor restrictions. Burbank is expected to follow suit, and in June 2007 an Oakland City Councilmember proposed an outdoor ban. In the past year, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties have banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. The beach restrictions may soon become statewide. Nassau County, New York and Volusia County, Florida are also considering park and beach bans. At least 43 colleges nationwide now prohibit smoking everywhere on campus. California and Nevada have banned smoking in state prisons. Arkansas, Louisiana, and Texas now prohibit smoking in a car where there are children present, and similar legislation has been proposed in Arizona, California, Connecticut, Illinois, Indiana, Iowa, Kansas, Massachusetts, Montana, New Jersey, New York, Oregon, Rhode Island, South Carolina, Utah, West Virginia, and in Rockland County, NY and Bangor, Maine.

In June 2006, the Office of The Surgeon General released a report, "The Health Consequences of Involuntary Exposure to Tobacco Smoke." It is a comprehensive review of health effects of involuntary exposure to tobacco smoke. It concludes definitively that secondhand smoke causes disease and adverse respiratory effects. It also concludes that policies creating completely smoke-free environments are the most economical and efficient approaches to providing protection to non-smokers. The report is expected to strengthen arguments in favor of further smoking restrictions across the country. Further, the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant in 2006.

Smokeless Tobacco Products. Smokeless tobacco products have been available for centuries. As cigarette consumption expanded in the last century, the use of smokeless products declined. Chewing tobacco and snuff are the most significant products in this market. Snuff is a ground or powdered form of tobacco that is placed under the lip and delivers nicotine effectively to the body. Moist snuff is both smoke-free and can be spit-free. According to the Global Insight Consumption Report, chewing tobacco and dry snuff consumption has been declining in the U.S. in this decade, but moist snuff consumption has increased at an annual rate of more than 5% since 2002, and by 10.4% in 2006, when over 5 million consumers purchased 1.1 billion cans. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco, is explicitly targeting adult smoker conversion in its growth strategy. The industry is responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. In 2006, the three largest U.S. cigarette manufacturers entered the market. Philip Morris introduced a snuff product, Taboka, Reynolds American acquired Conwood Company, L.P., the nation's second largest smokeless-tobacco manufacturer, and introduced Camel Snus, and Lorillard entered into an agreement with Swedish Match North America to develop smokeless tobacco products in the United States. In June 2007, Altria Group

announced that it will be entering the snus market with a product using the "Marlboro" name. Test marketing of the new product is expected to begin in August.

Advocates of the use of snuff as part of a tobacco harm reduction strategy point to Sweden, where 'snus,' a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men. The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

Voluntary Private Sector Regulation. In recent years, many employers have initiated programs restricting or eliminating smoking in the workplace and providing incentives to employees who do not smoke, including charging higher health insurance premiums to employees who smoke, and many common carriers have imposed restrictions on passenger smoking more stringent than those required by governmental regulations. Similarly, many restaurants, hotels and other public facilities have imposed smoking restrictions or prohibitions more stringent than those required by governmental regulations, including outright bans.

International Agreements. On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force on February 27, 2005 for the first forty countries, including the U.S., that had ratified the treaty prior to November 30, 2004. As of April 27, 2005, 168 countries signed and 64 countries ratified the FCTC. On June 29, 2004 the FCTC was closed for signature, but there is no deadline for ratification. It has been reported that as of December 20, 2006, at least 191 countries had ratified the FCTC.

Excise Taxes. Cigarettes are also currently subject to substantial excise taxes in the U.S. The federal excise tax has remained constant, at $0.39 per pack of 20 cigarettes, since 2002. This March the U.S. Senate included a $0.61 increase in the federal excise tax in an amendment to its proposed budget for the 2008 fiscal year, which begins October 1, 2007. The amendment was designed to provide funding for the State Children's Health Insurance Program. House and Senate leaders have indicated that the excise tax is just one of many funding options for the program. If enacted the federal excise tax would equal $1.00 per pack. According to Global Insight's Consumption Report, should the federal excise tax increase to $1.00 per pack, the resulting price increase, would, according to its model, lead to a sharper, one-time, consumption decline of 4.3%, or 15.5 billion cigarettes, by 2009. The difference with Global Insight's Base Case forecast would be somewhat lower over the longer term, because forecast assumptions incorporate the likelihood of significant excise tax increases over time.

All states, the District of Columbia, and the Commonwealth of Puerto Rico currently impose taxes at levels ranging from $0.07 per pack in South Carolina to $2.575 per pack in New Jersey. In addition, certain municipalities also impose an excise tax on cigarettes ranging up to $1.50 per pack in New York City and $2.68 per pack in Chicago, which includes the Cook County tax of $2.00 per pack. According to the Global Insight Cigarette Consumption Report, excise tax increases were enacted in 20 states and in New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee," which has the same effect on consumer prices. Global Insight's Consumption Report considers any such fees as equivalent to excise taxes. In 2006, Texas passed a budget that raised the state excise tax by $1.00 in January 2007. In 2006, Hawaii, New Jersey, North Carolina, and Vermont enacted legislation which raises excise taxes, Arizona, Iowa, South Dakota and Texas have increased excise taxes in 2007 and Indiana and Tennessee have each passed legislation in May to increase excise taxes. These actions will increase the average state excise tax to $1.065 per pack. It is expected that other states will also enact increases in 2007 and in future years. At least eleven states (California, Connecticut, Delaware, Maine, Maryland, Michigan, Mississippi, New Hampshire, Oregon, Pennsylvania and Wisconsin), and New York City are now considering excise tax increases. After California voters rejected a ballot initiative on November 7, 2006 that would have raised the tax from $0.87 to $3.47 per pack, California lawmakers introduced three new smoking related bills that would: (a) raise the average tax by $1.90 per pack; (b) impose a fine of $100 on anyone smoking in a car with a child under the age of 18 present; and (c) ban smoking in state parks and on beaches.

As mentioned above, at least one state, Minnesota, currently imposes a 75-cent "health impact fee" on tobacco manufacturers for each pack of cigarettes sold. The purpose of this fee is to recover the state's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld by the Minnesota Supreme Court as not in violation of Minnesota's settlement with the tobacco companies. On February 20, 2007, the U.S. Supreme Court declined to hear Philip Morris' appeal of that decision. See "RISK FACTORS–Other Potential Payment Decreases Under the Terms of the MSA–*NPM Adjustment*" herein.

These tax increases and other legislative or regulatory measures could severely increase the cost of cigarettes, limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes.

Civil Litigation

The tobacco industry has been the target of litigation for many years. Both individual and class action lawsuits have been brought by or on behalf of smokers alleging that smoking has been injurious to their health, and by non-smokers alleging harm from environmental tobacco smoke, also known as "secondary smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of May 1, 2007, there were ten cases on appeal in which verdicts were returned against Philip Morris, including (i) a $74 billion (out of total a verdict of $145 billion) punitive damages judgment against Philip Morris in the *Engle* class action, which has been overturned on appeal by the Florida Supreme Court; and (ii) a compensatory and punitive damages verdict totaling approximately $10.1 billion in the Price case in Illinois. The Supreme Court of Illinois subsequently reversed the verdict in Price and instructed the trial court to dismiss the case in its entirety. In January 2006 the plaintiffs filed a motion asking the court to reconsider its decision. On May 5, 2006, the Supreme Court of Illinois denied this motion. In October 2006, plaintiffs filed a petition for certiorari with the U.S. Supreme Court. On November 27, 2006, the U.S. Supreme Court denied plaintiff's petition for certiorari. In December 2006, the trial court entered an order of dismissal. In January 2007, the plaintiff filed a motion to vacate the dismissal, which motion is pending. It has been reported that on May 2, 2007 the state trial court judge in the *Price* case asked the Illinois Fifth District Appellate Court whether he has the authority to reopen the *Price* case, citing possible new evidence presented in a case pending before the U.S. Supreme Court. It has also been reported that on May 17, 2007, Philip Morris petitioned the Illinois Supreme Court for an order that would prevent the trial court judge from reopening the *Price* case. See "–Class Action Lawsuits" below. The MSA does not release PMs from liability in either individual or class action cases. Healthcare cost recovery cases have also been brought by governmental and non-governmental healthcare providers seeking, among other things, reimbursement for healthcare expenditures incurred in connection with the treatment of medical conditions allegedly caused by smoking. The PMs are also exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims of the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Pending claims related to tobacco products generally fall within four categories: (1) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants alleging injury from exposure to ETS in aircraft cabins (the *Broin II* cases, discussed below); (2) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs; (3) healthcare cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for healthcare expenditures allegedly caused by cigarette smoking and/or disgorgement of profits; and (4) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act. A recent California Supreme Court decision (*Grisham v. Philip Morris*) regarding a statute of limitations issue in an individual case has held that the plaintiff need not have filed suit when she realized she was addicted, thus permitting her lawsuit to go forward after a lower court had held her claim to be time-barred. This decision could lead to an increase in individual lawsuits in California.

According to Altria, since January 1999 and through May 1, 2007, verdicts have been returned in 45 smoking and health cases, Lights/Ultra Lights cases and healthcare cost recovery cases in which Philip Morris was a

defendant. Verdicts in favor of Philip Morris and other tobacco industry defendants were returned in 28 of these cases. Verdicts in favor of plaintiffs were returned in 17 cases. Appeals or post-trial motions by defendants and by plaintiffs are pending in many of these cases. Of the 17 cases in which verdicts were returned in favor of plaintiffs, the *Carter* case (discussed below) was the first to reach final resolution in March 2001, when the plaintiff received payments from a trust in the full amount of the judgment and Brown & Williamson's petition for review of the judgment against it was denied by the U.S. Supreme Court. In addition, eight of the 17 cases have reached final resolution with respect to Philip Morris. A $17.8 million verdict against defendants in a healthcare cost recovery case in New York was reversed, and all claims were dismissed with prejudice in February 2005 in the *Blue Cross/Blue Shield* case. In October 2004, after exhausting all appeals, Philip Morris paid $3.3 million in an individual smoking and health case in Florida (the Eastman case, discussed below). In March 2005, after exhausting all appeals, Philip Morris paid $17 million in an individual smoking and health case in California (the *Henley* case, discussed below). Altria has reported that in December 2005, after exhausting all appeals, Philip Morris paid $328,759 as its share of the judgment amount and interest in a flight attendant ETS case in Florida (the *French* case, discussed below) and will pay attorneys' fees yet to be determined. In addition, in February 2005, after exhausting all appeals, Reynolds Tobacco, due to its obligation to indemnify B&W, paid approximately $9.1 million in the *Boerner* case (see below) and on June 17, 2005, after exhausting all appeals, Reynolds Tobacco paid a $196,416 plus interest and costs judgment in an individual case in Kansas (the *Burton* case, discussed below). In March 2006, after exhausting all appeals, Philip Morris paid approximately $82.5 million (including interest of approximately $27 million) in an individual smoking and health case in California (the *Boeken* case, described below). In October 2006, after exhausting all appeals, Philip Morris paid approximately $1.1 million in judgment, interest and attorneys' fees in an individual smoking and health case in Florida (the *Arnitz* case described below) and in January 2007, after exhausting all appeals, Philip Morris paid approximately $1.1 million in judgment and interest in an individual smoking and health case in Missouri (the *Thompson* case described below).

Class Action Lawsuits. The MSA does not release the PMs from liability in class action lawsuits. Plaintiffs have brought claims as class actions on behalf of large numbers of individuals for damages allegedly caused by smoking, price fixing and consumer fraud. One OPM (Altria) has reported that, as of May 1, 2007, there were 30 such class actions pending against it in the U.S., as well as one each in Brazil and Israel. Plaintiffs in class action smoking and health lawsuits allege essentially the same theories of liability against the tobacco industry as those in the individual lawsuits. Other class action plaintiffs allege consumer fraud or violations of consumer protection or unfair trade statutes. Plaintiffs historically have had limited success in obtaining class certification, a prerequisite to proceeding as a class action lawsuit, because of the individual circumstances related to each smoker's election to smoke and the individual nature of the alleged harm. One OPM (Altria) reports that class certification has been denied or reversed in 57 smoking and health class actions involving that OPM.

To date, plaintiffs have successfully maintained class certification in federal and state court class action cases in at least the following states: California, Florida, Illinois, Louisiana, Massachusetts, Minnesota, Missouri, New York, North Carolina, Ohio, Oregon, Washington, and West Virginia. One OPM (Reynolds) reports that 18 federal courts that have considered the issue, including two courts of appeals, have rejected class certification in smoking and health cases. Only two federal district courts have certified a smoker class action. See *In re Simon (II) Litigation* and *Schwab v. Philip Morris USA Inc.*, each discussed below. The class in the *Simon* case was subsequently dismissed by the plaintiffs after being decertified by the U.S. Court of Appeals for the Second Circuit.

On September 6, 2000, in *In re Simon (II) Litigation*, lawyers for plaintiffs in ten tobacco-related cases pending in U.S. District Court for the Eastern District of New York filed suit in the same court (before Judge Weinstein) to consolidate the pending cases and seek certification of a class and subclasses to obtain compensatory and punitive damages from the tobacco industry defendants. The pending cases included individual and purported nationwide class action lawsuits alleging tobacco-related personal injuries, as well as healthcare cost recovery cases brought by union trust funds, an insurance plan and an asbestos fund. The suit sought to certify a nationwide class action to consolidate all punitive damage aspects of the pending cases for a single trial and to try the compensatory damage aspects of the pending claims separately. On September 19, 2002, Judge Weinstein certified a class to hear the punitive damages claims. The class consisted of all smokers diagnosed with a variety of illnesses, including lung cancer, emphysema and some forms of heart disease, after April 9, 1993. In May 2005, the U.S. Court of Appeals for the Second Circuit, in a unanimous opinion, decertified the class. Plaintiffs' motion for rehearing en banc was denied on August 8, 2005, and the time for plaintiffs to petition the U.S. Supreme Court for further review has expired. On February 6, 2006, Judge Weinstein dismissed the case upon the plaintiffs' motion. He stayed the order for 30 days to allow potential plaintiffs who expressed interest in the case to receive notices and to protect their interest. On March 22, 2006, a final judgment was entered dismissing the case. Two of the 10 original cases, *Falise v. American Tobacco Co.*, and *H.K. Porter Company, Inc. v. The American Tobacco Company* were

dismissed in June 2001 and July 2001, respectively. Other plaintiffs who would have been part of the *Simon II* class remain free to pursue their own individual lawsuits.

On December 14, 2006, in *Donovan v. Philip Morris*, a federal class action complaint was filed by a group of Massachusetts residents who are fifty years of age or older, have smoked a pack of cigarettes a day for at least twenty years, continue to smoke or have quit smoking within one year of filing, have not been diagnosed with lung cancer, and have smoked Marlboro cigarettes within Massachusetts. The class seeks to compel Philip Morris to fund each member's CT scans to support the early detection of lung cancer. The case is pending in the U.S. District Court for the District of Massachusetts.

A number of state courts have rejected class certification. In May 2000, Maryland's highest court ordered the trial court to vacate its certification of a class in *Richardson v. Philip Morris*. The parties agreed to dismiss the case in March 2001. In September 2000, in *Walls v. American Tobacco Co.*, an Oklahoma state court answered a series of state law questions, certified to the state court by the federal court where the purported class was filed, in such a way that led the parties to stipulate that the case should not be certified as a class action in federal court and that the individual plaintiffs would dismiss their federal court cases without prejudice. In October 2000, the federal court issued its order refusing to certify the case as a class action, and dismissed the individual plaintiffs' cases.

In December 2000, in *Geiger v. American Tobacco Co.*, the Appellate Division of the Supreme Court of New York affirmed the trial court's denial of class action status to a purported class defined as all New York residents, including their heirs, representatives, and estates, who contracted lung or throat cancer as a result of smoking cigarettes. Plaintiffs filed a motion for leave to appeal the order denying certification to the New York Court of Appeals, the highest court in the state. The New York Court of Appeals dismissed the plaintiff's appeal in February 2001.

In *Engle v. R.J. Reynolds Tobacco Co.*, a Florida state court certified a class of Florida smokers alleging injury due to their tobacco use. The estimated size of the class ranges from 300,000 to 700,000 members. The court determined that the lawsuit could be tried as a class action because, even though certain factual issues are unique to individual plaintiffs and must be tried separately, certain other factual issues were common to all class members and could be tried in one proceeding for the whole class. In July 1999, in the first phase of a three-phase trial, the jury found against the defendants regarding the issues common to the class, such as whether smoking caused certain diseases, whether tobacco was addictive, and whether the tobacco companies withheld information from the public. In July 2000, in the second phase of the *Engle* trial, the jury returned a verdict assessing punitive damages totaling approximately $145 billion against the tobacco industry defendants. Following entry of judgment, the defendants appealed. The defendants posted bonds to stay collection of the final judgment with respect to the punitive damages against them and statutory interest thereon pending the exhaustion of all appeals. In May 2003, the Florida Third District Court of Appeal reversed the judgment entered by the trial court and instructed the trial court to order the decertification of the class. The plaintiffs petitioned the Florida Supreme Court for further review and, in May 2004, the Florida Supreme Court agreed to review the case.

On July 6, 2006, the Florida Supreme Court remanded the case to the District Court with directions to decertify the class, and it approved the District Court's reversal of the $145 billion class action punitive damages award. The court also reinstated the compensatory damages awards to two purported class members of $2.8 million and $4 million, and approved the District Court's findings (the "**Findings**") as to the adverse health effects of smoking, that nicotine is addictive, that the defendants placed defective and unreasonably dangerous products in the market, that defendants concealed or omitted information about the health effects and addictive nature of cigarettes, and otherwise that defendants were negligent. The Florida Supreme Court stated that certain individual members of the purported class could bring actions within one year of the court's decision, in which the courts would be bound by the conclusions reached in the Findings, and in which the plaintiffs would be expected to address causation, reliance, and apportionment of fault among the defendants. One result of the court's decision may be an increase in the number of individual plaintiffs' suits in Florida from members of the decertified *Engle* class. One such individual suit was filed in Florida state court on July 10, 2006 against Philip Morris and Reynolds Tobacco (*Pummer v. Philip Morris*). On November 16, 2006, that case was removed to the U.S. District Court for the Southern District of Florida. On December 15, 2006, the court dismissed the case without prejudice, pursuant to stipulation, due to the wrongful joinder of defendant Publix Supermarkets, Inc., a Florida corporation not named in the *Engle* case, and thus not privy to the allowance of one year for plaintiffs to sue (it had been nearly ten years since the initial cause of action, which exceeds Florida's statute of limitations).

On August 7, 2006, the *Engle* defendants filed a motion for rehearing with the Florida Supreme Court, asking the court to reverse its decision to uphold the Findings. On December 21, 2006, the Florida Supreme Court declined to reconsider and clarify its ruling, with the exception of invalidating the conspiracy to misrepresent charge against the tobacco companies. The court withdrew the July 6th opinion, issuing the December 21st opinion in lieu

thereof. In January 2007, the Florida Supreme Court issued the mandate from its revised opinion (which begins the one-year period for individual class members to file lawsuits) and defendants filed a motion with the Florida Third District Court of Appeals requesting the court's review of legal errors previously raised but not ruled on. On February 21, 2007, the court denied the defendants' motion. In March 2007, the U.S. Supreme Court granted defendants' motion for an extension of time in which to file a petition for a writ of certiorari, which is now due May 21, 2007. In addition, defendants' motion for a partial stay of the mandate pending the completion of appellate review is pending before the District Court of Appeal. Reynolds American has stated that it is likely that individual case filings in Florida will increase as a result of the *Engle* case.

Florida has enacted legislation capping the amount of the appeal bond necessary to stay execution of the punitive judgment pending appeal to the lesser of: (1) the amount of punitive damages, plus twice the statutory rate of interest; or (2) 10% of a defendant's net worth, but in no case more than $100 million. Forty-one other states have passed and several additional states are considering statutes limiting the amount of bonds required to file an appeal of an adverse judgment in state court. The limitation on the amount of such bonds generally ranges from $25 million to $150 million. Such bonding statutes allow defendants that are subject to large adverse judgments, such as cigarette manufacturers, to reasonably bond such judgments and pursue the appellate process. In six jurisdictions – Connecticut, Maine, Massachusetts, New Hampshire, Vermont and Puerto Rico – the filing of a notice of appeal automatically stays the judgment of the trial court.

One *Engle* purported class member has previously received a judgment at trial. In *Lukacs v. Reynolds Tobacco*, a Florida appellate court granted the plaintiff the right to proceed before he died, but stated that any award in favor of the plaintiff would not be enforced until after the *Engle* appeal is decided. On June 11, 2002, a Florida jury awarded $37.5 million in compensatory damages to the plaintiff. On April 1, 2003, the Miami-Dade County Circuit Court granted in part the defendants' motion for remittitur, reducing the total award to $25.125 million. Because the *Engle* appeal is now resolved, subject to motions for rehearing, the defendants' time to appeal the case is expected to begin to run. On August 2, 2006, plaintiff filed a motion for partial judgment on the compensatory damages award, and trial was scheduled to begin on November 27, 2006. However, on September 27, 2006, the trial court granted the defendants' motion to strike as premature the plaintiff's motions and removed the case from the trial calendar. On January 2, 2007, the defendants moved to set aside the June 11, 2002 verdict to dismiss the plaintiff's punitive damage claim. On January 3, 2007, the plaintiffs filed a motion for entry of judgment. A hearing on the motion was held in March 2007. One OPM (Vector) reports that it is a defendant in 11 separate cases pending in Florida courts in which the plaintiffs claim that they are members of the *Engle* class, that all liability issues associated with their claims were resolved in the earlier phases of the *Engle* proceedings, and that trials on their claims should proceed immediately. Vector also reported that settlement of the appellate activity in *Engle* would be a prerequisite for those cases proceeding.

On June 6, 2007, a plaintiff representing the estates of her deceased mother and grandmother filed suit against several PMs in Miami-Dade County Circuit Court, Florida, in which she alleges that her mother and grandmother died of health problems related to smoking PMs' tobacco products. In that case, *Gloria Tucker v. Philip Morris U.S.A. et al*, the plaintiff alleges that the PMs engaged in cynical and exploitative marketing that targeted African-American communities and asserts theories of strict liability, negligent design, fraud by concealment and civil conspiracy. The plaintiff in *Tucker* also reportedly is requesting more than $1 billion in compensatory and punitive damages. The PM defendants have not yet filed an answer or response to the *Tucker* complaint.

In October 1997, the tobacco industry defendants settled another class action case, *Broin I*. *Broin I* was brought in Florida state court by flight attendants alleging injuries related to ETS. See "*Individual Plaintiffs' Lawsuits*" below. The *Broin I* settlement established a protocol for the resolution of individual claims by class members against the tobacco companies. In addition to shifting the burden of proof to defendants as to whether ETS causes certain illnesses such as lung cancer and emphysema, the *Broin I* settlement required defendants to pay $300 million to be used to establish a foundation to sponsor research with respect to the early detection and cure of tobacco-related diseases. Individual members of the *Broin I* class retained the right to bring individual claims, although they are limited to non-fraud type claims and may not seek punitive damages. Altria has reported that as of May 1, 2007, approximately 2,623 of these individual cases (known as *Broin II* cases) are pending against it in Florida. In October 2000, Judge Robert P. Kaye, the presiding judge of the original *Broin I* class action, held that the flight attendants will not be required to prove the substantive liability elements of their claims for negligence, strict liability and breach of implied warranty in order to recover damages, if any. The court also ruled that the trials of these suits will address whether the plaintiffs' alleged injuries were caused by their exposure to ETS and, if so, the amount of damages. The defendants' appeal of these rulings was dismissed by the intermediate appellate court on the basis that the appeal was premature and that the court lacked jurisdiction. On January 23, 2002, the defendants asked the Florida Supreme Court to review the district court's order. That request was denied.

Seven *Broin II* cases have gone to trial since Judge Kaye's ruling in October 2000. Six of these cases have resulted in verdicts for the defendants: *Fontana* in June 2001, Tucker in June 2002, *Janoff* in October 2002, *Seal* in February 2003, *Routh* in October 2003 and *Swaty* in May 2005. Appeals are pending in some of these cases. On September 12, 2002, the plaintiff in the *Janoff* case filed a motion for a new trial, which the judge granted on January 8, 2003. The defendants appealed to the Florida Third District Court of Appeal, which, on October 27, 2004, affirmed the trial court's order granting a new trial. The defendants' motion for rehearing was denied. The defendants filed a notice of intent to invoke the discretionary jurisdiction of the Florida Supreme Court on June 17, 2005. On November 1, 2005, the Florida Supreme Court refused to hear the case. In *Swaty*, the plaintiff filed a motion for a new trial on May 12, 2005, which was denied on June 23, 2005. On May 17, 2005, the court entered a final judgment in favor of the defendants. The plaintiff's motion for a new trial was denied on June 23, 2005. The plaintiff's appeal to the Third District Court of Appeal was denied and the Court of Appeal affirmed the trial court's verdict in November 2006. The one plaintiff's verdict was returned in *French v. Philip Morris*. On June 18, 2002, the *French* jury awarded the plaintiff $5.5 million in damages, finding that the flight attendant's sinus disease was cause by ETS. On September 13, 2002, the judge reduced the award to $500,000. The defendants appealed the trial court's final judgment to the Florida Third District Court of Appeal on various grounds, the primary one being that under Judge Kaye's October 2000 ruling, the burden of proof was erroneously shifted and the plaintiff was not required to show that the tobacco companies' cigarettes were defective, that the tobacco company defendants acted negligently or that a warranty was made and breached. In December 2004, the Florida Third District Court of Appeal affirmed the judgment awarding plaintiff $500,000 and directed the trial court to hold the defendants jointly and severally liable. In April 2005, the appellate court denied defendants' motion for a rehearing. On May 11, 2005, the defendants filed a notice of intent to invoke the discretionary jurisdiction of the Florida Supreme Court. On November 28, 2005, the Florida Supreme Court declined to hear the appeal. The defendants satisfied the judgment on December 6, 2005.

In *Scott v. American Tobacco Company, Inc.*, a Louisiana medical monitoring and smoking cessation case, the court certified a class consisting of smokers desiring to participate in a program designed to assist them in the cessation of smoking and monitor the medical condition of class members to ascertain whether they might be suffering from diseases caused by cigarette smoking. The class members may also choose to bring individual smoking and health lawsuits. On July 28, 2003, following the first phase of a trial, the jury returned a verdict in favor of the tobacco industry defendants on the medical monitoring claim and found that cigarettes were not defective products. The jury found against the defendants, however, on claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On March 31, 2004, phase two of the trial began to address the scope and cost of smoking cessation programs. On May 21, 2004, the jury returned a verdict in the amount of $591 million ($590 million plus prejudgment interest accruing from the date the suit commenced) on the class's claim for a smoking cessation program. On July 1, 2004, the judge upheld the jury's verdict and awarded the plaintiffs prejudgment interest, which, as of November 1, 2006, totals approximately $430 million, as reported by Altria. On August 31, 2004, the defendants' motion for judgment notwithstanding the verdict or, in the alternative, for a new trial was denied. On September 29, 2004, pursuant to a stipulation of the parties, the defendants posted a $50 million bond (pursuant to legislation that limits the amount of the bond to $50 million collectively for MSA signatories) and noticed their appeal. Oral argument occurred on April 27, 2006. The defendants filed post-argument briefs on April 28, 2006. Under the terms of the stipulation, the plaintiffs reserved the right to contest the constitutionality of the bond cap law. On February 7, 2007, the state appeals court upheld part of the jury's verdict but reduced the $591 million by approximately $312 million, eliminated the award of prejudgment interest, and remanded the case back to the trial court. On March 6, 2007, the state appeals court refused to reconsider its verdict. It has been reported that both the plaintiffs and the defendants have filed petitions for a writ of certiorari with the Louisiana Supreme Court.

In August 2000, a West Virginia state court conditionally certified, only to the extent of medical monitoring, in *In re Tobacco Litigation* (formerly known as *Blankenship*), a class of West Virginia residents. The plaintiffs proposed that the class include all West Virginia residents who: (1) on or after January 1, 1995, smoked cigarettes supplied by defendants; (2) smoked at least a pack a day for five years without having developed any of a specified list of tobacco-related illness; and (3) do not receive healthcare paid or reimbursed by the state of West Virginia. Trial began in January 2001. On January 25, 2001, the trial court granted a motion for a mistrial, ruling that the plaintiffs had improperly introduced testimony about addiction to smoking as a basis for claiming damages. In March 2001, the court denied the defendants' motion to decertify the class. The retrial began in September 2001, and on November 14, 2001 the jury returned a verdict that defendants were not liable for funding the medical monitoring program. On July 18, 2002, the plaintiffs petitioned the Supreme Court of West Virginia for leave to appeal, which was granted on February 25, 2003. The Supreme Court of West Virginia affirmed the judgment for the defendants on May 6, 2004. On July 1, 2004, the class's petition for rehearing was denied. The plaintiffs did not seek review by the U.S. Supreme Court.

Altria has reported that approximately 928 cases against Philip Morris and other tobacco industry defendants are pending in a single West Virginia court in a consolidated proceeding. The West Virginia court has scheduled a single trial for these consolidated cases, but it has certified a question to the Supreme Court of Appeals of West Virginia requesting a determination of the extent to which the claims in these individual cases can be consolidated in a single trial. On December 2, 2005, the Supreme Court of Appeals of West Virginia held that the Due Process Clause of the 14th Amendment, as interpreted by *State Farm v. Campbell*, does not preclude a bifurcated trial plan in which a punitive damages multiplier is established prior to compensatory damages.

In *Daniels v. Philip Morris* (also known as *In re Tobacco Case II*), a California state court certified a class comprised of individuals who were minors residing in California, who were exposed to defendants' marketing and advertising activities, and who smoked one or more cigarettes within the applicable time period. Certification was granted as to plaintiffs' claims that defendants violated the state's unfair business practice laws. On September 12, 2002, the trial court judge granted the defendants' motion for summary judgment on First Amendment and preemption (Federal Cigarette Labeling and Advertising Act) claims. In November 2002, the court confirmed its earlier rulings granting defendant's motion for summary judgment. The plaintiffs filed a petition for review with the California Supreme Court. On February 16, 2005, the California Supreme Court granted the petition. Briefing by the parties is complete. The Attorney General of the State of California has filed an amicus curiae brief in support of the plaintiffs' position.

During April 2001, a California state court issued an oral ruling in the case of *Brown v. The American Tobacco Company, Inc.*, in which it granted in part plaintiffs' motion for class certification and certified a class comprised of residents of California who smoked at least one of defendants' cigarettes during the period from June 10, 1993 through April 23, 2001 and who were exposed to defendants' marketing and advertising activities in California. Certification was granted as to plaintiffs' claims that defendants violated California Business and Professions Code Sections 17200 and 17500. The court denied the motion for class certification as to plaintiffs' claims under the California Legal Remedies Act. Defendants' writ with the court of appeals challenging the trial court's class certification was denied on January 16, 2002. The defendants filed a motion for summary judgment on January 31, 2003. On August 4, 2004, the defendants' motion for summary judgment was granted in part and denied in part. Following the November 2004 election, and the passage of a proposition in California that brought about a change in the law regarding the requirements for filing cases of this nature, the defendants filed a motion to decertify the class based on the changes in the law. On March 7, 2005, the court granted the defendants' motion to decertify the class. On March 17, 2005, plaintiffs filed a motion for reconsideration of the court's ruling decertifying the class. The trial judge denied the plaintiffs' motion on April 20, 2005, and the plaintiffs appealed on May 19, 2005. On September 5, 2006, the California Court of Appeals affirmed the judge's order decertifying the class. On October 13, 2006, the plaintiffs filed a petition for review with the California Supreme Court, which review was granted on November 1, 2006.

Altria has reported that, as of May 1, 2007, there are 19 putative class actions pending against Philip Morris in the U.S. on behalf of individuals who purchased and consumed various brands of cigarettes, including Marlboro Lights, Marlboro Ultra Lights, Virginia Slims Lights, Merit Lights, and Cambridge Lights. These actions allege, among other things, that the use of the term "Lights" or "Ultra Lights" constitutes deceptive and unfair trade practices and seek injunctive and equitable relief, including restitution. As reported by Altria, trial courts have certified classes in cases pending against Philip Morris in Massachusetts (*Aspinall*), Minnesota (*Curtis*), Missouri (*Craft*), and New York (*Schwab*). Philip Morris has appealed or otherwise challenged these class certification orders. Additionally, an appellate court in Florida has overturned a class certification by the trial court in the "lights" case styled *Hines v. Philip Morris, Inc.*, and the plaintiffs have petitioned the Florida Supreme Court for further review. On December 10, 2004, the Florida Supreme Court stayed further proceedings pending its decision in the *Engle* case, which was entered thereafter on December 21, 2006. On January 8, 2007, the court ordered the plaintiff in *Hines* to respond by January 23, 2007 as to why the decision in *Engle* should not control the outcome in *Hines*.

In August 2004, the Massachusetts Supreme Judicial Court affirmed class certification in the "lights" case *Aspinall v. Philip Morris Cos*. In April 2006, plaintiffs filed a motion to redefine the class to include all persons who after November 25, 1994 purchased packs or cartons of *Marlboro Lights* in Massachusetts that displayed the legend "Lower Tar & Nicotine" (the original class definition did not include a reference to lower tar and nicotine). In August 2006, the trial court denied Philip Morris's motion for summary judgment based on the state consumer protection statutory exemption and federal preemption. On motion of the parties, the trial court subsequently reported its decision to deny summary judgment to the appeals court for review and the trial court proceedings are stayed pending completion of the appellate review. Motions for direct appellate review with the Massachusetts Supreme Judicial Court was granted in April 2007.

In *Watson v. Philip Morris*, the U.S. District Court for the Eastern District of Arkansas upheld the federal officer removal statute as a basis for removal of "lights" cases from state to federal court, and the U.S. Court of Appeals for the Eighth Circuit affirmed. The U.S. Supreme Court granted a writ of certiorari and requested comment from the U.S. Solicitor General as to whether federal jurisdiction of the matter, based on the involvement of the Federal Trade Commission ("**FTC**"), was appropriate. The U.S. Solicitor General filed its brief amicus curiae on December 19, 2006, recommending that the petition for writ of certiorari be denied, despite its belief that the Eighth Circuit erred, because the error below (that Philip Morris marketed its cigarettes as "light" pursuant to the FTC's comprehensive direction and control) was fact-specific and insufficient to warrant review. On January 12, 2007, the U.S. Supreme Court granted the petition for a writ of certiorari. On June 11, 2007, the Supreme Court issued a ruling in which it reversed the trial court's order and directed that the *Watson* case be remanded and transferred back for further proceedings to the Arkansas state court where it had originally been filed. The Court held that the *Watson* case did not qualify under applicable federal law for removal and transfer from the Arkansas state court to the Arkansas federal court.

In April 2005, the Minnesota Supreme Court declined to review the trial court's class certification order in the "lights" case *Curtis v. Altria*. In September 2005, the case was removed to the U.S. District Court for the District of Minnesota, based on the Eighth Circuit's decision in *Watson*. In February 2006, the U.S. District Court denied plaintiffs' motion to remand the case to state court, and the case is pending in federal court. On July 31, 2006, the court stayed all proceedings pending resolution of the appeal in *Dahl* (described below). In February 2007, the U.S. Court of Appeals for the Eighth Circuit issued its ruling in *Dahl*, and reversed the federal district court's denial of plaintiff's motion to remand that case to the state trial court. *Curtis* continues to be stayed pending an appeal in the Minnesota state trial court in *Dahl* of the dismissal of that Lights class action based on preemption.

In August 2005, the Missouri Court of Appeals, Eastern District, affirmed the class certification order in *Craft v. Philip Morris Cos*. In September 2005, Philip Morris removed the case to federal court based on *Watson*. In March 2006, the federal trial court granted plaintiffs' motion and remanded the case to the Missouri state trial court. Philip Morris filed a motion for appellate review of the trial court's class certification. In May 2006, the Missouri Supreme Court declined to review the class certification decision. A status conference is scheduled for June 30, 2007 in the trial court.

On May 11, 2004, smokers of "Lights" cigarettes filed a purported class action suit, presently styled *Schwab v. Philip Morris USA, Inc.* (but originally filed as *McLaughlin et al. v. Philip Morris USA, Inc.*), in the U.S. District Court for the Eastern District of New York against the OPMs and their parent companies, Liggett and certain other entities. Plaintiffs allege that the defendants formed an "association-in-fact" enterprise, in violation of the federal RICO statute, to defraud the public into believing that "light" cigarettes were healthier alternatives to regular cigarettes. Plaintiffs seek to certify a nationwide class of smokers comprising all purchasers of "light" cigarettes manufactured by the defendants since the 1970s. Oral argument on the plaintiffs' motion for class certification occurred on September 12, 2005. The defendants filed a motion to deny class certification and to dismiss the complaint, asserting that the plaintiffs' request – that any determination as to damages payable to a certified class be allocated among class members on a "fluid recovery" basis – is illegal. On November 14, 2005, the court denied the defendants' motion, ruling that the plaintiffs' request for "fluid recovery" is not illegal and does not require denial of class certification or dismissal of the action. The trial judge ordered several months of additional discovery before deciding the class certification issue. On September 25, 2006, the court granted class certification and set a trial date of January 22, 2007. On October 6, 2006, the defendants filed a petition seeking review by the U.S. Court of Appeals for the Second Circuit of the class certification decision along with a motion to stay that decision pending review. On October 24, 2006, the Second Circuit ordered a temporary stay of all pretrial and trial proceedings pending the disposition of the petition for review and motion to stay. In November 2006, the Second Circuit granted the defendants' petition for review of the class certification order. Oral arguments in the *Schwab* national lights action suit have been scheduled for July 10, 2007.

In *Marrone v. Philip Morris, USA, Inc.*, smokers of "Lights" cigarettes manufactured and sold by Philip Morris, Inc. filed class-action complaints in an Ohio state court against Philip Morris, alleging violations of Ohio's Consumer Sales Practices Act ("**OCSPA**") in that, among other allegations, Philip Morris falsely represented the cigarettes as "light" to mislead smokers into believing that the cigarettes delivered lower tar and nicotine and therefore were safer than their "regular" cigarette counterparts. The trial court certified a limited class of consumers from an area of Ohio on the OCSPA claims and Philip Morris appealed. The Ohio appellate court affirmed the trial court's judgment certifying the class. In contrast to the above "lights" cases, on June 14, 2006, the Supreme Court of Ohio reversed the judgment of the appellate court and ruled that the plaintiffs did not meet the standard to qualify for class-action certification under the OCSPA, concluding that the plaintiffs had not shown prior rules or court decisions determining that conduct sufficiently similar to the alleged acts of Philip Morris constituted a deceptive act or practice.

Moreover, the Supreme Court of Illinois has overturned a judgment in favor of a plaintiff class in *Price v. Philip Morris Cos., Inc.* (formerly known as *Miles v. Philip Morris, Inc.*). A Madison County Illinois state court certified a class comprised of all residents of Illinois who purchased and consumed Cambridge Lights and Marlboro Lights within a specified time period but who did not have a claim for personal injury resulting from the purchase or consumption of cigarettes. The plaintiffs alleged consumer fraud claims and sought economic damages in the form of a refund of purchase costs of the cigarettes. On March 21, 2003, after a non-jury trial, the trial court judge ruled in favor of the plaintiffs, ordering Philip Morris to pay $10.1 billion ($7.1 billion in compensatory damages, $3.0 billion in punitive damages) to the State of Illinois, and $1.78 billion in plaintiff lawyer fees to be paid from the $10.1 billion. The court also stayed execution of the judgment for 30 days. After entry of the judgment on March 21, 2003, Philip Morris had 30 days within which to file a notice of appeal. Under Illinois court rules then-applicable, the enforcement of a trial court's money judgment may be stayed only if, among other things, an appeal bond in an amount sufficient to cover the amount of the judgment, interest, and costs is posted by a defendant within the 30-day period during which an appeal may be taken. With the approval of the trial court, such 30-day period may be extended for up to an additional 15 days. The trial court judge initially set the bond at $12 billion. Because of the difficulty of posting a bond of that magnitude, Philip Morris pursued various avenues of relief from the $12 billion bond requirement. In April 2003, the judge reduced the amount of the appeal bond. He ordered the bond to be secured by $800 million, payable in four equal quarterly installments beginning in September 2003, and a pre-existing 7.0%, $6 billion long-term note from Altria Group, Inc. to Philip Morris to be placed in an escrow account pending resolution of the case. The plaintiffs appealed the judge's order reducing the amount of the bond. On July 14, 2003, the Illinois Fifth District Court of Appeals ruled that the trial court had exceeded its authority in reducing the bond and ordered the trial judge to reinstate the original bond. On September 16, 2003, the Illinois Supreme Court upheld the reduced bond set by the trial court and agreed to hear Philip Morris's appeal without the need for intermediate appellate court review. On December 15, 2005, the Illinois Supreme Court reversed the trial court's judgment and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission, and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the U.S. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. The plaintiffs filed a motion asking the court to reconsider its decision, which was denied on May 5, 2006 by the Supreme Court of Illinois. In June 2006, the Illinois Supreme Court ordered the return to Philip Morris of approximately $2.15 billion held in escrow to secure the appeal bond and terminated Philip Morris's obligations to pay administrative fees. The pre-existing 7.0%, $6 billion long-term note from Altria Group, Inc. to Philip Morris was being held in escrow pending the outcome of plaintiffs' petition for writ of certiorari to the U.S. Supreme Court, filed on October 2, 2006. On November 27, 2006, the U.S. Supreme Court denied plaintiff's petition for certiorari. In December 2006, the trial court then entered an order of dismissal. In January 2007, the plaintiff filed a motion to vacate the dismissal, which motion is pending. In May 2007, the state trial court judge in the *Price* case asked the Illinois Fifth District Appellate Court whether he has the authority to reopen the *Price* case, citing possible new evidence presented in a case pending before the U.S. Supreme Court. On May 30, 2007, Philip Morris filed a motion to stay the Fifth District proceeding, which motion was granted by the Illinois Fifth District Appellate Court on June 1, 2007. It has also been reported that on May 17, 2007, Philip Morris petitioned the Illinois Supreme Court for an order that would prevent the trial court judge from reopening the *Price* case

According to Reynolds American, "lights" class-action cases are pending against Reynolds or Brown & Williamson in Illinois (*Turner and Howard*), Missouri (*Collora and Black*), Minnesota (*Dahl and Thompson*), Louisiana (*Harper and Brown*), Florida (*Rios*), Washington (*Huntsberry*), and New York (*Schwab*). Illinois state courts have certified classes in *Turner v. R.J. Reynolds Tobacco Co.* and *Howard v. Brown & Williamson*. In Turner, the state court certified a class defined as "[a]ll persons who purchased defendants' Doral Lights, Winston Lights, Salem Lights and Camel Lights, in Illinois, for personal consumption, between the first date that defendants sold Doral Lights, Winston Lights, Salem Lights and Camel Lights through the date the court certifies this suit as a class action…." On June 6, 2003, Reynolds Tobacco filed a motion to stay the case pending Philip Morris's appeal of the Price case. On July 11, 2003, the court denied the motion, and Reynolds Tobacco appealed to the Illinois Fifth District Court of Appeals. The Court of Appeals denied this motion on October 17, 2003. On October 20, 2003, the trial judge ordered that the case be stayed for 90 days, or pending the result of the Price appeal. The order stated that a hearing would be held at the end of the 90-day period to determine if the stay should be continued. However, on October 24, 2003, the Illinois Supreme Court ordered an emergency stay of all proceedings pending review by the entire Illinois Supreme Court of Reynolds Tobacco's emergency stay order request filed on October 15, 2003. On November 5, 2003, the Illinois Supreme Court granted Reynolds Tobacco's motion for a stay pending the court's final appeal decision in Price. The *Howard* case also remains stayed by order of the trial judge,

although the plaintiffs appealed this stay order to the Illinois Fifth District Court of Appeals, which appeal was denied on August 19, 2005. Both cases remain stayed, notwithstanding the *Price* decision.

On December 31, 2003, a Missouri state court judge certified a similar class in the "lights" case *Collora v. R.J. Reynolds Tobacco Co*. On January 14, 2004, Reynolds Tobacco removed the case to the U.S. District Court for the Eastern District of Missouri. On September 30, 2004, the case was remanded to the Circuit Court for the City of St. Louis. Reynolds Tobacco removed the case once again, and on April 18, 2006, the case was remanded for the second time to the Circuit Court for the City of St. Louis. *Black v. Brown & Williamson Tobacco Corp.* is another "lights" case pending in Missouri. Brown & Williamson removed the case to the U.S. District Court for the Eastern District of Missouri on September 23, 2005. On October 25, 2005, the plaintiffs filed a motion to remand, which was granted on March 17, 2006. A consolidated hearing in both *Black* and *Collora* has been set for December 25, 2007. On December 22, 2006, the plaintiffs filed a motion to reassign both *Black* and *Collora* to a single general division, which motion was granted on April 19, 2007.

In May 2005, a Minnesota state court dismissed in its entirety the "lights" case *Dahl v. R.J. Reynolds Tobacco* Company, ruling that the plaintiffs' claims conflicted with the federal Cigarette Labeling and Advertising Act. On July 11, 2005, the plaintiffs appealed. Pending appeal, Reynolds Tobacco removed the case to the U.S. District Court for the District of Minnesota. The plaintiffs filed a motion to remand, which was denied on February 14, 2006. On March 9, 2006, the case was transferred to the U.S. Court of Appeals for the Eighth Circuit. On February 28, 2007, the Eighth Circuit reversed and remanded the case to the Minnesota Court of Appeals where briefing is underway. In *Thompson v. R.J. Reynolds Tobacco Co.*, also pending in Minnesota, Reynolds removed the case on September 23, 2005 to the United States District Court for the District of Minnesota. On October 21, 2005, the plaintiffs filed a motion to remand, which was denied on February 14, 2006. On August 7, 2006, the parties filed a stipulation to stay the case, pending resolution of the appeal in *Dahl*.

On August 31, 2005, a Louisiana federal district court ruled in a proposed class action, *Sullivan v. Philip Morris*, that the Federal Cigarette Labeling and Advertising Act (FCLAA) does not preempt plaintiffs' claims of a breach of express warranty and certain state law remedies with respect to manufacturing defects. On September 14, 2005, the same district court ruled in the proposed class action *Brown v. Brown & Williamson* that the FCLAA does not preempt plaintiffs' fraudulent misrepresentation/concealment and defective product claims. Brown & Williamson filed a petition to the U.S. Court of Appeals for the Fifth Circuit for permission to appeal, which was granted on February 10, 2006. In February 2007, the Fifth Circuit reversed the judgment and remanded the case with directions to dismiss all claims with prejudice. Philip Morris also filed a petition to the U.S. Court of Appeals for the Fifth Circuit for permission to appeal the Sullivan ruling, which was granted on March 31, 2006. On January 27, 2005, also in Louisiana, a federal judge denied the plaintiffs' motion to remand in *Harper v. R.J. Reynolds Tobacco Co*. The plaintiffs appealed, and on July 17, 2006, the Fifth Circuit Court of Appeals affirmed the district court's order.

Pending in the state of Washington is the "lights" case *Huntsberry v. R.J. Reynolds Tobacco Co.*, in which the plaintiffs' motion for class certification was denied on April 21, 2006. On September 18, 2006, the court denied the plaintiffs' motion for discretionary review. The plaintiffs filed a motion to modify the ruling with the Washington Court of Appeals on October 17, 2006, which motion was denied in December 2006. In January 2007, plaintiffs filed a motion with the Washington Supreme Court, asking the court to review the rulings that denied their motions for class certification, which motion was denied on March 1, 2007. The plaintiffs filed a motion to modify the ruling of that court on April 2, 2007, which motion is set for reconsideration on June 5, 2007. Pending in Florida is the "lights" case *Rios v. R.J. Reynolds Tobacco Co.*, which is currently dormant pending plaintiffs' counsel's attempt to appeal decertification in the Florida case *Hines v. Philip Morris, Inc.* Also pending in Florida is *Rivera v. Brown & Williamson Tobacco Corp.* which was filed in October 2006 and removed by the defendant in November 2006 to the federal District Court for the Southern District of Florida.

On June 9, 2005, a proposed "lights" class action was filed in U.S. District Court for the District of New Mexico (*Mulford v. Altria Group, Inc.*). Philip Morris's motions for summary judgment on preemption and consumer protection statutory exemption grounds are pending resolution of the plaintiffs' amended motion for class certification. On June 27, 2005, a similar class action was filed in Kansas state court against Philip Morris and its parent, Altria (*Benedict v. Altria Group, Inc*). The case has been transferred to U.S. District Court for the District of Kansas, where plaintiffs' motion for class certification and Philip Morris's motion for summary judgment are pending. It is also reported that on August 15, 2005, three individuals filed a similar class action in the U.S. District Court for the District of Maine against the same defendants (*Good v. Altria Group, Inc.*). In May 2006, the court granted Philip Morris's motion for summary judgment on the grounds that plaintiffs' claims are preempted by the Federal Cigarette Labeling and Advertising Act and dismissed the case. In June 2006, plaintiffs appealed to the U.S. Court of Appeals for the First Circuit. Oral argument took place in January 2007.

On April 3, 2002, in *Deloach v. Philip Morris*, a federal district court in North Carolina granted class certification to a group of tobacco growers and quota-holders from Alabama, Florida, Georgia, North Carolina, South Carolina, and Tennessee. The class accused cigarette manufacturers of conspiring to set prices offered for tobacco in violation of antitrust laws. In June 2002, the defendants' petition to the Fourth Circuit Court of Appeals seeking permission to appeal the class certification was denied. In May 2003, the plaintiffs reached a settlement with all of the tobacco industry defendants other than Reynolds Tobacco. The settling defendants agreed to pay $210 million to the plaintiffs, to pay plaintiffs' attorney fees of $75.3 million as set by the court and to purchase a minimum amount of U.S. leaf for ten years. The case continued against Reynolds Tobacco. On April 22, 2004, after the trial began, the parties settled the case. Under the settlement, Reynolds Tobacco has paid $33 million into a settlement fund, which, after deductions for attorneys' fees and administrative costs, will be distributed to the class pending final settlement approval. Reynolds Tobacco has also agreed to purchase a minimum amount of U.S. leaf for the next ten years. On March 21, 2005, the court approved the settlement and dismissed the suit.

On May 23, 2001, a lawsuit was filed in the U.S. District Court for the District of Columbia styled *Simms v. Philip Morris Incorporated*, which sought class action status for millions of youths who began smoking cigarettes before they were legally allowed to buy cigarettes. Plaintiffs sought to recover moneys that underage smokers spent on cigarettes before they were legally allowed to buy cigarettes, whether or not they have suffered health problems, and/or profits the tobacco manufacturers have earned from sales to children. The lawsuit alleged that tobacco manufacturers concealed the addictive nature of cigarettes and concealed the health risks of smoking in their advertising. In February 2003, the court denied plaintiffs' motion for class certification. The plaintiffs have filed several motions for reconsideration of the order denying class certification, which motions were denied in December 2006. The case has been stayed pending resolution of the *U.S. Department of Justice* case described below under "–*Healthcare Cost Recovery Lawsuits*".

On January 19, 2006, a lawsuit styled *Caronia v. Philip Morris USA, Inc.* was filed in the U.S. District Court for the Eastern District of New York to require Philip Morris to pay for low dose CAT scans (on an annual basis) for a class of smokers over the age of 50 who have been smoking at least a pack of Marlboro a day for 20 years and have not been diagnosed with lung cancer. Philip Morris filed its answer on March 16, 2006. On November 3, 2006, plaintiffs filed a Third Amended Complaint, which Philip Morris answered on November 13, 2006. Class certification discovery ended in February 2007, and briefing was due in April. A similar lawsuit, styled *Donovan, et al. v. Philip Morris USA, Inc. et al.*, was filed on March 2, 2007 in the United States District Court in Massachusetts.

On December 2006, a lawsuit styled *Espinosa, et al. v. Philip Morris USA, Inc. et al.* was filed in the Cook County, Illinois circuit court on behalf of individuals from throughout Illinois and/or the United States who purchased cigarettes manufactured by certain defendants from 1996 through the date of any judgment in plaintiffs' favor. Excluded from the class are any individuals who allege personal injury or healthcare costs. The complaint alleges, among other things, that defendants were negligent and violated the Illinois consumer fraud statute by certain defendants' steadily and purposefully increasing the nicotine level and absorption of their cigarettes into the human body, including the brands most popular with young people and minorities. On January 12, 2007, Philip Morris removed the case to the United States District Court for the Northern District of Illinois. In March 2007, the District Court rejected plaintiffs' motion to remand the case to the Circuit Court of Cook County. Philip Morris' motion to dismiss the action is pending.

Individual Plaintiffs' Lawsuits. The MSA does not release PMs from liability in individual plaintiffs' cases. Numerous cases have been brought by individual plaintiffs who allege that their cancer or other health effects have resulted from their use of cigarettes, addiction to smoking, or exposure to environmental tobacco smoke. Individual plaintiffs' allegations of liability are based on various theories of recovery, including but not limited to, negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, restitution, indemnification, violations of deceptive trade practice laws and consumer protection statutes, and claims under federal and state RICO statutes. The tobacco industry has traditionally defended individual health and smoking lawsuits by asserting, among other defenses, assumption of risk and/or comparative fault on the part of the plaintiff, as well as lack of proximate cause.

Altria has reported that as of May 1, 2007, there were approximately 183 individual plaintiff smoking and health cases and 11 smoking and health class actions and aggregated claims pending in the U.S. against it (many of which cases include other tobacco industry defendants), including 928 cases pending before a single West Virginia state court in a consolidated proceeding. In addition, approximately 2,623 additional individual cases (referred to herein as the *Broin II* cases) are pending in Florida by individual current and former flight attendants claiming personal injury allegedly related to ETS in airline cabins. The individuals in the *Broin II* cases are limited by the settlement of a previous class action lawsuit, *Broin v. Philip Morris* (known as *Broin I*), to the recovery of

compensatory damages only, and are precluded from seeking or recovering punitive damages. As a result of the settlement, however, the burden of proof as to whether ETS causes certain illnesses such as lung cancer and emphysema was shifted to the tobacco industry defendants. To date, seven individual *Broin II* flight attendant cases have gone to trial, one of which has resulted in a jury verdict against the tobacco industry defendants. The defendants' appeal in that case is pending. See also "*Class Action Lawsuits*," above.

In the last ten years, juries have returned verdicts in individual smoking and health cases against the tobacco industry, including one or more of the PMs. Thus far, a number of those cases have resulted in significant verdicts against the defendants – some have been appealed, some have been overturned, and others have been affirmed.

By way of example only, and not as an exclusive or complete list, the following individual matters are illustrative of individual cases.

- In February 1999, a California jury in *Henley v. Philip Morris* awarded $1.5 million in compensatory damages and $50 million in punitive damages. The award was subsequently reduced by the trial judge to $25 million in punitive damages, and both Philip Morris and the plaintiff appealed. In September 2003, a California Court of Appeal further reduced the punitive damage award to $9 million, but otherwise affirmed the judgment for compensatory damages, and Philip Morris appealed to the California Supreme Court. In September 2004, the California Supreme Court dismissed Philip Morris's appeal. In October 2004, the California Court of Appeal issued an order allowing the execution of the judgment. In December 2004, Philip Morris filed with the U.S. Supreme Court a petition for a writ of certiorari. On March 21, 2005, the U.S. Supreme Court denied Philip Morris's petition. Philip Morris subsequently satisfied the judgment, paying $1.5 million in compensatory damages, $9 million in punitive damages and $6.4 million in accumulated interest.
- In March 1999, an Oregon jury in *Williams-Branch v. Philip Morris* awarded $821,500 in actual damages and $79.5 million in punitive damages. The trial judge subsequently reduced the punitive damages award to $32 million, but the reduction was overturned and the full amount of the punitive damages award was reinstated by the Oregon Court of Appeals. The Oregon Supreme Court declined to review the reinstated punitive damage award and Philip Morris petitioned the U.S. Supreme Court for further review. In October 2003, the U.S. Supreme Court set aside the Oregon appellate court's ruling and directed the Oregon court to reconsider the case in light of *State Farm v. Campbell*. In June 2004, the Oregon Court of Appeals reinstated the punitive damages award. In December 2004, the Oregon Supreme Court granted Philip Morris's petition for review of the case. On February 2, 2006, the Oregon Supreme Court affirmed the Court of Appeals decision, holding that the punitive damage award does not violate the due process guarantees of the U.S. Constitution. On March 30, 2006, Philip Morris filed a petition for certiorari review with the U.S. Supreme Court challenging the ruling of the Oregon Supreme Court as a violation of the principles set forth in *State Farm v. Campbell* regarding the permissible size of punitive damage awards relative to compensatory damage awards. The U.S. Supreme Court granted Philip Morris's petition for review in May 2006, and oral argument was heard on October 31, 2006. On February 20, 2007, the U.S. Supreme Court ruled that a punitive damage award may not be based on a jury's desire to punish a defendant for harming persons who were not parties to the case in question and held that such an award would amount to an unconstitutional taking of property from a defendant without due process. The Court vacated the judgment of the Oregon Supreme Court and remanded the case for further proceedings not inconsistent with its opinion.
- In April 1999, a Maryland jury in *Connor v. Lorillard* awarded $2.225 million in damages. An appellate court has remanded the case for a determination of the date of injury to determine whether a statutory cap on non-economic damages applies.
- In March 2000, a California jury in *Whiteley v. Raybestos-Manhattan, Inc.* returned a verdict in favor of the plaintiff and found the defendants, including Philip Morris and Reynolds Tobacco, liable for negligent product design and fraud, and awarded $1.72 million in compensatory damages and $20 million in punitive damages. Both damage awards were upheld by the trial judge, who denied the defendants' post-verdict challenge. The defendants appealed the verdict. In April 2004, the California Court of Appeal reversed the judgment and remanded the case for a new trial. The plaintiff's motion for rehearing was denied on April 29, 2004. In May 2006, the plaintiff filed an amended consolidated complaint. In September 2006, the trial court granted the plaintiff's motion for a preferential trial date and trial began on January 22, 2007. On May 2, 2007, the jury awarded plaintiffs $2.5 million in

compensatory damages against Philip Morris and the other defendant in the case. The jury also found that plaintiffs are entitled to punitive damages against the other defendant, but not Philip Morris, in an amount to be determined in a later phase of the trial. Philip Morris has stated it intends to seek review of the compensatory damage verdict.

- In October 2000, a Tampa, Florida jury in *Jones v. R.J. Reynolds Tobacco Co.* found Reynolds Tobacco liable for negligence and strict liability and returned a verdict in favor of the widower of a deceased smoker, awarding approximately $200,000 in compensatory damages; the jury rejected the plaintiff's conspiracy claim and did not award punitive damages. Reynolds Tobacco filed a motion for judgment notwithstanding the verdict, or, in the alternative, for a new trial. On December 28, 2000, the court granted the motion for a new trial and on August 30, 2002 the Second District Court of Appeal of Florida affirmed the decision to grant a new trial. The plaintiff has filed for permission to appeal to the Florida Supreme Court. On December 9, 2002, the Supreme Court of Florida issued an order to show cause as to why Jones's notice of appeal should not be treated as a notice to invoke discretionary jurisdiction. On April 27, 2005 the Florida Supreme Court denied the plaintiff's notice of appeal without prejudice. On May 25, 2005 the plaintiff served an amended notice of intent to invoke discretionary jurisdiction. On August 31, 2005, the Florida Supreme Court denied review for lack of jurisdiction. On April 20, 2006, the plaintiff voluntarily dismissed all claims against Reynolds Tobacco.

- In November 2000, the Supreme Court of Florida reinstated the verdict by a Florida jury in *Carter v. Brown & Williamson Tobacco Corporation* to award $750,000 in damages to the plaintiff. In 1996, the jury had found that cigarettes were a defective product and that B&W was negligent for not warning people of the danger, but an appeals court reversed this decision. In March 2001, the plaintiff received slightly over $1 million from a trust account that contained the $750,000 jury award plus interest and became the first smoker to be paid by a tobacco company in an individual lawsuit. On June 29, 2001, the U.S. Supreme Court denied B&W's petition for a writ of certiorari, thus leaving the jury verdict intact.

- In March 2001, a Massachusetts lower court in *Haglund v. Philip Morris* dismissed, without factual inquiries, a claim brought on behalf of a deceased smoker for breach of implied warranty of merchantability, based upon the applicability of a defense as to "unreasonable" use of the product by the smoker and the stipulation by the plaintiff that the defendant would prevail if the defense was made applicable. In May 2006, the Massachusetts Supreme Judicial Court, in reversing and remanding the case for further factual proceedings as to reasonableness of use, noted that such defense will not be available in most cases involving the manufacture and sale of cigarettes, but will only be available in situations where the plaintiff has acted so overwhelmingly unreasonable that imposing liability would be unfair.

- In June 2001, in *Boeken v. Philip Morris Incorporated*, a California state court jury found against Philip Morris on all six claims of fraud, negligence and making a defective product alleged by the plaintiff. The jury awarded the plaintiff $5.5 million in compensatory damages and $3 billion in punitive damages. The $3 billion punitive damages award was reduced to $100 million post-trial. Philip Morris appealed. In September 2004, the California Second District Court of Appeal further reduced the punitive damage award to $50 million, but otherwise affirmed the judgment entered in the case. In October 2004 the Court of Appeal granted the parties' motions for rehearing and, in April 2005, reaffirmed the amount of the September 2004 ruling. On August 10, 2005, the California Supreme Court denied Philip Morris's request for review. Philip Morris and the plaintiff petitioned the U.S. Supreme Court for review. Plaintiff agreed not to execute on the judgment pending the disposition of Philip Morris's petition. On March 20, 2006, the U.S. Supreme Court denied all parties' petitions for review. After exhausting all appeals, Philip Morris paid approximately $82.5 million (including interest of approximately $27 million) to the plaintiffs.

- In December 2001, a Florida state court jury awarded the plaintiff $165,000 in compensatory damages but no punitive damages in *Kenyon v. R.J. Reynolds Tobacco Co*. Reynolds Tobacco appealed to the Second District Court of Appeal of Florida, which, on May 30, 2003, affirmed per curium (that is, without writing an opinion) the trial court's judgment in favor of the plaintiff. Reynolds Tobacco paid $196,000, which represents the amount of the judgment plus accrued interest, in order to pursue further appeals. On September 5, 2003, Reynolds Tobacco petitioned the Florida Supreme Court to require the Second District Court of Appeal to write an opinion. On April 22, 2004, the Florida Supreme Court denied the petition. On January 26, 2004, the U.S. Supreme Court denied Reynolds

Tobacco's petition for a writ of certiorari, thus leaving the jury verdict intact. Reynolds Tobacco subsequently paid approximately $1.3 million in attorneys' fees to the plaintiff's counsel.

- In February 2002, a federal jury in Kansas City awarded $198,000 in compensatory damages to a former smoker in *Burton v. R.J. Reynolds Tobacco Co*. The jury also determined that punitive damages were appropriate and, after a separate hearing was held to address that issue, the court awarded the plaintiff $15 million in punitive damages. On February 9, 2005, the U.S. Court of Appeals for the Tenth Circuit upheld the compensatory damages award, but unanimously reversed the award of punitive damages in its entirety. On May 17, 2005, the District Court entered a second amended judgment for $196,416 plus interest and costs. On June 17, 2005, Reynolds Tobacco paid the judgment.

- In March 2002, a Portland, Oregon jury awarded approximately $168,500 in compensatory damages and $150 million in punitive damages to the family of a light cigarette smoker in *Schwarz v. Philip Morris Incorporated*. The trial judge subsequently reduced the punitive damages awarded to $100 million. Philip Morris and the plaintiffs appealed this judgment. In May 2006, the Oregon Court of Appeals affirmed the compensatory damages verdict and reversed the award of punitive damages and remanded the case to the trial court for a second trial to determine the amount of punitive damages, if any. In June 2006, plaintiffs filed a petition to the Oregon Supreme Court to review the portion of the Oregon Court of Appeals decision reversing the punitive damages and remanding the case for a new trial on punitive damages. In October 2006, the Oregon Supreme Court announced that it would hold this petition in abeyance until the U.S. Supreme Court decides the *Williams* case described above. In February 2007, the U.S. Supreme Court vacated the punitive damages judgment in the *Williams* case and remanded the case to the Oregon Supreme Court for proceedings consistent with its decision. The parties have submitted their briefs to the Oregon Supreme Court setting forth their respective views on how the *Williams* decision impacts the plaintiffs pending petition for review.

- In June 2002, in *Lukacs v. Philip Morris, Inc.,* a Florida jury awarded a smoker $37.5 million in compensatory damages against Philip Morris and other defendants. In March 2003, the trial court reduced the damages award to $24.9 million. The court has not yet entered the judgment in the jury verdict. In January 2007, defendants petitioned the trial court to set aside the jury's verdict and plaintiff filed a motion for entry of judgment. Philip Morris has stated it intends to appeal if a judgment is entered in this case.

- In September 2002, in *Figueroa-Cruz v. R.J. Reynolds Tobacco Co.*, a Puerto Rico jury awarded two sons of a deceased smoker $500,000 each. The trial judge vacated one of the awards on statute of limitations grounds, and granted Reynolds Tobacco's motion for judgment as a matter of law on the other award on October 9, 2002. On October 28, 2003, the U.S. Court of Appeals for the First Circuit affirmed the trial court's ruling. The plaintiffs' petition for a writ of certiorari was denied by the U.S. Supreme Court in November 2004.

- In October 2002, in *Bullock v. Philip Morris, Inc.*, a Los Angeles, California jury awarded a smoker $850,000 in compensatory damages. In October 2002, the same jury awarded the plaintiff $28 billion in punitive damages. In December 2002, the trial judge reduced the punitive damage award to $28 million. Philip Morris and the plaintiff each appealed and the appeal was argued on January 18, 2006. On April 21, 2006, the California Court of Appeal, Second Appellate District, Division Three, upheld the $28 million punitive damages award. In August 2006, the California Supreme Court denied the plaintiff's petition to overturn the trial court's reduction in the punitive damage award and granted Philip Morris's petition for review challenging the punitive damage award, with further action deferred pending the U.S. Supreme Court's decision on punitive damages in the *Williams* case described above. In February 2007, the U.S. Supreme Court vacated the punitive damages judgment in *Williams* and remanded the case to the Oregon Supreme Court for proceedings consistent with its decision. Parties to the appeal in *Bullock* have requested that the court establish a briefing schedule on the merits of the pending appeal.

- In April 2003, in *Eastman v. Philip Morris*, a Florida jury awarded a smoker $3.26 million in damages, after reducing the award to reflect the plaintiff's partial responsibility. Defendants Philip Morris and B&W appealed to the Second District of Florida Court of Appeal. In May 2004, the Second District Court of Appeal rejected the appeal in a per curium decision (that is, without a written opinion). The defendants' petition for a written opinion and rehearing was denied on October 14,

2004, and that ruling is not subject to review by the Florida Supreme Court. On October 29, 2004, Philip Morris and Reynolds Tobacco, due to their obligation to indemnify B&W, satisfied their respective portions the judgment.

- In May 2003, in *Boerner v. Brown & Williamson*, an Arkansas jury awarded the plaintiff $15 million in punitive damages and $4 million in compensatory damages. Following a series of appeals, on January 7, 2005, the U.S. Court of Appeals for the Eighth Circuit affirmed the trial court's May 2003 judgment, but reduced the punitive damages award to $5 million. Reynolds Tobacco, due to its obligation to indemnify B&W, satisfied the approximately $9.1 million judgment on February 16, 2005.

- In November 2003, in *Thompson v. Philip Morris, Inc.*, a Missouri jury returned a split verdict, awarding approximately $1.6 million in compensatory damages to the plaintiff and an additional $500,000 in damages to his wife. The jury apportioned 40% of fault to Philip Morris, 10% of fault to B&W and the remaining 50% to the plaintiff. Accordingly, under Missouri law, the court must reduce the damages award by half. On March 8, 2004, the defendants appealed to the Missouri Court of Appeals for the Western District, which affirmed the judgment entered in favor of the plaintiffs on August 22, 2006. On September 26, 2006, the Court of Appeals denied the defendants' motion to transfer the case to the Missouri Supreme Court. The defendants filed an application to transfer in the Missouri Supreme Court on October 10, 2006, and on December 19, 2006, the application was denied. In January 2007, Philip Morris and Reynolds Tobacco paid approximately $1.1 million and $268,100, respectively, in judgment and interest to the plaintiff.

- In December 2003, in *Frankson v. Brown & Williamson*, a New York jury awarded the plaintiff $350,000 in compensatory damages and $20 million in punitive damages. On June 22, 2004, the trial judge granted a new trial unless the parties agree to an increase in compensatory damages to $500,000 and a decrease in punitive damages to $5 million. On January 21, 2005, the plaintiff stipulated to the court's reduction in the amount of punitive damages. The defendants' appeal was denied by the appellate division in July 2006. On August 4, 2006, the defendants filed a motion for rehearing, or, in the alternative, for leave to appeal to the New York Court of Appeals. That motion was denied on October 5, 2006. The defendants' motion to stay entry and enforcement of the final judgment pending further appeal was granted in January 2007 and the defendants also appealed the judgment that same month. Judgment was entered against the defendants on March 7, 2007 and they have filed a notice of appeal. The appeals will be considered.

- In April 2004, a Florida jury returned a verdict in favor of the plaintiff in *Davis v. Liggett Group, Inc.*, awarding a total of $540,000 in actual damages. In addition, the jury awarded legal fees of $752,000. The jury did not award punitive damages. Liggett has appealed.

- In October 2004, in *Arnitz v. Philip Morris, Inc.*, a Florida jury returned a verdict in favor of the plaintiff, who claims that as a result of his smoking he developed lung cancer and emphysema. The jury awarded a total of $240,000 in compensatory damages. Philip Morris, the sole defendant in the case, appealed to the Florida Second District Court of Appeals. In July 2006, the appellate court affirmed the judgment of the trial court. In September 2006, the appellate court denied Philip Morris's motion for rehearing. Philip Morris subsequently filed a motion to stay the issuance of the mandate with the appellate court. On October 6, 2006, the appellate court denied this motion, and the mandate was issued. On October 16, 2006, Philip Morris paid $1,094,352 in judgment, interest, and attorneys' fees. On October 19, 2006, Philip Morris filed a petition for discretionary review with the Florida Supreme Court. The petition was denied on December 20, 2006.

- In February 2005, in *Smith v. Brown & Williamson*, a Missouri state court jury returned a split verdict, finding in favor of the defendant on counts of fraudulent concealment and conspiracy and in favor of the plaintiffs on a negligence count. The jury awarded the plaintiffs $500,000 in compensatory damages and $20 million in punitive damages. On March 10, 2005, the defendant filed a motion for judgment notwithstanding the verdict or, in the alternative, for a new trial. On May 23, 2005, the trial court denied defendant's motion, and on June 1, 2005, the defendant appealed. Oral argument occurred on October 5, 2006, and a decision is pending.

- In March 2005, in *Rose v. Philip Morris*, a New York jury awarded $3.42 million in compensatory damages against B&W and Philip Morris. On August 18, 2005, B&W filed a notice of appeal. Pursuant to its agreement to indemnify B&W, on February 7, 2006, Reynolds Tobacco posted a supersedeas bond in the approximate amount of $2.058 million. The jury also returned a punitive

damages award totaling $17.1 million against Philip Morris. In December 2005, Philip Morris's post-trial motions challenging the verdict were denied by the trial court. Philip Morris has appealed. Oral argument occurred on December 12, 2006, and a decision is pending.

- Also in March 2005, the Ninth Circuit Court of Appeals referred the case *Grisham v. Philip Morris* to the California Supreme Court to determine the statute of limitations in tobacco cases, noting an inconsistency in federal and California state law. The plaintiff, who was diagnosed with severe periodontal disease caused by toxins in cigarette smoke, alleged that Philip Morris and Brown & Williamson deceived her for four decades about the safety of their products. The case had reached the Ninth Circuit after a Los Angeles federal court dismissed the case as being time-barred. On December 6, 2006, the California Supreme Court heard arguments regarding whether long-term smokers who relied on manufacturers' false safety claims are required to file suit when health problems emerge or much earlier, when smokers realize they are addicted. On February 15, 2007, the California Supreme Court ruled that such smokers need not have filed suit when they realized they were addicted, thus permitting the *Grisham* lawsuit to proceed in federal court in California.

In August 2002, the California Supreme Court issued a decision limiting evidence of wrongdoing between 1988 and 1998 by tobacco companies. One OPM has reported that this decision worked to the advantage of the tobacco industry defendants in the Whiteley case, and it believes that it will have a favorable impact for tobacco industry defendants in other California cases, both at the trial court level and on appeal.

Healthcare Cost Recovery Lawsuits. In certain pending proceedings, domestic and foreign governmental entities and non-governmental plaintiffs, including Native American tribes, insurers and self-insurers such as Blue Cross and Blue Shield plans, hospitals and others, are seeking reimbursement of healthcare cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages as well. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees. The PMs are exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims belonging to the Settling States. Altria has reported that as of May 1, 2007, there were three healthcare cost recovery actions pending against Philip Morris in the U.S. For example, on August 4, 2005, a national senior citizens' organization filed a lawsuit (*United Senior Association, Inc. v. Philip Morris Inc., et al.*) in Boston against cigarette manufacturers under the federal "Medicare as Secondary Payer" statute, which permits Medicare beneficiaries or others to bring actions on behalf of Medicare to recover healthcare costs paid by Medicare for which another party may be liable. The plaintiffs are reportedly seeking to recover more than $60 billion in alleged Medicare spending on treatment of smoking related illnesses since August 4, 1999. On October 24, 2005, the defendants filed a motion to dismiss, or, in the alternative, to transfer the case to the U.S. District Court for the Middle District of Florida, where a similar lawsuit involving Medicare payments in Florida was dismissed on July 26, 2005. The Boston lawsuit reportedly does not seek to recover Medicare payments in Florida. On August 28, 2006, the defendants' motion to dismiss was granted. On September 7, 2006, the plaintiffs filed a notice of appeal with the U.S. Court of Appeals for the First Circuit.

The claims asserted in the healthcare cost recovery actions include the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of healthcare costs allegedly attributable to smoking, the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under federal and state statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under federal Racketeer Influenced and Corrupt Organizations Act ("**RICO**") and parallel state statutes.

Defenses raised include lack of proximate cause, remoteness of injury, failure to state a valid claim, lack of benefit, adequate remedy at law, "unclean hands" (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), lack of antitrust standing and injury, federal preemption, lack of statutory authority to bring suit, and statutes of limitations. In addition, defendants argue that they should be entitled to "set off" any alleged damages to the extent the plaintiff benefits economically from the sale of cigarettes through the receipt of excise taxes or otherwise. Defendants also argue that these cases are improper because plaintiffs must proceed under principles of subrogation and assignment. Under traditional theories of recovery, a payor of medical costs (such as an insurer) can seek recovery of healthcare costs from a third party solely by "standing in the shoes" of the injured party. Defendants argue that plaintiffs should be required to bring any actions as subrogees of individual healthcare recipients and should be subject to all defenses available against the injured party.

Although there have been some decisions to the contrary, most courts that have decided motions in these cases have dismissed all or most of the claims against the industry. In addition, eight federal Courts of Appeals (the Second, Third, Fifth, Seventh, Eighth, Ninth, Eleventh, and District of Columbia Circuits), as well as California, Florida, New York, and Tennessee intermediate appellate courts, relying primarily on grounds that plaintiffs' claims were too remote, have affirmed dismissals of, or reversed trial courts that had refused to dismiss, healthcare cost recovery actions. The U.S. Supreme Court has refused to consider plaintiffs' appeals from the cases decided by the U.S. Courts of Appeals for the Second, Third, Fifth, Ninth, and District of Columbia Circuits.

A number of foreign governmental entities have filed suit in state and federal courts in the U.S. against tobacco industry defendants to recover funds for healthcare and medical and other assistance paid by those foreign governments to their citizens. Such suits have been brought in the U.S. by 13 countries, a Canadian province, 11 Brazilian states and 11 Brazilian cities. All of these suits have been dismissed. In addition to these cases brought in the U.S., healthcare cost recovery actions have also been brought in Israel, the Marshall Islands (where the suit was dismissed), Canada and France. In September 2003, the case pending in France was dismissed and the plaintiff has appealed. Other governmental entities have stated that they are considering filing such actions. On September 29, 2005, the Supreme Court of Canada upheld legislation passed in 1998 by the province of British Columbia allowing the provincial government to seek damages from tobacco companies for healthcare costs incurred during the past 50 years, as well as for future illness-related expenses in connection with tobacco use. The legislation also lightens the required burden of proof and curtails certain traditional defenses in civil suits. Other provinces are reported to have already adopted or are expected to adopt similar legislation. See discussion of HHCR Act, below.

In September 1999, the U.S. government filed a lawsuit in the U.S. District Court for the District of Columbia against the OPMs, certain related parent companies and two tobacco industry research and lobbying organizations, seeking medical cost recovery for federal funds spent to treat alleged tobacco-related illnesses and asserting violation of RICO. In September 2000, the trial court dismissed the government's medical cost recovery claims, but permitted discovery to proceed on the government's claims for relief under RICO. The government alleged that disgorgement by defendants of approximately $280 billion is an appropriate remedy. In May 2004, the court issued an order denying defendants' motion for partial summary judgment limiting the disgorgement remedy. In June 2004, the trial court certified that order for immediate appeal, and in July 2004, the U.S. Court of Appeals for the District of Columbia agreed to hear the appeal on an expedited basis. On February 4, 2005, the appeals court, in a 2-1 decision, ruled that disgorgement is not an available remedy in this case. This ruling eliminated the government's claim for $280 billion and limits the government's potential remedies principally to forward-looking relief, including funding for anti-smoking programs. The government appealed this ruling to seek a rehearing en banc. On April 20, 2005, the appeals court denied the government's appeal. On July 18, 2005, the government appealed the ruling with regard to the $280 billion disgorgement decision to the U.S. Supreme Court. On October 17, 2005 the U.S. Supreme Court, without comment, denied the appeal.

In addition to the claim for disgorgement, the government sought relief consisting of, among other things: (1) prohibitory injunctions (including prohibitions on committing acts of racketeering, making false or misleading statements about cigarettes, and on youth marketing); (2) disclosure of documents concerning the health risks and addictive nature of smoking, the ability to develop less hazardous cigarettes and youth marketing campaigns; (3) mandatory corrective statements about the health risks of smoking and the addictive properties of nicotine in future marketing campaigns; and (4) funding of remedial programs (including research, public education campaigns, medical monitoring programs, and smoking cessation programs). The trial phase of the case concluded on June 9, 2005. In its closing argument and submissions, the government requested that the tobacco industry be required to fund an up to ten-year, $14 billion smoking cessation program. The government reportedly also asked the court to appoint a lawyer as monitor with power to order the defendants to sell off their research and development facilities related to developing so-called safer cigarettes. The monitor would also have power to review the business policies of the defendants. The government also reportedly requested that restrictions be placed on the defendants' ability to sell their cigarette businesses and that the defendants be compelled to run public advertisements regarding the dangers of smoking. The defendants filed a motion to dismiss the government's request for the $14 billion award, arguing that the award was barred by the February 4, 2005 appellate decision. On July 22, 2005, the District Court judge granted the motion made under Federal Rule of Civil Procedure 24 by six public interest groups to intervene in this action for the very limited purpose of being heard on the issue of permissible and appropriate remedies in this case, should the government prevail on its claims with respect to smoking cessation programs. On August 15, 2005, the parties filed their proposed findings of fact. Post-trial briefing was completed on October 9, 2005. In August 2006, the District Court entered judgment in favor of the government, finding the defendants liable for the RICO claims, but imposing no direct financial penalties on the defendants, instead ordering the defendants to make certain "corrective communications" in a variety of media and enjoining the defendants from using certain brand descriptors. Both parties appealed – the defendants filed on September 11, 2006, and the government filed on

October 16, 2006. In March 2007, the trial court denied defendants' post-trial motion for clarification of those portions of the court's remedial order prohibiting defendants from making certain statements to consumers about their products both within and outside the United States, but granted defendants' post-trial motion for clarification that the court's remedial order requiring corrective statements on display at retail points of sale do not apply outside the United States. The defendants have filed amended notices of appeal. The District Court's stay of the proceedings remains in effect pending appeal to the Court of Appeals.

In January of 2001, the Canadian Province of British Columbia enacted the Damages and Healthcare Costs Recovery Act (the "**HCCR Act**"). The HCCR Act authorizes an action by the government of British Columbia against a manufacturer of tobacco products for the recovery by the government of the present value of past and reasonably expected future healthcare expenditures incurred by the government in treating British Columbians with diseases caused by exposure to tobacco products, where such exposure was caused by a manufacturer's tort in British Columbia or a breach of a duty owed to persons in British Columbia. The HCCR Act allows the government to bring such action for expenditures related to a particular individual or on an aggregate basis for a population of persons. In an action brought on an aggregate basis, the Act does not require the government identify a particular person or to prove particular injury, healthcare costs or causation of harm with respect to any particular person. Where the government proves in an aggregate claim with respect of a type of tobacco product that a manufacturer breached a legal duty owed to persons who have been or might become exposed to the tobacco product and that exposure to the tobacco product can cause or contribute to a disease, the court is required to presume that: (1) the population of persons who were exposed to the tobacco product would not have been exposed to the product but for the breach of duty; and (2) such exposure caused or contributed to disease or risk of disease in such population of persons. In such cases, the court is required to determine on an aggregate basis the cost of healthcare benefits provided after the date of the breach of duty and to assess liability among defendants based on the proportion of the aggregate cost equal to each defendant's market share in the type of tobacco product. Statistical information and information derived from epidemiological and other relevant studies is admissible as evidence under the HCCR Act to establish causation and for quantifying damages in an action brought by the government under the HCCR Act or in an action brought by a class of persons under Canada's class action statute.

Subsequently to the enactment of the HCCR Act, the government of British Columbia brought an action under the HCCR Act against certain foreign and domestic tobacco manufacturers, including Philip Morris International, a subsidiary of Altria. The defendants challenged the constitutionality of the HCCR Act, and in a decision dated June 5, 2003, British Columbia's trial level court held that the HCCR Act was unconstitutional as exceeding the territorial jurisdiction of the Province. On appeal, British Columbia's highest court reversed the lower court in a decision dated May 20, 2004, holding that the HCCR Act was constitutional. The matter was appealed to the Canadian Supreme Court, Canada's highest court. By a unanimous decision dated September 29, 2005 the Canadian Supreme Court affirmed the lower court, holding that the HCCR Act was constitutional. In the decision, the court also vacated the stay of proceedings and the action was allowed to continue. On September 15, 2006, the British Columbia Court of Appeal unanimously ruled that the foreign defendants served ex juris are subject to British Columbia law, allowing the government to proceed with its lawsuit against them. On November 10, 2006, the ex juris defendants applied for leave to appeal the judgment to the Supreme Court of Canada. On April 5, 2007, the Supreme Court of Canada dismissed the defendants' application. While the judgment only applies to British Columbia, it is expected that other provincial governments may follow suit. It has been reported that Newfoundland has enacted, and Saskatchewan and Nova Scotia are considering enacting, legislation similar to the HCCR Act.

Other Tobacco-Related Litigation. The tobacco industry is also the target of other litigation. By way of example only, and not as an exclusive or complete list, the following are additional tobacco-related litigation:

- *Asbestos Contribution Cases.* These cases, which have been brought against cigarette manufacturers on behalf of former asbestos manufacturers, their personal injury settlement trusts and insurers, seek, among other things, contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking. Two of the cases were dismissed.

- *Cigarette Price-Fixing Cases.* According to one OPM, as of May 1, 2007, there were two cases pending against domestic cigarette manufacturers in Kansas (*Smith v. Philip Morris*) and New Mexico (*Romero v. Philip Morris*), alleging that defendants conspired to fix cigarette prices in violation of antitrust laws. The plaintiffs' motions for class certification have been granted in both cases. In February 2005, the New Mexico Court of Appeals affirmed the class certification decision in the Romero case. On April 19, 2005, the defendants filed motions for summary judgment. In June 2006, the court granted defendant's motion, and the plaintiffs appealed on August 14, 2006. In the Smith case, on July 14, 2006, the court issued an order confirming that fact discovery is closed, except for

such privilege issues that the court determines, based on a Special Master's report, justify further limited fact discovery. Expert discovery, as necessary, will begin in early 2007.

- *Cigarette Contraband Cases.* In May 2001 and August 2001, various governmental entities of Colombia, the European Community and ten member states filed suits in the U.S. against certain PMs, alleging that defendants sold to distributors cigarettes that would be illegally imported into various jurisdictions. The claims asserted in these cases include negligence, negligent misrepresentation, fraud, unjust enrichment, violations of RICO and its state-law equivalents and conspiracy. Plaintiffs in these cases seek actual damages, treble damages and undisclosed injunctive relief. In February 2002, the trial court granted defendants' motions to dismiss all of the actions. Plaintiffs in each case have appealed. In January 2004, the U.S. Court of Appeals for the Second Circuit affirmed the dismissals of the cases. In April 2004, plaintiffs petitioned the U.S. Supreme Court for further review. The European Community and the 10 member states moved to dismiss their petition in July 2004 following an agreement entered into among Philip Morris, the European Commission and 10 member states of the European Community. The terms of this cooperation agreement provide for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts and resolve all disputes between the parties on these issues. In May 2005, the U.S. Supreme Court granted the petitions for review, vacated the judgment of the Second Circuit Court of Appeals and remanded the case to that court for further review in light of the Supreme Court's recent decision in *U.S. v. Pasquantino*. On September 13, 2005, the Second Circuit Court of Appeals found that *Pasquantino* was inapplicable to the case and affirmed its earlier decision that the revenue rule bars foreign sovereigns' civil claims for recovery of lost tax revenue and law enforcement costs related to cigarette smuggling. In January 2006, the U.S. Supreme Court rejected the European Union's petition for review.

- *Patent Litigation.* In 2001 and 2002, Star Scientific, Inc. ("**Star**") filed two patent infringement actions against Reynolds Tobacco in the U.S. District Court for the District of Maryland. Such actions have been consolidated. Reynolds Tobacco filed various motions for summary judgment, which were all denied. Reynolds Tobacco has also filed counterclaims seeking a declaration that the claims of the two Star patents in dispute are invalid, unenforceable and not infringed by Reynolds Tobacco. Between January 31, 2005 and February 8, 2005, the District Court held a first bench trial on Reynolds Tobacco's affirmative defense and counterclaim based upon inequitable conduct. The District Court has not yet issued a ruling on this issue. Additionally, in response to the court's invitation, Reynolds Tobacco filed two summary judgment motions on January 20, 2005. The District Court has indicated that it will rule on Reynolds Tobacco's two pending summary judgment motions and the issue of inequitable conduct at the same time. The District Court has not yet set a trial date for the remaining issues in the case.

- *Vermont Litigation.* On July 22, 2005, Vermont announced that it had sued Reynolds Tobacco in the Vermont Superior Court for using false and misleading advertising to promote its "Eclipse" brand of cigarettes. The lawsuit charges that Reynolds Tobacco's advertising, which claims that smoking Eclipse cigarettes is less harmful than smoking other brands of cigarettes, violated Vermont's consumer protection statutes. The State of Vermont is seeking declaratory, injunctive, and monetary relief. Reynolds Tobacco has answered the complaint. Discovery is underway. No trial date has been set. According to the Vermont Attorney General, the offices of Attorneys General across the country, including California, Connecticut, the District of Columbia, Idaho, Illinois, Iowa, Maine, New York, and Tennessee, have actively participated in the investigation leading up to this lawsuit and will continue to assist Vermont in it.

- *Foreign Lawsuits.* Lawsuits have been filed in foreign jurisdictions against certain OPMs and/or their subsidiaries and affiliates, including individual smoking and health actions, class actions and healthcare cost recovery suits.

The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon the Corporation's examination or analysis of the court records of the cases mentioned or of any other court records. It is based on SEC filings by OPMs and on other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2007 Bonds are referred to the reports filed with the SEC by certain of the OPMs and applicable court records for additional descriptions thereof.

Litigation is subject to many uncertainties. In its SEC filing, one OPM states that it is not possible to predict the outcome of litigation pending against it, and that it is unable to make a meaningful estimate of the

amount or range of loss that could result from an unfavorable outcome of pending litigation, and that it is possible that its business, volume, results of operations, cash flows, or financial position could be materially affected by an unfavorable outcome or settlement of certain pending litigation or by the enactment of federal or state tobacco legislation. It can be expected that at any time and from time to time there will be developments in the litigation presently pending and filing of new litigation that could adversely affect the business of the PMs and the market for or prices of securities such as the Series 2007 Bonds payable from tobacco settlement payments made under the MSA.

GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT

The following information has been extracted from the Global Insight Cigarette Consumption Report, a copy of which is attached hereto as Appendix A. This summary does not purport to be complete and the Global Insight Cigarette Consumption Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The Global Insight Cigarette Consumption Report forecasts future United States domestic cigarette consumption. The MSA payments are based in part on cigarettes shipped in and to the United States. Cigarette shipments and cigarette consumption may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

General

Global Insight (USA), Inc., formerly known as DRI•WEFA, Inc., has prepared a report dated June 21, 2007 on the consumption of cigarettes in the United States from 2007 through 2052 entitled, "A Forecast of U.S. Cigarette Consumption (2007-2052) for the Tobacco Settlement Financing Corporation." Global Insight is an internationally recognized econometric and consulting firm of over 325 economists in 23 offices worldwide. Global Insight is a privately held subsidiary of Global Insight (USA), Inc., a publicly traded company which is a provider of financial, economic and market research information.

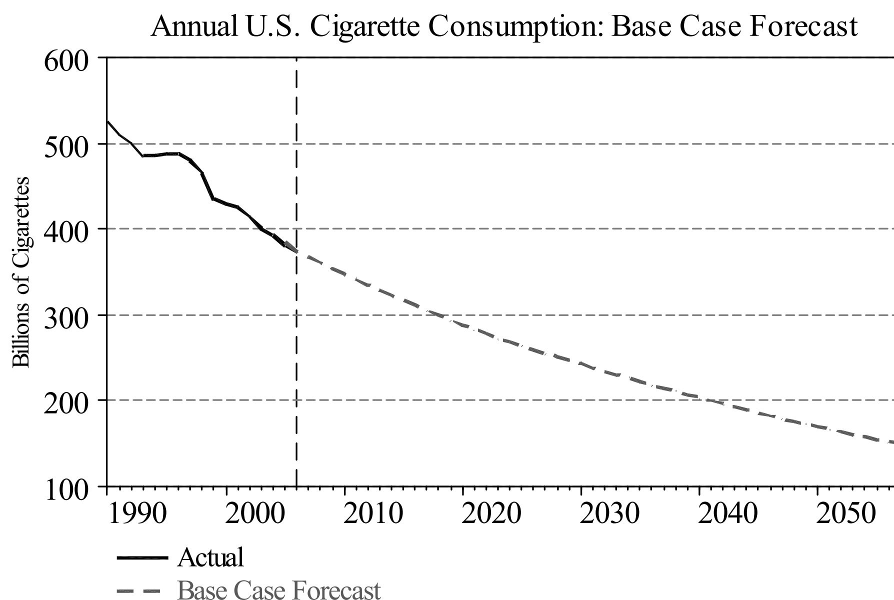
Global Insight has developed a cigarette consumption model based on historical United States data between 1965 and 2003. Global Insight constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building this cigarette consumption model (real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places, and the trend over time in individual behavior and preferences), Global Insight employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The multivariate regression analysis showed: (i) long run price elasticity of demand of -0.33; (ii) income elasticity of demand of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.40% per year holding other recognized significant factors constant.

Global Insight's model, coupled with its long term forecast of the United States economy, was then used to project total United States cigarette consumption from 2007 through 2052 (the "**Base Case Forecast**"). The Base Case Forecast indicates that the total United States cigarette consumption in 2052 will be 163 billion cigarettes (approximately 8 billion packs), a 59% decline from the 2003 level. After 2005, the rate of decline in total cigarette consumption is projected to moderate and average less than 2% per year. From 2004 through 2052 the average annual rate of decline is projected to be 1.81%. On a per capita basis, consumption is forecast to fall at an average annual rate of 2.52%. Total consumption of cigarettes in the United States is forecast to fall from an estimated 381 billion in 2005 to 373 billion in 2006, to under 300 billion by 2018, and to under 200 billion by 2041, as set forth in the following table. The Global Insight Cigarette Consumption Report states that Global Insight believes that the assumptions on which the Base Case Forecast is based are reasonable.

Global Insight Base Case Forecast of Cigarette Consumption

Year	Cigarettes (billions)	Year	Cigarettes (billions)
2004	393.00	2029	246.48
2005	381.00	2030	242.34
2006	373.34	2031	238.16
2007	366.86	2032	234.12
2008	360.59	2033	230.14
2009	353.96	2034	226.19
2010	347.62	2035	221.88
2011	341.27	2036	217.98
2012	334.93	2037	214.19
2013	328.54	2038	210.53
2014	322.14	2039	206.72
2015	316.45	2040	203.02
2016	310.82	2041	199.44
2017	305.06	2042	195.80
2018	299.41	2043	192.24
2019	293.71	2044	188.76
2020	288.43	2045	185.34
2021	283.17	2046	182.02
2022	278.11	2047	178.77
2023	273.09	2048	175.61
2024	268.43	2049	172.52
2025	263.84	2050	169.46
2026	259.36	2051	166.45
2027	254.97	2052	163.47
2028	250.69		

The following graph displays the projected time trend of cigarette consumption in the United States:



The Global Insight Cigarette Consumption Report also presents alternative forecasts that project higher and lower paths of cigarette consumption, predicting that by 2052, total United States consumption could be as low as 134 billion or as high as 176 billion cigarettes. In addition, the Global Insight Cigarette Consumption Report presents scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of

consumption. In one such scenario, Global Insight projects that assuming a 4% decline per year total United States consumption could be as low as 56 billion cigarettes by 2052.

Comparison with Prior Forecasts

In May 2002 Global Insight, then DRI•WEFA presented a similar study, “A Forecast of U.S. Cigarette Consumption (2001-2043).” Its long run conclusions were similar to this study. The current forecast of consumption for the year 2043 is 4.5% less than that of the original study, 192.2 billion vs. 206.6 billion.

Historical Cigarette Consumption

The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco and Firearms) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2004.

The following table sets forth United States domestic cigarette consumption for the nine years ended December 31, 2006. The data in this table vary from statistics on cigarette shipments in the United States. While the Global Insight Cigarette Consumption Report is based on consumption, payments under the MSA are computed based in part on shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

U.S. Cigarette Consumption

Year Ended December 31	Consumption (Billions of Cigarettes)	Percentage Change
2006	373(est.)	-2.01%
2005	381(est.)	-3.05
2004	393(est.)	-1.75
2003	400	-3.61
2002	415	-2.35
2001	425	-1.16
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13

Factors Affecting Cigarette Consumption

Most empirical studies have found a common set of variables that are relevant in building a model of cigarette demand. These conventional analyses usually evaluate one or more of the following factors: (i) general population growth, (ii) price increases, (iii) changes in disposable income, (iv) youth consumption, (v) trends over time, (vi) smoking bans in public places, (vii) nicotine dependence, and (viii) health warnings. While some of these factors were not found to have a measurable impact on changes in demand for cigarettes, all of these factors are thought to affect smoking in some manner and to be incorporated into current levels of consumption. Since 1964 there has been a significant decline in United States adult per capita cigarette consumption. The 1964 Surgeon General's health warning and numerous subsequent health warnings, together with the increased health awareness of the population over the past 30 years, may have contributed to decreases in cigarette consumption levels. If, as assumed by Global Insight, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. Global Insight's analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables which are difficult to quantify.

METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS

Introduction

The following discussion describes the methodology and assumptions used to calculate a forecast of Pledged TSRs to be received by the Corporation (the "**Collection Methodology and Assumptions**"), as well as the methodology and assumptions used to structure the schedules of Accreted Value and to calculate the projected Turbo Redemptions for the Series 2007 Bonds (the "**Structuring Assumptions**"). For sensitivity analyses which evaluate the impact of different consumption levels on Turbo Redemptions, see "-Effect of Changes in Consumption Level on Turbo Redemptions" below. The assumptions are only assumptions and no guarantee can be made as to the ultimate outcome of certain events assumed here. If actual results are different from those assumed, it could have a material effect on the forecast of Pledged TSRs and Residual Pledged TSRs as well as assumed Turbo Redemptions.

Collection Methodology and Assumptions

In calculating a forecast of Residual Pledged TSRs to be received by the Trustee, the forecast of cigarette consumption in the United States developed by Global Insight and described as the Base Case Forecast, was applied to calculate Annual Payments and Strategic Contribution Fund Payments to be made by the PMs pursuant to the MSA. The calculation of payments required to be made was performed in accordance with the terms of the MSA; however, as described below, certain assumptions were made with respect to consumption of cigarettes in the United States and the applicability of certain adjustments and offsets to such payments set forth in the MSA. In addition, it was assumed that the PMs make all payments required to be made by them pursuant to the MSA, and that the relative market share for each of the PMs remains constant throughout the forecast period at 85.27% for the OPMs, 9.13% for the SPMs and 5.6% for the NPMs.† It was further assumed that each company that is currently a PM remains such throughout the term of the Series 2007 Bonds.

In applying the consumption forecast from the Global Insight Cigarette Consumption Report, it was assumed that United States consumption, which was forecasted by Global Insight, was equal to the number of cigarettes shipped in and to the United States, the District of Columbia and Puerto Rico, which is the number that is applied to determine the Volume Adjustment. The Global Insight Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time. Global Insight's Base Case Forecast for United States cigarette consumption is set forth herein in Appendix A – "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached hereto. See Appendix A for a discussion of the assumptions underlying the projections of cigarette consumption contained in the Global Insight Cigarette Consumption Report.

Annual Payments

In accordance with the Collection Methodology and Assumptions, the amount of Annual Payments to be made by the PMs was calculated by applying the adjustments applicable to the Annual Payments in the order, and in the amounts, set out in the MSA, as follows:

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Annual Payments set forth in the MSA. Inflation was assumed to be at a rate of 3.4% for 2000, 3.0% for 2001 through 2003, 3.256% for 2004, 3.416% for 2005 and 3.0% for 2006. Thereafter, the rate of inflation was assumed to be the minimum provided in the MSA, at a rate of 3.0% per year, compounded annually, for the rest of the forecast period.

Volume Adjustment. Next, the annual amounts calculated for each year after application of the Inflation Adjustment were adjusted for the Volume Adjustment by applying the Global Insight Base Case Forecast for United States cigarette consumption to the market share of the OPMs for the prior year. No add back or benefit was assumed from any Income Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—

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† The aggregate market share information utilized in the bond structuring assumptions may differ materially from the market share information used by the MSA Auditor in calculating adjustments to Annual Payments and Strategic Contribution Fund Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments" herein.

Adjustments to Payments—Volume Adjustment" for a description of the formula used to calculate the Volume Adjustment.

Previously Settled States Reduction. Next, the annual amounts calculated for each year after application of the Inflation Adjustment and the Volume Adjustment were reduced by the Previously Settled States Reduction which applies only to the payments owed by the OPMs. The Previously Settled States Reduction is as follows for each year of the following period:

2000 through 2007	**12.4500000%**
2008 through 2017	**12.2373756%**
2018 and after	**11.0666667%**

Non-Settling States Reduction. The Non-Settling States Reduction was not applied to the Annual Payments because such reduction has no effect on the amount of payments to be received by states that remain parties to the MSA. Thus, the Collection Methodology and Assumptions include an assumption that the State will remain a party to the MSA.

NPM Adjustment. The NPM Adjustment will not apply to the Annual Payments payable to any state that enacts and diligently enforces a Qualifying Statute so long as such statute is not held to be unenforceable. The Collection Methodology and Assumptions include an assumption that the State will diligently enforce a Qualifying Statute that is not held to be unenforceable. For a discussion of the State's Qualifying Statute, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" and "—MSA Provisions Relating to Model/Qualifying Statutes—*State Qualifying Statute*" herein. Should a PM be determined with finality to be entitled to an NPM adjustment in a future year due to a non-diligent enforcement of the Qualifying Statute by the State or as a result of a settlement of an NPM Adjustment dispute, the payments by the PMs under the MSA, the amounts of Pledged TSRs available to the Corporation to make Turbo Redemption on the 2002 Indenture Bonds and the amounts of Residual Pledged TSRs available to the Corporation to make Turbo Redemptions on the Series 2007 Bonds, and pay the interest or Accreted Value of the Series 2007 Bonds could be reduced. In such a situation, the estimated redemption schedules set forth under Appendix H – "DEFEASANCE TURBO SCHEDULES" attached hereto may not be realized. See "RISK FACTORS- Other Potential Payment Decreases Under the Terms of the MSA – NPM Adjustment" herein.

Offset for Miscalculated or Disputed Payments. The Collection Methodology and Assumptions include an assumption that there will be no adjustments to the Annual Payments due to miscalculated or disputed payments. However, a deposit into the Disputed Payments Account or withholding of payment by a PM based upon a claim of entitlement to an adjustment to Annual Payments due in one or more future years could reduce the amounts of Residual Pledged TSRs available to the Corporation to make Turbo Redemptions and pay principal or interest on the 2002 Indenture Bonds or the Accreted Value of the Series 2007 Bonds. See "RISK FACTORS- Other Potential Payment Decreases Under the Terms of the MSA –Disputed or Recalculated Payments and Disputes under the Terms of the MSA" herein.

Offset for Claims-Over. The Collection Methodology and Assumptions include an assumption that the Offset for Claims-Over will not apply.

Litigating Releasing Parties Offset. The Collection Methodology and Assumptions include an assumption that the Litigating Releasing Parties Offset will have no effect on payments.

Subsequent Participating Manufacturers. The Collection Methodology and Assumptions assume that the relative market share of the SPMs remains constant at 9.13%. Because the 9.13% market share is greater than 3.125% (125% of 2.5%, the SPMs' estimated 1997 market share), the Collection Methodology and Assumptions assume that the SPMs are required to make Annual Payments in each year.

State Allocation Percentage. The amount of Annual Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled States Reduction for each year was multiplied by the State Allocation Percentage (0.7189054%) in order to determine the amount of Annual Payments to be made by the PMs in each year to be allocated to the Rhode Island State-Specific Account.

The following table shows the projection of Pledged TSRs to be received by the 2002 Indenture Trustee or Residual Pledged TSRs to be received by the Trustee, as the case may be, from Annual Payments from 2008 through 2052, calculated in accordance with the Collection Methodology and Assumptions.

Projection of Annual Payments to be Received by the 2002 Indenture Trustee or the Trustee, as the case may be (assuming 100% of TSRs are pledged)

Date	Global Insight Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Annual Payments	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Subtotal	Rhode Island Allocation	Annual Payments to Rhode Island	Total OPM Payments to Trustees	SPM Payments to Trustees	Total Annual Payments to Trustees
4/25/2007	366,860,000,000	312,821,522,000										
4/25/2008	360,590,000,000	307,475,093,000	$8,139,000,000	$2,591,450,817	$(3,599,957,975)	$(872,585,191)	$6,257,907,651	0.7189054%	$44,988,436	$44,988,436	$3,610,007	$48,598,443
4/25/2009	353,960,000,000	301,821,692,000	8,139,000,000	2,913,364,342	(3,829,701,983)	(883,864,321)	6,338,798,038	0.7189054%	45,569,961	45,569,961	3,656,670	49,226,632
4/25/2010	347,620,000,000	296,415,574,000	8,139,000,000	3,244,935,272	(4,077,190,533)	(894,153,798)	6,412,590,941	0.7189054%	46,100,463	46,100,463	3,699,239	49,799,702
4/25/2011	341,270,000,000	291,000,929,000	8,139,000,000	3,586,453,330	(4,330,107,777)	(904,996,212)	6,490,349,341	0.7189054%	46,659,472	46,659,472	3,744,096	50,403,568
4/25/2012	334,930,000,000	285,594,811,000	8,139,000,000	3,938,216,930	(4,594,742,761)	(915,658,468)	6,566,815,701	0.7189054%	47,209,193	47,209,193	3,788,207	50,997,400
4/25/2013	328,540,000,000	280,146,058,000	8,139,000,000	4,300,533,438	(4,871,140,205)	(926,172,707)	6,642,220,526	0.7189054%	47,751,282	47,751,282	3,831,706	51,582,988
4/25/2014	322,140,000,000	274,688,778,000	8,139,000,000	4,673,719,441	(5,161,111,715)	(936,355,977)	6,715,251,749	0.7189054%	48,276,307	48,276,307	3,873,836	52,150,143
4/25/2015	316,450,000,000	269,836,915,000	8,139,000,000	5,058,101,024	(5,464,329,340)	(946,288,315)	6,786,483,369	0.7189054%	48,788,395	48,788,395	3,914,927	52,703,323
4/25/2016	310,820,000,000	265,036,214,000	8,139,000,000	5,454,014,055	(5,764,139,800)	(958,048,748)	6,870,825,507	0.7189054%	49,394,736	49,394,736	3,963,582	53,358,317
4/25/2017	305,060,000,000	260,124,662,000	8,139,000,000	5,861,804,477	(6,075,545,171)	(969,843,749)	6,955,415,557	0.7189054%	50,002,858	50,002,858	4,012,379	54,015,237
4/25/2018	299,410,000,000	255,306,907,000	9,000,000,000	6,946,364,111	(7,081,172,884)	(981,081,165)	7,884,110,062	0.7189054%	56,679,293	56,679,293	4,488,245	61,167,538
4/25/2019	293,710,000,000	250,446,517,000	9,000,000,000	7,424,755,034	(7,456,641,516)	(992,471,232)	7,975,642,286	0.7189054%	57,337,323	57,337,323	4,540,353	61,877,676
4/25/2020	288,430,000,000	245,944,261,000	9,000,000,000	7,917,497,685	(7,849,751,268)	(1,003,497,273)	8,064,249,144	0.7189054%	57,974,323	57,974,323	4,590,795	62,565,117
4/25/2021	283,170,000,000	241,459,059,000	9,000,000,000	8,425,022,616	(8,246,879,262)	(1,015,714,534)	8,162,428,820	0.7189054%	58,680,142	58,680,142	4,646,686	63,326,828
4/25/2022	278,110,000,000	237,144,397,000	9,000,000,000	8,947,773,294	(8,660,139,536)	(1,027,831,472)	8,259,802,286	0.7189054%	59,380,165	59,380,165	4,702,119	64,082,283
4/25/2023	273,090,000,000	232,863,843,000	9,000,000,000	9,486,206,493	(9,084,277,817)	(1,040,480,110)	8,361,448,567	0.7189054%	60,110,905	60,110,905	4,759,983	64,870,889
4/25/2024	268,430,000,000	228,890,261,000	9,000,000,000	10,040,792,688	(9,524,732,212)	(1,053,110,696)	8,462,949,780	0.7189054%	60,840,603	60,840,603	4,817,766	65,658,369
4/25/2025	263,840,000,000	224,976,368,000	9,000,000,000	10,612,016,469	(9,971,034,240)	(1,066,935,370)	8,574,046,859	0.7189054%	61,639,286	61,639,286	4,881,011	66,520,297
4/25/2026	259,360,000,000	221,156,272,000	9,000,000,000	11,200,376,963	(10,433,057,928)	(1,080,916,643)	8,686,402,391	0.7189054%	62,447,016	62,447,016	4,944,972	67,391,988
4/25/2027	254,970,000,000	217,412,919,000	9,000,000,000	11,806,388,272	(10,909,808,249)	(1,095,221,526)	8,801,358,496	0.7189054%	63,273,442	63,273,442	5,010,414	68,283,856
4/25/2028	250,690,000,000	213,763,363,000	9,000,000,000	12,430,579,920	(11,402,385,351)	(1,109,786,869)	8,918,407,700	0.7189054%	64,114,915	64,114,915	5,077,048	69,191,962
4/25/2029	246,480,000,000	210,173,496,000	9,000,000,000	13,073,497,317	(11,910,432,522)	(1,124,712,507)	9,038,352,288	0.7189054%	64,977,203	64,977,203	5,145,329	70,122,532
4/25/2030	242,340,000,000	206,643,318,000	9,000,000,000	13,735,702,237	(12,435,904,386)	(1,139,844,299)	9,159,953,552	0.7189054%	65,851,401	65,851,401	5,214,554	71,065,955
4/25/2031	238,160,000,000	203,079,032,000	9,000,000,000	14,417,773,304	(12,979,305,302)	(1,155,190,462)	9,283,277,539	0.7189054%	66,737,984	66,737,984	5,284,760	72,022,743
4/25/2032	234,120,000,000	199,634,124,000	9,000,000,000	15,120,306,503	(13,545,812,969)	(1,170,243,955)	9,404,249,580	0.7189054%	67,607,658	67,607,658	5,353,627	72,961,285
4/25/2033	230,140,000,000	196,240,378,000	9,000,000,000	15,843,915,698	(14,128,519,211)	(1,185,837,215)	9,529,559,272	0.7189054%	68,508,516	68,508,516	5,424,962	73,933,479
4/25/2034	226,190,000,000	192,872,213,000	9,000,000,000	16,589,233,169	(14,731,299,242)	(1,201,611,358)	9,656,322,569	0.7189054%	69,419,824	69,419,824	5,497,126	74,916,950
4/25/2035	221,880,000,000	189,197,076,000	9,000,000,000	17,356,910,164	(15,356,141,271)	(1,217,418,428)	9,783,350,465	0.7189054%	70,333,035	70,333,035	5,569,440	75,902,475
4/25/2036	217,980,000,000	185,871,546,000	9,000,000,000	18,147,617,469	(16,022,385,387)	(1,231,192,354)	9,894,039,728	0.7189054%	71,128,786	71,128,786	5,632,453	76,761,239
4/25/2037	214,190,000,000	182,639,813,000	9,000,000,000	18,962,045,993	(16,694,642,570)	(1,246,925,983)	10,020,477,441	0.7189054%	72,037,753	72,037,753	5,704,431	77,742,185
4/25/2038	210,530,000,000	179,518,931,000	9,000,000,000	19,800,907,373	(17,387,249,229)	(1,263,111,505)	10,150,546,639	0.7189054%	72,972,828	72,972,828	5,778,477	78,751,304
4/25/2039	206,720,000,000	176,270,144,000	9,000,000,000	20,664,934,594	(18,099,612,004)	(1,279,895,704)	10,285,426,887	0.7189054%	73,942,489	73,942,489	5,855,261	79,797,750
4/25/2040	203,020,000,000	173,115,154,000	9,000,000,000	21,554,882,632	(18,847,119,973)	(1,295,659,071)	10,412,103,587	0.7189054%	74,853,175	74,853,175	5,927,375	80,780,550
4/25/2041	199,440,000,000	170,062,488,000	9,000,000,000	22,471,529,111	(19,617,106,862)	(1,311,889,400)	10,542,532,850	0.7189054%	75,790,838	75,790,838	6,001,625	81,792,463
4/25/2042	195,800,000,000	166,958,660,000	9,000,000,000	23,415,674,984	(20,409,496,702)	(1,328,683,734)	10,677,494,549	0.7189054%	76,761,085	76,761,085	6,078,456	82,839,541
4/25/2043	192,240,000,000	163,923,048,000	9,000,000,000	24,388,145,234	(21,235,293,971)	(1,344,915,544)	10,807,935,720	0.7189054%	77,698,834	77,698,834	6,152,713	83,851,547
4/25/2044	188,760,000,000	160,955,652,000	9,000,000,000	25,389,789,591	(22,087,437,172)	(1,361,460,339)	10,940,892,081	0.7189054%	78,654,664	78,654,664	6,228,402	84,883,066
4/25/2045	185,340,000,000	158,039,418,000	9,000,000,000	26,421,483,279	(22,966,618,843)	(1,378,338,335)	11,076,526,101	0.7189054%	79,629,744	79,629,744	6,305,616	85,935,360
4/25/2046	182,020,000,000	155,208,454,000	9,000,000,000	27,484,127,777	(23,874,826,939)	(1,395,429,297)	11,213,871,541	0.7189054%	80,617,128	80,617,128	6,383,803	87,000,931
4/25/2047	178,770,000,000	152,437,179,000	9,000,000,000	28,578,651,610	(24,810,255,640)	(1,413,035,825)	11,355,360,145	0.7189054%	81,634,297	81,634,297	6,464,350	88,098,647
4/25/2048	175,610,000,000	149,742,647,000	9,000,000,000	29,706,011,159	(25,775,562,731)	(1,430,969,630)	11,499,478,797	0.7189054%	82,670,374	82,670,374	6,546,393	89,216,767
4/25/2049	172,520,000,000	147,107,804,000	9,000,000,000	30,867,191,493	(26,770,155,434)	(1,449,405,328)	11,647,630,731	0.7189054%	83,735,446	83,735,446	6,630,733	90,366,179
4/25/2050	169,460,000,000	144,498,542,000	9,000,000,000	32,063,207,238	(27,796,175,822)	(1,468,218,148)	11,798,813,268	0.7189054%	84,822,306	84,822,306	6,716,797	91,539,103
4/25/2051	166,450,000,000	141,931,915,000	9,000,000,000	33,295,103,455	(28,857,435,136)	(1,487,101,965)	11,950,566,354	0.7189054%	85,913,267	85,913,267	6,803,187	92,716,454
4/25/2052			9,000,000,000	34,563,956,559	(29,953,526,731)	(1,506,220,905)	12,104,208,922	0.7189054%	87,017,812	87,017,812	6,890,652	93,908,464

Strategic Contribution Fund Payments

In accordance with the Collection Methodology and Assumptions, the amount of Strategic Contribution Fund Payments to be made by the PMs was calculated by applying the adjustments applicable to the Strategic Contribution Fund Payments in the amounts, set out in the MSA, as follows:

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Strategic Contribution Fund Payments set forth in the MSA. Inflation was assumed to be at a rate of 3.4% for 2000, 3.0% for 2001 through 2003, 3.256% for 2004, 3.416% for 2005, and 3.0% for 2006. Thereafter, the rate of inflation was assumed to be the minimum provided in the MSA, at a rate of 3.0% per year, compounded annually, for the rest of the forecast period.

Volume Adjustment. Next, the Strategic Contribution Fund Payments calculated for each year after application of the Inflation Adjustment was adjusted for the Volume Adjustment by applying the Global Insight Base Case Forecast for United States cigarette consumption to the market share of the OPMs for the prior year. No add back or benefit was assumed from any Income Adjustment as it does not apply to Strategic Contribution Fund Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—Volume Adjustment" for a description of the formula used to calculate the Volume Adjustment.

*Non-Settling States Red*uction. The Non-Settling States Reduction was not applied to the Strategic Contribution Fund Payments because such reduction has no effect on the amount of payments to be received by states that remain parties to the MSA. Thus, the Collection Methodology and Assumptions include an assumption that the State will remain a party to the MSA.

NPM Adjustment. The NPM Adjustment will not apply to the Strategic Contribution Fund Payments payable to any state that enacts and diligently enforces a Qualifying Statute so long as such statute is not held to be unenforceable. The Collection Methodology and Assumptions include an assumption that the State will diligently enforce a Qualifying Statute that it is not held to be unenforceable. For a discussion of Rhode Island's Qualifying Statute, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—MSA Provisions Relating to Model/Qualifying Statutes—State Qualifying Statute" herein. Should a PM be determined with finality to be entitled to an NPM adjustment in a future year due to a non-diligent enforcement of the Qualifying Statute by the State or as a result of a settlement of an NPM Adjustment dispute, the payments by the PMs under the MSA and the amounts of Pledged TSRs to the Corporation to make Turbo Redemption on the 2002 Indenture Bonds and the Residual Pledged TSRs available to the Corporation to make Turbo Redemptions on the Series 2007 Bonds, and pay Accreted Value of the Series 2007 Bonds could be reduced. In such a situation, the estimated redemption schedules set forth under Appendix H – "DEFEASANCE TURBO SCHEDULES" attached hereto may not be realized. See "RISK FACTORS- Other Potential Payment Decreases Under the Terms of the MSA – NPM Adjustment" herein.

Offset for Miscalculated or Disputed Payments. The Collection Methodology and Assumptions include an assumption that there will be no adjustments to the Strategic Contribution Fund Payments due to miscalculated or disputed payments. However, a deposit into the Disputed Payments Account or withholding of payment by a PM based upon a claim of entitlement to an adjustment to Strategic Contribution Fund Payments due in one or more future years could reduce the amounts of Pledged TSRs to the Corporation to make Turbo Redemptions or principal and interest on the 2002 Indenture Bonds and the Residual Pledged TSRs available to the Corporation to pay the Accreted Value of the Series 2007 Bonds. See "RISK FACTORS- Other Potential Payment Decreases Under the Terms of the MSA –Disputed or Recalculated Payments and Disputes under the Terms of the MSA" herein.

Litigating Releasing Parties Offset. The Collection Methodology and Assumptions include an assumption that the Litigating Releasing Parties Offset will have no effect on payments.

Offset for Claims-Over. The Collection Methodology and Assumptions include an assumption that the Offset for Claims-Over will not apply.

*Subsequent Participating Manufactu*rers. The Collection Methodology and Assumptions assume that the relative market share of the SPMs remains constant at 9.13%. Because the 9.13% market share is greater than 3.125% (125% of 2.5%, the SPMs' estimated 1997 market share), Collection Methodology and Assumptions assume that the SPMs are required to make Strategic Contribution Fund Payments in each year.

State Allocation Percentage. The amount of Strategic Contribution Fund Payments, after application of the Inflation Adjustment and the Volume Adjustment for each year was multiplied by the State Allocation Percentage (1.0954758%) in order to determine the amount of Strategic Contribution Fund Payments to be made by the PMs in each year to be allocated to the Rhode Island State-Specific Account.

The following table shows the projection of Pledged TSRs to be received by the 2002 Indenture Trustee or Residual Pledged TSRs to be received by the Trustee, as the case may be, from Strategic Contribution Fund Payments and total payments (including Annual Payments) from 2008 through 2052, calculated in accordance with the Collection Methodology and Assumptions.

Projections of Strategic and Total Payments to be Received by the 2002 Indenture Trustee or the Trustee, as the case may be (assuming 100% of TSRs are pledged)

Date	Global Insight Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Strategic Contribution Payments	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Subtotal	Rhode Island Allocation	OPM Payments to Trustees	SPM Payments to Trustees	Total Strategic Contribution Payments to Trustees	Total Annual Payments to Trustees	Total Payments to Trustees
4/25/2007	366,860,000,000	312,821,522,000											
4/25/2008	360,590,000,000	307,475,093,000	$861,000,000	$274,141,682	$(380,828,580)	$0	$754,313,102	1.0954758%	$8,263,317	$581,931	$8,845,248	$48,598,443	$57,443,691
4/25/2009	353,960,000,000	301,821,692,000	861,000,000	308,195,933	(405,132,499)	0	764,063,434	1.0954758%	8,370,130	589,453	8,959,583	49,226,632	58,186,214
4/25/2010	347,620,000,000	296,415,574,000	861,000,000	343,271,811	(431,313,558)	0	772,958,253	1.0954758%	8,467,571	596,315	9,063,885	49,799,702	58,863,587
4/25/2011	341,270,000,000	291,000,929,000	861,000,000	379,399,965	(458,068,902)	0	782,331,063	1.0954758%	8,570,247	603,546	9,173,793	50,403,568	59,577,361
4/25/2012	334,930,000,000	285,594,811,000	861,000,000	416,611,964	(486,063,831)	0	791,548,134	1.0954758%	8,671,218	610,656	9,281,875	50,997,400	60,279,274
4/25/2013	328,540,000,000	280,146,058,000	861,000,000	454,940,323	(515,303,074)	0	800,637,249	1.0954758%	8,770,787	617,668	9,388,456	51,582,988	60,971,444
4/25/2014	322,140,000,000	274,688,778,000	861,000,000	494,418,533	(545,978,276)	0	809,440,257	1.0954758%	8,867,222	624,460	9,491,682	52,150,143	61,641,825
4/25/2015	316,450,000,000	269,836,915,000	861,000,000	535,081,089	(578,054,744)	0	818,026,345	1.0954758%	8,961,281	631,084	9,592,364	52,703,323	62,295,687
4/25/2016	310,820,000,000	265,036,214,000	861,000,000	576,963,521	(609,770,779)	0	828,192,743	1.0954758%	9,072,651	638,927	9,711,578	53,358,317	63,069,895
4/25/2017	305,060,000,000	260,124,662,000	861,000,000	620,102,427	(642,713,404)	0	838,389,023	1.0954758%	9,184,349	646,793	9,831,142	54,015,237	63,846,379
4/25/2018	299,410,000,000	255,306,907,000	0	0	0	0	0	1.0954758%	0	0	0	61,167,538	61,167,538
4/25/2019	293,710,000,000	250,446,517,000	0	0	0	0	0	1.0954758%	0	0	0	61,877,676	61,877,676
4/25/2020	288,430,000,000	245,944,261,000	0	0	0	0	0	1.0954758%	0	0	0	62,565,117	62,565,117
4/25/2021	283,170,000,000	241,459,059,000	0	0	0	0	0	1.0954758%	0	0	0	63,326,828	63,326,828
4/25/2022	278,110,000,000	237,144,397,000	0	0	0	0	0	1.0954758%	0	0	0	64,082,283	64,082,283
4/25/2023	273,090,000,000	232,863,843,000	0	0	0	0	0	1.0954758%	0	0	0	64,870,889	64,870,889
4/25/2024	268,430,000,000	228,890,261,000	0	0	0	0	0	1.0954758%	0	0	0	65,658,369	65,658,369
4/25/2025	263,840,000,000	224,976,368,000	0	0	0	0	0	1.0954758%	0	0	0	66,520,297	66,520,297
4/25/2026	259,360,000,000	221,156,272,000	0	0	0	0	0	1.0954758%	0	0	0	67,391,988	67,391,988
4/25/2027	254,970,000,000	217,412,919,000	0	0	0	0	0	1.0954758%	0	0	0	68,283,856	68,283,856
4/25/2028	250,690,000,000	213,763,363,000	0	0	0	0	0	1.0954758%	0	0	0	69,191,962	69,191,962
4/25/2029	246,480,000,000	210,173,496,000	0	0	0	0	0	1.0954758%	0	0	0	70,122,532	70,122,532
4/25/2030	242,340,000,000	206,643,318,000	0	0	0	0	0	1.0954758%	0	0	0	71,065,955	71,065,955
4/25/2031	238,160,000,000	203,079,032,000	0	0	0	0	0	1.0954758%	0	0	0	72,022,743	72,022,743
4/25/2032	234,120,000,000	199,634,124,000	0	0	0	0	0	1.0954758%	0	0	0	72,961,285	72,961,285
4/25/2033	230,140,000,000	196,240,378,000	0	0	0	0	0	1.0954758%	0	0	0	73,933,479	73,933,479
4/25/2034	226,190,000,000	192,872,213,000	0	0	0	0	0	1.0954758%	0	0	0	74,916,950	74,916,950
4/25/2035	221,880,000,000	189,197,076,000	0	0	0	0	0	1.0954758%	0	0	0	75,902,475	75,902,475
4/25/2036	217,980,000,000	185,871,546,000	0	0	0	0	0	1.0954758%	0	0	0	76,761,239	76,761,239
4/25/2037	214,190,000,000	182,639,813,000	0	0	0	0	0	1.0954758%	0	0	0	77,742,185	77,742,185
4/25/2038	210,530,000,000	179,518,931,000	0	0	0	0	0	1.0954758%	0	0	0	78,751,304	78,751,304
4/25/2039	206,720,000,000	176,270,144,000	0	0	0	0	0	1.0954758%	0	0	0	79,797,750	79,797,750
4/25/2040	203,020,000,000	173,115,154,000	0	0	0	0	0	1.0954758%	0	0	0	80,780,550	80,780,550
4/25/2041	199,440,000,000	170,062,488,000	0	0	0	0	0	1.0954758%	0	0	0	81,792,463	81,792,463
4/25/2042	195,800,000,000	166,958,660,000	0	0	0	0	0	1.0954758%	0	0	0	82,839,541	82,839,541
4/25/2043	192,240,000,000	163,923,048,000	0	0	0	0	0	1.0954758%	0	0	0	83,851,547	83,851,547
4/25/2044	188,760,000,000	160,955,652,000	0	0	0	0	0	1.0954758%	0	0	0	84,883,066	84,883,066
4/25/2045	185,340,000,000	158,039,418,000	0	0	0	0	0	1.0954758%	0	0	0	85,935,360	85,935,360
4/25/2046	182,020,000,000	155,208,454,000	0	0	0	0	0	1.0954758%	0	0	0	87,000,931	87,000,931
4/25/2047	178,770,000,000	152,437,179,000	0	0	0	0	0	1.0954758%	0	0	0	88,098,647	88,098,647
4/25/2048	175,610,000,000	149,742,647,000	0	0	0	0	0	1.0954758%	0	0	0	89,216,767	89,216,767
4/25/2049	172,520,000,000	147,107,804,000	0	0	0	0	0	1.0954758%	0	0	0	90,366,179	90,366,179
4/25/2050	169,460,000,000	144,498,542,000	0	0	0	0	0	1.0954758%	0	0	0	91,539,103	91,539,103
4/25/2051	166,450,000,000	141,931,915,000	0	0	0	0	0	1.0954758%	0	0	0	92,716,454	92,716,454
4/25/2052			0	0	0	0	0	1.0954758%	0	0	0	93,908,464	93,908,464

Structuring Assumptions- 2002 Indenture Bonds

The Structuring Assumptions for the 2002 Indenture Bonds were applied to the forecast of Pledged TSRs described above. The Structuring Assumptions assume that no optional redemption is exercised on the 2002 Indenture Bonds.

Interest Earnings. The Collections Methodology and Assumptions assume that the 2002 Indenture Trustee will receive ten days after April 15 the Pledged TSRs in 2008 and each year thereafter. Interest is assumed to be earned on amounts in the Debt Service Account at the rate of 5.00% per annum, from the receipt thereof until the next Distribution Date of the 2002 Indenture Bonds. No interest earnings have been assumed on the Annual Payments or Strategic Contribution Payments prior to the time they are received by the 2002 Indenture Trustee.

The amount on deposit in the Debt Service Reserve Account securing the 2002 Indenture Bonds is assumed to equal the Debt Service Reserve Requirement on the 2002 Indenture Bonds, invested at the actual rate of 5.00% per annum at which rate such funds are invested.

The outstanding amounts of the 2002 Indenture Bonds shown in the table below have been projected based on current balances, outstanding 2002 Indenture Bond interest rates, the terms of the outstanding 2002 Indenture Bonds and the forecast of Pledged TSRs reflecting the Global Insight Base Case Consumption Forecast and the Collection Methodology and Assumptions and other Structuring Assumptions outlined herein.

Projected Turbo Redemptions of 2002 Indenture Bonds

Date	Projected Outstanding Amounts	Projected Turbo Redemption*
Settlement	$663,155,000	$ 0
6/1/2008	644,875,000	18,280,000
6/1/2009	622,825,000	22,050,000
6/1/2010	598,730,000	24,095,000
6/1/2011	572,440,000	26,290,000
6/1/2012	543,830,000	28,610,000
6/1/2013	512,750,000	31,080,000
6/1/2014	479,050,000	33,700,000
6/1/2015	442,585,000	36,465,000
6/1/2016	403,055,000	39,530,000
6/1/2017	360,265,000	42,790,000
6/1/2018	317,555,000	42,710,000
6/1/2019	271,410,000	46,145,000
6/1/2020	221,625,000	49,785,000
6/1/2021	167,895,000	53,730,000
6/1/2022	109,975,000	57,920,000
6/1/2023	0	109,975,000

* Projected Turbo Redemptions are based upon the Global Insight Base Case Forecast and represents the sum of Turbo Redemptions made on December 1 of the previous year and those made on the date shown.

Interest Earnings

The Collection Methodology and Assumptions assume that the Trustee will receive 10 days after April 15 the Residual Pledged TSRs in 2008 and each year thereafter. Interest is assumed to be earned on amounts on deposit in the Debt Service Account at the rate of 5.00% per annum.

Structuring Assumptions- Series 2007 Bonds

General

The Structuring Assumptions for the Series 2007 Bonds were applied to the forecast of Residual Pledged TSRs Assets described above. The Series 2007 Bonds were structured using assumed payments of Accreted Value. Turbo Redemptions for the Series 2007 Bonds were structured to allow for amortization of the Series 2007 Bonds prior to maturity using the Global Insight Base Case Consumption Forecast and the other assumptions presented herein.

The Structuring Assumptions are described below:

Debt Service Reserve Account. No Debt Service Reserve Account was established for the Series 2007 Bonds.

Operating Expense Assumptions. Operating expenses of the Corporation have been assumed at $347,782.22 in 2007, inflated at 3.0% per year. No arbitrage rebate expense was assumed since it has been assumed that the yield on the Corporation investments will not exceed the yield on the Series 2007 Bonds.

Issuance Date. The Series 2007 Bonds were assumed to be issued on June 27, 2007.

Accretion. The Series 2007 Bonds were assumed to accrete interest at the rates set forth on the inside cover hereof.

Effect of Changes in Consumption Level on Turbo Redemptions

Weighted Average Lives and Final Principal Payments. The tables below have been prepared to show the effect of changes in consumption on the weighted average lives and final payments on the Series 2007 Bonds. For the purpose of measuring the effect of changes in consumption level, the Series 2007 Bonds were assumed to have yields as shown in the inside cover. The tables are based on the Collection Methodology and Assumptions and the Structuring Assumptions, except that the annual cigarette consumption varies in each case. In addition to the Global Insight Base Case Forecast, several alternative cigarette consumption scenarios are presented below, including four alternative forecasts of Global Insight (the Global Insight High Forecast, the Global Insight Low Case 1, the Global Insight Low Case 2 and the Global Insight Low Case 3, each as hereinafter defined) and two other consumption scenarios prepared by Global Insight (assuming a 3.5% and a 4.0% annual consumption decline). In each case, if actual cigarette consumption in the United States is as forecast and assumed, and events occur as assumed by the Collection Methodology and Assumptions and the Structuring Assumptions, the final principal payments and weighted average lives (in years) of the Series 2007 Bonds will be as set forth in such tables. The tables presented below are for illustrative purposes only. Actual cigarette consumption in the United States cannot be definitively forecast. To the degree actual consumption and other structuring variables vary from the alternative scenarios presented below, the weighted average lives (and final principal payment dates) for the Series 2007 Bonds will be either shorter (sooner) or longer (later) than projected below.

Effect of Changes in Consumption Level

Consumption Forecast	Series 2007A Turbo Capital Appreciation Bond Maturing June 1, 2052	
	Weighted Average Life (in years)*	Final Principal Payment (in years)
Global Insight Base Case Forecast…..…..…………......	20.8	24.9
Global Insight High Forecast…………..……...……….…	20.2	23.9
Global Insight Low Case 1 ……………..……………..…..	21.7	25.9
Global Insight Low Case 2 ……………..……………..…..	22.9	27.9
Global Insight Low Case 3 ……………..……………..…..	31.2	38.9
3.39% Annual Consumption Decline……………..	32.9	44.9
3.5% Annual Consumption Decline……………..	n/a**	n/a**
4.0% Annual Consumption Decline……………..	n/a†	n/a†

Consumption Forecast	Series 2007B Turbo Capital Appreciation Bond Maturing June 1, 2052	
	Weighted Average Life (in years)*	Final Principal Payment (in years)
Global Insight Base Case Forecast…..…..…………......	25.6	25.9
Global Insight High Forecast…………..……...……….…	24.8	24.9
Global Insight Low Case 1 ……………..……………..…..	27.0	27.9
Global Insight Low Case 2 ……………..……………..…..	28.7	29.9
Global Insight Low Case 3 ……………..……………..…..	40.6	41.9
3.24% Annual Consumption Decline ……………..	42.9	44.9
3.5% Annual Consumption Decline……………..	n/a**	n/a**
4.0% Annual Consumption Decline……………..	n/a†	n/a†

Consumption Forecast	Series 2007C Turbo Capital Appreciation Bond Maturing June 1, 2052	
	Weighted Average Life (in years)*	Final Principal Payment (in years)* **
Global Insight Base Case Forecast…..…..…………......	25.9	25.9
Global Insight High Forecast…………..……...……….…	25.2	25.9
Global Insight Low Case 1 ……………..……………..…..	27.9	27.9
Global Insight Low Case 2 ……………..……………..…..	29.9	29.9
Global Insight Low Case 3 ……………..……………..…..	42.2	42.9
3.20% Annual Consumption Decline……………..	44.4	44.9
3.5% Annual Consumption Decline……………..	n/a**	n/a**
4.0% Annual Consumption Decline……………..	n/a†	n/a†

* Series 2007 Bonds Weighted Average Life is calculated based on Accreted Value at the time of Turbo Redemption

** In the event of an annual consumption decline of 3.5%, and assuming the values of all other Structuring variables as set forth under the caption "- Collection Methodology and Assumptions" above, the Series 2007 Bonds may never be repaid.

† In the event of an annual consumption decline of 4.0%, and assuming the values of all other Structuring variables as set forth under the caption "- Collection Methodology and Assumptions" above, the Series 2007 Bonds may never be repaid.

Turbo Redemptions of the Series 2007 Bonds. The tables below have been prepared to show the effect of changes in cigarette consumption on the estimated Turbo Redemptions with respect to the Series 2007 Bonds. The tables are based upon the same assumptions and utilize the same alternative Global Insight forecasts as shown in the preceding paragraph and tables.

Table 3
Projected Outstanding Amounts for Series 2007A Bonds*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1 Forecast	Global Insight Low Case 2 Forecast	Global Insight Low Case 3 Forecast	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Settlement	$176,974,413	$176,974,413	$176,974,413	$176,974,413	$176,974,413	$176,974,413	$176,974,413
6/1/2008	186,954,741	186,954,741	186,954,741	186,954,741	186,954,741	186,954,741	186,954,741
6/1/2009	198,346,430	198,346,430	198,346,430	198,346,430	198,346,430	198,346,430	198,346,430
6/1/2010	210,418,595	210,418,595	210,418,595	210,418,595	210,418,595	210,418,595	210,418,595
6/1/2011	223,246,845	223,246,845	223,246,845	223,246,845	223,246,845	223,246,845	223,246,845
6/1/2012	236,831,181	236,831,181	236,831,181	236,831,181	236,831,181	236,831,181	236,831,181
6/1/2013	251,272,415	251,272,415	251,272,415	251,272,415	251,272,415	251,272,415	251,272,415
6/1/2014	266,570,544	266,570,544	266,570,544	266,570,544	266,570,544	266,570,544	266,570,544
6/1/2015	282,801,180	282,801,180	282,801,180	282,801,180	282,801,180	282,801,180	282,801,180
6/1/2016	300,014,726	300,014,726	300,014,726	300,014,726	300,014,726	300,014,726	300,014,726
6/1/2017	318,286,793	318,286,793	318,286,793	318,286,793	318,286,793	318,286,793	318,286,793
6/1/2018	337,667,784	337,667,784	337,667,784	337,667,784	337,667,784	337,667,784	337,667,784
6/1/2019	358,233,310	358,233,310	358,233,310	358,233,310	358,233,310	358,233,310	358,233,310
6/1/2020	380,058,978	380,058,978	380,058,978	380,058,978	380,058,978	380,058,978	380,058,978
6/1/2021	403,195,194	403,195,194	403,195,194	403,195,194	403,195,194	403,195,194	403,195,194
6/1/2022	427,767,973	427,767,973	427,767,973	427,767,973	427,767,973	427,767,973	427,767,973
6/1/2023	448,573,575	428,347,435	453,802,517	453,802,517	453,802,517	453,802,517	453,802,517
6/1/2024	410,490,040	387,234,048	446,893,672	481,450,044	481,450,044	481,450,044	481,450,044
6/1/2025	369,241,433	342,640,995	410,500,992	454,348,646	510,786,161	510,786,161	510,786,161
6/1/2026	324,604,897	294,323,964	371,149,187	420,592,887	541,886,478	541,886,478	541,886,478
6/1/2027	276,369,382	242,050,596	328,657,885	384,180,847	574,877,009	574,877,009	574,877,009
6/1/2028	224,307,791	185,567,612	282,829,442	344,947,065	609,883,767	609,883,767	609,883,767
6/1/2029	168,164,568	124,598,771	233,445,873	302,700,074	647,032,768	600,223,187	647,032,768
6/1/2030	107,674,670	58,842,815	180,263,999	257,243,932	637,394,827	589,446,812	686,450,025
6/1/2031	42,552,222	0	123,065,250	208,399,409	617,192,866	578,181,726	716,452,970
6/1/2032	0	0	61,608,886	155,958,845	595,018,148	566,447,688	718,740,196
6/1/2033	0	0	0	99,666,921	570,694,430	554,184,637	721,520,083
6/1/2034	0	0	0	39,286,841	544,086,433	541,364,146	724,821,773
6/1/2035	0	0	0	0	515,043,903	527,935,832	728,652,035
6/1/2036	0	0	0	0	483,531,041	513,867,381	733,050,541
6/1/2037	0	0	0	0	449,305,388	499,117,890	738,049,811
6/1/2038	0	0	0	0	412,167,937	483,639,809	743,670,234
6/1/2039	0	0	0	0	371,916,475	467,387,928	749,946,703
6/1/2040	0	0	0	0	328,407,549	450,302,883	756,910,554
6/1/2041	0	0	0	0	281,423,964	432,336,285	764,594,945
6/1/2042	0	0	0	0	230,722,594	413,419,852	773,028,517
6/1/2043	0	0	0	0	176,114,207	393,504,309	782,265,443
6/1/2044	0	0	0	0	117,331,681	372,515,701	792,335,477
6/1/2045	0	0	0	0	54,111,854	350,384,994	803,288,317
6/1/2046	0	0	0	0	0	327,041,817	815,163,776
6/1/2047	0	0	0	0	0	302,405,617	828,023,352
6/1/2048	0	0	0	0	0	276,388,675	841,899,047
6/1/2049	0	0	0	0	0	248,907,431	856,867,662
6/1/2050	0	0	0	0	0	219,863,261	872,967,139
6/1/2051	0	0	0	0	0	189,158,961	890,271,542
6/1/2052	0	0	0	0	0	156,685,000	908,850,000

* Outstanding amounts represent principal balances after the application of Revenues to Accreted Value and Turbo Redemptions on the referenced date.

Table 4
Projected Outstanding Amounts of Series 2007B Bonds*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1 Forecast	Global Insight Low Case 2 Forecast	Global Insight Low Case 3 Forecast	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Settlement	$17,336,218	$17,336,218	$17,336,218	$17,336,218	$17,336,218	$17,336,218	$17,336,218
6/1/2008	18,334,679	18,334,679	18,334,679	18,334,679	18,334,679	18,334,679	18,334,679
6/1/2009	19,473,917	19,473,917	19,473,917	19,473,917	19,473,917	19,473,917	19,473,917
6/1/2010	20,683,541	20,683,541	20,683,541	20,683,541	20,683,541	20,683,541	20,683,541
6/1/2011	21,971,375	21,971,375	21,971,375	21,971,375	21,971,375	21,971,375	21,971,375
6/1/2012	23,337,416	23,337,416	23,337,416	23,337,416	23,337,416	23,337,416	23,337,416
6/1/2013	24,789,488	24,789,488	24,789,488	24,789,488	24,789,488	24,789,488	24,789,488
6/1/2014	26,330,195	26,330,195	26,330,195	26,330,195	26,330,195	26,330,195	26,330,195
6/1/2015	27,967,360	27,967,360	27,967,360	27,967,360	27,967,360	27,967,360	27,967,360
6/1/2016	29,706,195	29,706,195	29,706,195	29,706,195	29,706,195	29,706,195	29,706,195
6/1/2017	31,554,523	31,554,523	31,554,523	31,554,523	31,554,523	31,554,523	31,554,523
6/1/2018	33,517,556	33,517,556	33,517,556	33,517,556	33,517,556	33,517,556	33,517,556
6/1/2019	35,603,116	35,603,116	35,603,116	35,603,116	35,603,116	35,603,116	35,603,116
6/1/2020	37,816,417	37,816,417	37,816,417	37,816,417	37,816,417	37,816,417	37,816,417
6/1/2021	40,167,886	40,167,886	40,167,886	40,167,886	40,167,886	40,167,886	40,167,886
6/1/2022	42,665,344	42,665,344	42,665,344	42,665,344	42,665,344	42,665,344	42,665,344
6/1/2023	45,319,219	45,319,219	45,319,219	45,319,219	45,319,219	45,319,219	45,319,219
6/1/2024	48,137,332	48,137,332	48,137,332	48,137,332	48,137,332	48,137,332	48,137,332
6/1/2025	51,130,110	51,130,110	51,130,110	51,130,110	51,130,110	51,130,110	51,130,110
6/1/2026	54,310,589	54,310,589	54,310,589	54,310,589	54,310,589	54,310,589	54,310,589
6/1/2027	57,689,197	57,689,197	57,689,197	57,689,197	57,689,197	57,689,197	57,689,197
6/1/2028	61,276,360	61,276,360	61,276,360	61,276,360	61,276,360	61,276,360	61,276,360
6/1/2029	65,087,721	65,087,721	65,087,721	65,087,721	65,087,721	65,087,721	65,087,721
6/1/2030	69,133,707	69,133,707	69,133,707	69,133,707	69,133,707	69,133,707	69,133,707
6/1/2031	73,435,175	61,430,955	73,435,175	73,435,175	73,435,175	73,435,175	73,435,175
6/1/2032	50,546,848	0	77,999,944	77,999,944	77,999,944	77,999,944	77,999,944
6/1/2033	0	0	78,454,577	82,851,478	82,851,478	82,851,478	82,851,478
6/1/2034	0	0	12,756,770	88,002,811	88,002,811	88,002,811	88,002,811
6/1/2035	0	0	0	68,040,450	93,477,406	93,477,406	93,477,406
6/1/2036	0	0	0	4,720,884	99,290,905	99,290,905	99,290,905
6/1/2037	0	0	0	0	105,464,162	105,464,162	105,464,162
6/1/2038	0	0	0	0	112,023,248	112,023,248	112,023,248
6/1/2039	0	0	0	0	118,989,019	118,989,019	118,989,019
6/1/2040	0	0	0	0	126,390,150	126,390,150	126,390,150
6/1/2041	0	0	0	0	134,250,104	134,250,104	134,250,104
6/1/2042	0	0	0	0	142,597,558	142,597,558	142,597,558
6/1/2043	0	0	0	0	151,466,402	151,466,402	151,466,402
6/1/2044	0	0	0	0	160,885,312	160,885,312	160,885,312
6/1/2045	0	0	0	0	170,890,786	170,890,786	170,890,786
6/1/2046	0	0	0	0	167,673,595	181,519,322	181,519,322
6/1/2047	0	0	0	0	105,898,194	192,807,415	192,807,415
6/1/2048	0	0	0	0	39,314,351	204,796,778	204,796,778
6/1/2049	0	0	0	0	0	217,534,336	217,534,336
6/1/2050	0	0	0	0	0	231,061,799	231,061,799
6/1/2051	0	0	0	0	0	245,431,308	245,431,308
6/1/2052	0	0	0	0	0	260,695,000	260,695,000

* Outstanding amounts represent principal balances after the application of Revenues to Accreted Value and Turbo Redemptions on the referenced date.

TABLE 5
Projected Outstanding Amounts for Series 2007C Bonds*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1 Forecast	Global Insight Low Case 2 Forecast	Global Insight Low Case 3 Forecast	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Settlement	$2,695,112	$2,695,112	$2,695,112	$2,695,112	$2,695,112	$2,695,112	$2,695,112
6/1/2008	2,866,416	2,866,416	2,866,416	2,866,416	2,866,416	2,866,416	2,866,416
6/1/2009	3,062,724	3,062,724	3,062,724	3,062,724	3,062,724	3,062,724	3,062,724
6/1/2010	3,273,396	3,273,396	3,273,396	3,273,396	3,273,396	3,273,396	3,273,396
6/1/2011	3,497,900	3,497,900	3,497,900	3,497,900	3,497,900	3,497,900	3,497,900
6/1/2012	3,737,832	3,737,832	3,737,832	3,737,832	3,737,832	3,737,832	3,737,832
6/1/2013	3,994,788	3,994,788	3,994,788	3,994,788	3,994,788	3,994,788	3,994,788
6/1/2014	4,268,768	4,268,768	4,268,768	4,268,768	4,268,768	4,268,768	4,268,768
6/1/2015	4,561,900	4,561,900	4,561,900	4,561,900	4,561,900	4,561,900	4,561,900
6/1/2016	4,874,716	4,874,716	4,874,716	4,874,716	4,874,716	4,874,716	4,874,716
6/1/2017	5,209,344	5,209,344	5,209,344	5,209,344	5,209,344	5,209,344	5,209,344
6/1/2018	5,567,380	5,567,380	5,567,380	5,567,380	5,567,380	5,567,380	5,567,380
6/1/2019	5,949,356	5,949,356	5,949,356	5,949,356	5,949,356	5,949,356	5,949,356
6/1/2020	6,357,932	6,357,932	6,357,932	6,357,932	6,357,932	6,357,932	6,357,932
6/1/2021	6,794,172	6,794,172	6,794,172	6,794,172	6,794,172	6,794,172	6,794,172
6/1/2022	7,260,204	7,260,204	7,260,204	7,260,204	7,260,204	7,260,204	7,260,204
6/1/2023	7,758,688	7,758,688	7,758,688	7,758,688	7,758,688	7,758,688	7,758,688
6/1/2024	8,291,220	8,291,220	8,291,220	8,291,220	8,291,220	8,291,220	8,291,220
6/1/2025	8,860,460	8,860,460	8,860,460	8,860,460	8,860,460	8,860,460	8,860,460
6/1/2026	9,468,536	9,468,536	9,468,536	9,468,536	9,468,536	9,468,536	9,468,536
6/1/2027	10,118,640	10,118,640	10,118,640	10,118,640	10,118,640	10,118,640	10,118,640
6/1/2028	10,813,432	10,813,432	10,813,432	10,813,432	10,813,432	10,813,432	10,813,432
6/1/2029	11,555,572	11,555,572	11,555,572	11,555,572	11,555,572	11,555,572	11,555,572
6/1/2030	12,348,784	12,348,784	12,348,784	12,348,784	12,348,784	12,348,784	12,348,784
6/1/2031	13,196,260	13,196,260	13,196,260	13,196,260	13,196,260	13,196,260	13,196,260
6/1/2032	14,102,256	3,870,168	14,102,256	14,102,256	14,102,256	14,102,256	14,102,256
6/1/2033	0	0	15,069,964	15,069,964	15,069,964	15,069,964	15,069,964
6/1/2034	0	0	16,104,704	16,104,704	16,104,704	16,104,704	16,104,704
6/1/2035	0	0	0	17,209,668	17,209,668	17,209,668	17,209,668
6/1/2036	0	0	0	18,391,240	18,391,240	18,391,240	18,391,240
6/1/2037	0	0	0	0	19,653,676	19,653,676	19,653,676
6/1/2038	0	0	0	0	21,002,296	21,002,296	21,002,296
6/1/2039	0	0	0	0	22,444,016	22,444,016	22,444,016
6/1/2040	0	0	0	0	23,984,688	23,984,688	23,984,688
6/1/2041	0	0	0	0	25,631,228	25,631,228	25,631,228
6/1/2042	0	0	0	0	27,390,552	27,390,552	27,390,552
6/1/2043	0	0	0	0	29,270,640	29,270,640	29,270,640
6/1/2044	0	0	0	0	31,279,472	31,279,472	31,279,472
6/1/2045	0	0	0	0	33,426,624	33,426,624	33,426,624
6/1/2046	0	0	0	0	35,721,140	35,721,140	35,721,140
6/1/2047	0	0	0	0	38,172,596	38,172,596	38,172,596
6/1/2048	0	0	0	0	40,792,696	40,792,696	40,792,696
6/1/2049	0	0	0	0	11,226,054	43,593,144	43,593,144
6/1/2050	0	0	0	0	0	46,585,112	46,585,112
6/1/2051	0	0	0	0	0	49,782,432	49,782,432
6/1/2052	0	0	0	0	0	53,200,000	53,200,000

* Outstanding amounts represent principal balances after the application of Revenues to Accreted Value and Turbo Redemptions on the referenced date.

Explanation of Alternative Global Insight Forecasts

The alternative Global Insight forecast of cigarette consumption decline are based upon the methodology described below. See also "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" herein and Appendix A - "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached hereto.

Global Insight's high forecast of consumption (the "**Global Insight High Forecast**") deviates from the Base Case Forecast by assuming a lower price forecast, under which prices are increasing at an annual rate 0.5% more slowly than the Base Case Forecast. Under the Global Insight High Forecast, the average annual rate of decline in cigarette consumption is moderated slightly, from an average annual rate in the Base Case Forecast of 1.81%, to 1.66%.

Global Insight's low forecast of consumption (the "**Global Insight Low Case 1**") deviates from the Base Case Forecast by assuming a sharper price elasticity of demand. The Global Insight Base Case Forecast applied a price elasticity of demand of -0.33. However, in order to develop the lowest consumption forecast that Global Insight believed may be reasonably anticipated, a price elasticity of -0.4 was applied. Under the Global Insight Low Case 1, the average rate of decline in cigarette consumption increased to 1.98%. Under the Base Case Forecast, the rate of decline was 1.81%.

Although beyond the range of Global Insight's reasonably anticipated decline in consumption, Global Insight also prepared an alternative low case (the "**Global Insight Low Case 2**") that deviated from the Base Case Forecast by assuming a price elasticity of demand of -0.5. This produces a decline in consumption of an average annual rate of 2.14%. Global Insight prepared another alternative low case (the "**Global Insight Low Case 3**") that deviated from the Base Case Forecast by assuming an adverse federal government settlement and tort claims of three times the size of the MSA, resulting in an immediate real price increase of 57% and a decline in consumption of 18% over two years. Under the Global Insight Low Case 3, the average annual rate of decline in cigarette consumption would be 2.21%, compared to the Base Case Forecast of 1.81%.

Finally, for comparative purposes Global Insight calculated the volume of total cigarette consumption under four alternative annual rates of decline, 2.5%, 3.0%, 3.5% and 4.0%. Global Insight states that at 2.5% per per year consumption falls to 116 billion by 2052, at 3.0% per year it falls 91 billion by 2052, at 3.5% per year it falls to 71 billion by 2052, and at 4.0% per year it falls to 56 billion by 2052.

Average Annual Rate of Cigarette Consumption Decline (2004-2052)

Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3
1.81%	**1.66%**	**1.98%**	**2.14%**	**2.21%**

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2007 Bonds will be as assumed, or that the other assumptions underlying the Collection Methodology and Assumptions and Structuring Assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Collection Methodology and Assumptions or the Structuring Assumptions, the amount of Residual Pledged TSRs available to make payments with respect to the Series 2007 Bonds (and, accordingly, the amount of Residual Pledged TSRs available to make Turbo Redemptions of the Series 2007 Bonds) could be adversely affected. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

CONTINUING DISCLOSURE UNDERTAKING

To the extent that Rule 15c2-12 (the "**Rule**") of the Securities and Exchange Commission ("**SEC** ") promulgated under the Securities Exchange Act of 1934, as amended (the "**1934 Act**"), requires the Underwriters to determine, as a condition to purchasing the Series 2007 Bonds, that the Corporation will make such covenants, the Corporation will covenant for the sole benefit of the Bondholders as follows:

The Corporation shall provide or cause to be provided to each nationally recognized municipal securities information repository and to any public or private repository or entity designated by the State as a repository for purposes of the Rule:

(a) within 210 days after the end of each Fiscal Year ending June 30, 2007 and of each Fiscal Year thereafter, core financial information and operating data for the prior Fiscal Year, including (i) its audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, (ii) an update of operating data for such preceding Fiscal Year set forth under the column titled "Total Payments to the Trustee" in the table captioned "Projection of Strategic Contribution Fund and Total Payments to be Received by the 2002 Indenture Trustee or the Trustee, as the case may be" in "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" and (iii) to the extent not included in the Corporation's audited financial statements, Residual Pledged TSRs received during such Fiscal Year and Accreted Value and Turbo Redemptions paid during such Fiscal Year; and

(b) in a timely manner, notice of any of the following events with respect to the Series 2007 Bonds, if material:

(1) principal and interest payment delinquencies;

(2) non-payment related defaults;

(3) unscheduled draws on debt service reserves reflecting financial difficulties;

(4) unscheduled draws on credit enhancements reflecting financial difficulties;

(5) substitution of credit or liquidity providers, or their failure to perform;

(6) adverse tax opinions or events affecting the tax-exempt status of the Series 2007 Bonds;

(7) modifications to rights of Bondholders;

(8) bond calls;

(9) defeasances;

(10) release, substitution, or sale of property securing repayment of the Series 2007 Bonds;

(11) rating changes; and

(12) failure of the Corporation to comply with clause (a) above.

The Corporation will not undertake to provide any notice with respect to (i) credit enhancement if the credit enhancement is added after the primary offering of the Series 2007 Bonds, the Corporation does not apply for or participate in obtaining the enhancement and the enhancement is not described in this Offering Circular or (ii) tax exemption other than pursuant to Section 103 of the Code.

The Corporation will not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if (i) the terms, dates and amounts of redemption are set forth in detail herein (ii) the only open issue is which Bonds will be redeemed in the case of a partial redemption, (iii) notice of redemption is given to the Bondholders as required under the terms of the Bonds and (iv) public notice of the redemption is given pursuant to 1934 Act Release No. 23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or Series 2007 Bond purchases.

The Corporation will not undertake to provide updates or revisions to any forward-looking statements contained in this Offering Circular, including but not limited to those that include the words "expects", "forecasts", "projects", "intends," "anticipates," "estimates," "assumes" or analogous expressions.

No Bondholder may institute any suit, action or proceeding at law or in equity ("**Proceeding**") for the enforcement of the continuing disclosure undertaking (the "**Undertaking**") or for any remedy for breach thereof, unless such Bondholder shall have filed with the Corporation evidence of ownership and a written notice of and request to cure such breach, and the Corporation shall have refused to comply within a reasonable time. All

Proceedings shall be instituted only as specified herein, in the federal or state courts located in the State, and for the equal benefit of all holders of the outstanding bonds benefited by the same or a substantially similar covenant, and no remedy shall be sought or granted other than specific performance of the covenant at issue.

An amendment to the Undertaking may only take effect if:

(a) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Corporation, or type of business conducted; the Undertaking, as amended, would have complied with the requirements of the Rule at the time of sale of a series of Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and the amendment does not materially impair the interests of Bondholders, as determined by parties unaffiliated with the Corporation (such as, but without limitation, the Corporation's financial advisor or bond counsel) and the annual financial information containing (if applicable) the amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the "impact" (as that word is used in the letter from the SEC staff to the National Association of Bond Lawyers dated June 23, 1995) of the change in the type of operating data or financial information being provided; or

(b) all or any part of the Rule, as interpreted by the staff of the SEC at the date of issuance of the Series 2007 Bonds, ceases to be in effect for any reason, and the Corporation elects that the Undertaking shall be deemed terminated or amended (as the case may be) accordingly.

For purposes of the Undertaking, a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares investment power which includes the power to dispose, or to direct the disposition of, such security, subject to certain exceptions as set forth in the Undertaking. Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above.

In 2003, 2004 and 2005, the Corporation submitted filings of its annual disclosure at the same time the State made all its required annual disclosure filings relating to State indebtedness. In 2006, the Corporation determined that such filings were not timely as required by the continuing disclosure undertaking relating to the 2002 Indenture Bonds. The Corporation implemented procedures to ensure that future filings will be made in the time frame required by such continuing disclosure agreement. The Corporation submitted timely filings of its annual disclosure in 2006 and 2007.

LITIGATION

There is no litigation pending in any court (either in State or federal court) to restrain or enjoin the issuance or delivery of the Series 2007 Bonds or questioning the creation, organization or existence of the Corporation, the validity or enforceability of the Act, the Purchase Agreement, the Indenture, the transfer of the Residual Pledged TSRs by the State to the Corporation, the proceedings for the authorization, execution, authentication and delivery of the Series 2007 Bonds or the validity of the Series 2007 Bonds. For a discussion of other legal matters, including certain pending litigation involving the MSA and the PMs, see "RISK FACTORS," "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" and "LEGAL CONSIDERATIONS."

TAX MATTERS

Opinion of Bond Counsel

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Series 2007 Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended, and (ii) interest on the Series 2007 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel has relied on certain representations, certifications of fact, and statements of reasonable expectations made by the Corporation and the State in connection with the Series 2007 Bonds, and Bond Counsel has assumed compliance by the Corporation and the State with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the Series 2007 Bonds from gross income under Section 103 of the Code.

In addition, in the opinion of Bond Counsel to the Corporation, pursuant to the provisions of the Act, income on the Series 2007 Bonds, including any profit made on the sale thereof, is free from State personal income taxes, excepting inheritance, estate, and gift taxes. See "Miscellaneous" below for a discussion of certain litigation

that may relate to this Rhode Island personal tax exemption. Interest on the Series 2007 Bonds may be included in the measure of certain business and corporate taxes.

Bond Counsel expresses no opinion regarding any other Federal or state tax consequences with respect to the Series 2007 Bonds. Bond Counsel renders its opinion as of the issue date and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. Bond Counsel expresses no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Series 2007 Bonds, or under state and local tax law.

Certain Ongoing Federal Tax Requirements and Covenants

The Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Series 2007 Bonds in order that interest on the Series 2007 Bonds be and remain excluded from gross income under Section 103 of the Code. These requirements include, but are not limited to, requirements relating to use and expenditure of gross proceeds of the Series 2007 Bonds, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the Federal government. Noncompliance with such requirements may cause interest on the Series 2007 Bonds to become included in gross income for Federal income tax purposes retroactive to their issue date, irrespective of the date on which such noncompliance occurs or is discovered. The Corporation and the State have covenanted to comply with certain applicable requirements of the Code to assure the exclusion of interest on the Series 2007 Bonds from gross income under Section 103 of the Code.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral Federal income tax matters with respect to the Series 2007 Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of a Series 2007 Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Series 2007 Bonds.

Prospective owners of the Series 2007 Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security and railroad retirement benefits, individuals otherwise eligible for the earned income tax credit, and taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is excluded from gross income for Federal income tax purposes. Interest on the Series 2007 Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Original Issue Discount

"**Original issue discount**" ("**OID**") is the excess of the sum of all amounts payable at the stated maturity of a Series 2007 Bond (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates) over the issue price of that maturity. In general, the "**issue price**" of a maturity means the first price at which a substantial amount of the Series 2007 Bonds of that maturity was sold (excluding sales to bond houses, brokers, or similar persons acting in the capacity as underwriters, placement agents, or wholesalers). In general, the issue price for each maturity of Series 2007 Bonds is expected to be the initial public offering price set forth on the cover page of the Official Statement. Bond Counsel further is of the opinion that, for any Series 2007 Bonds having OID (a "**Discount Bond**"), OID that has accrued and is properly allocable to the owners of the Discount Bonds under Section 1288 of the Code is excludable from gross income for Federal income tax purposes to the same extent as other interest on the Series 2007 Bonds.

In general, under Section 1288 of the Code, OID on a Discount Bond accrues under a constant yield method, based on periodic compounding of interest over prescribed accrual periods using a compounding rate determined by reference to the yield on that Discount Bond. An owner's adjusted basis in a Discount Bond is increased by accrued OID for purposes of determining gain or loss on sale, exchange, or other disposition of such Series 2007 Bond. Accrued OID may be taken into account as an increase in the amount of tax-exempt income received or deemed to have been received for purposes of determining various other tax consequences of owning a Discount Bond even though there will not be a corresponding cash payment.

Owners of Discount Bonds should consult their own tax advisors with respect to the treatment of original issue discount for Federal income tax purposes, including various special rules relating thereto, and the state and local tax consequences of acquiring, holding, and disposing of Discount Bonds.

Information Reporting and Backup Withholding

Information reporting requirements applies to interest paid on tax-exempt obligations, including the Series 2007 Bonds. In general, such requirements are satisfied if the interest recipient completes, and provides the payor with, a Form W-9, "Request for Taxpayer Identification Number and Certification", or unless the recipient is one of a limited class of exempt recipients, including corporations. A recipient not otherwise exempt from information reporting who fails to satisfy the information reporting requirements will be subject to "**backup withholding**", which means that the payor is required to deduct and withhold a tax from the interest payment, calculated in the manner set forth in the Code. For the foregoing purpose, a "**payor**" generally refers to the person or entity from whom a recipient receives its payments of interest or who collects such payments on behalf of the recipient.

If an owner purchasing a Series 2007 Bond through a brokerage account has executed a Form W-9 in connection with the establishment of such account, as generally can be expected, no backup withholding should occur. In any event, backup withholding does not affect the excludability of the interest on the Series 2007 Bonds from gross income for Federal income tax purposes. Any amounts withheld pursuant to backup withholding would be allowed as a refund or a credit against the owner's Federal income tax once the required information is furnished to the Internal Revenue Service.

Miscellaneous

Tax legislation, administrative actions taken by tax authorities, and court decisions, whether at the federal or state level, may adversely affect the tax-exempt status of interest on the Series 2007 Bonds under federal or state law and could affect the market price or marketability of the Series 2007 Bonds.

Prospective purchasers of the Series 2007 Bonds should be aware that the United States Supreme Court has agreed to review Davis v. Dep't. of Revenue of the Finance and Admin. Cabinet, 197 S.W. 3d 557 (Ky. App. 2006), cert. granted 2007 U.S. LEXIS 5914 (May 21, 2007), a decision of a Kentucky appellate court, which held that provisions of Kentucky tax law that provided more favorable income tax treatment for holders of bonds issued by Kentucky municipal bond issuers than for holders of non-Kentucky municipal bonds violated the Commerce Clause of the United States Constitution. Rhode Island statutes provide more favorable state personal income tax treatment for holders of bonds issued by the State of Rhode Island and its political subdivisions, including the Series 2007 Bonds, than for bonds issued by other states and their political subdivisions. If the United States Supreme Court were to affirm the holding of the Kentucky appellate court, subsequent Rhode Island judicial decisions or legislation designed to ensure the constitutionality of Rhode Island tax law could, among other alternatives, adversely affect the Rhode Island tax exemption of outstanding bonds, including the Series 2007 Bonds, to the extent constitutionally permissible, or result in the exemption from Rhode Island personal income tax of interest on certain bonds issued by other states and their political subdivisions, either of which actions could affect the market price or marketability of the Series 2007 Bonds.

Prospective purchasers of the Series 2007 Bonds should consult their own tax advisors regarding the foregoing matters.

RATINGS

It is a condition to the obligation of the Underwriters to purchase the Series 2007 Bonds, that, at the date of delivery thereof to the Underwriters, Standard & Poor's Ratings Services, a division of The McGraw Hill Companies, Inc. ("**S&P**" or the "**Rating Agency**") assign the Series 2007A Bonds a rating of "BBB" and the Series 2007B Bonds a rating of "BBB-". No request has been made and no rating has been assigned to the Series 2007C Bonds.

The ratings address S&P's assessment of the ability of the Corporation to pay the Accreted Value on such Bonds on the Maturity Dates therefor set forth on the inside cover page of this Offering Circular. However, projections of Turbo Redemptions Payments for such Bonds have not been rated by S&P. The ratings of the Series 2007A Bonds and the Series 2007B Bonds by S&P reflect only the views of such organization and any desired explanation of the significance of such ratings and any outlooks or other statements given by S&P with respect thereto should be obtained from S&P, at the following address: 55 Water Street, New York, New York 10041.

There is no assurance that the initial ratings assigned to the rated Series 2007 Bonds will continue for any given period of time or that any of such ratings will not be revised downward, suspended or withdrawn entirely by the Rating Agency. Any such downward revision, suspension or withdrawal of such ratings may have an adverse effect on the availability of a market for or the market price of such Bonds.

UNDERWRITING

The Underwriters listed on the cover page hereof have jointly and severally agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2007 Bonds from the Corporation at an underwriters' discount of $938,686.55. The Underwriters will be obligated to purchase all of the Series 2007 Bonds if any are purchased. The initial public offering prices of the Series 2007 Bonds may be changed from time to time by the Underwriters. Citigroup Global Markets Inc. is acting as representative on behalf of the Underwriters. The Representative of the Underwriters has agreed to allocate book-running lead management credit to Citigroup Global Markets Inc. and Morgan Stanley Inc. in the amounts of 50% each. The Series 2007 Bonds may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Series 2007 Bonds into investment trusts) at prices lower than such public offering prices. The Corporation has agreed to indemnify, to the extent permitted by law, the Underwriters against certain liabilities, including liabilities under federal securities laws.

Citigroup Global Markets, Inc., an Underwriter, is an affiliate of Citibank, N.A. which is acting as MSA Escrow Agent under the MSA.

LEGAL MATTERS

Hawkins Delafield & Wood LLP, New York, New York, Bond Counsel, will render an opinion with respect to the validity of the Series 2007 Bonds in substantially the form set forth in Appendix C hereto.

Certain legal matters will be passed upon for the Corporation by Nixon Peabody LLP, Providence, Rhode Island, as Disclosure Counsel, and for the Underwriters by Edwards Angell Palmer & Dodge LLP, Providence, Rhode Island, as Underwriters' Counsel.

OTHER PARTIES

Global Insight

Global Insight has been retained as an independent econometric consultant. The Global Insight Cigarette Consumption Report attached as Appendix A hereto is included herein in reliance on Global Insight as experts in such matters. Global Insight's fees for acting as independent economic consultant are not contingent upon the issuance of the Series 2007 Bonds. The Global Insight Cigarette Consumption Report should be read in their entirety.

Financial Advisor to the State

First Southwest has been retained by the State as its Financial Advisor in connection with the issuance of the Series 2007 Bonds. The Financial Advisor has assisted the Corporation in matters relating to the planning, structuring, execution and delivery of the Series 2007 Bonds. The Financial Advisor has not audited, authenticated or otherwise independently verified the information set forth in the Offering Circular, or any other related information available to the Corporation, with respect to accuracy and completeness of disclosure of such information. The Financial Advisor makes no guaranty, warranty or other representation respecting accuracy and completeness of the Offering Circular.

TOBACCO SETTLEMENT FINANCING CORPORATION

By: Rosemary Booth Gallogly
Authorized Officer

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APPENDIX A

GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT

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A Forecast of U.S. Cigarette Consumption (2007-2052) for Tobacco Settlement Financing Corporation

Submitted to:

Tobacco Settlement Financing Corporation

Prepared by:

Global Insight (USA), Inc.

June 21, 2007

Jim Diffley
Group Managing Director

Jeannine Cataldi
Senior Economist

Global Insight, Inc.
800 Baldwin Tower
Eddystone, PA 19022

(610) 490-2642

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Executive Summary

Global Insight[1] has developed a cigarette consumption model based on historical U.S. data between 1965 and 2003. This econometric model, coupled with our long term forecast of the U.S. economy, has been used to project total U.S. cigarette consumption from 2004 through 2052. Our Base Case Forecast indicates that total consumption in 2052 will be 163 billion cigarettes (approximately 8 billion packs), a 59% decline from the 2003 level. From 2004 through 2052 the average annual rate of decline is projected to be 1.81%. On a per capita basis consumption is projected to fall at an average rate of 2.52% per year. We also present alternative forecasts that project higher and lower paths of cigarette consumption. Under these, less likely, scenarios we forecast that by 2052 U.S. cigarette consumption could be as low as 150 billion and as high as 176 billion cigarettes. In addition, we also present scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption.

Our model was constructed from widely accepted economic principles and Global Insight's long experience in building econometric forecasting models. A review of the economic research literature indicates that our model is consistent with the prevalent consensus among economists concerning cigarette demand. We considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking amongst underage youth, and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After extensive analysis, we found the following variables to be effective in building an empirical model of adult per capita cigarette consumption: real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places, and the trend over time in individual behavior and preferences. The projections and forecasts are based on reasonable assumptions regarding the future paths of these factors.

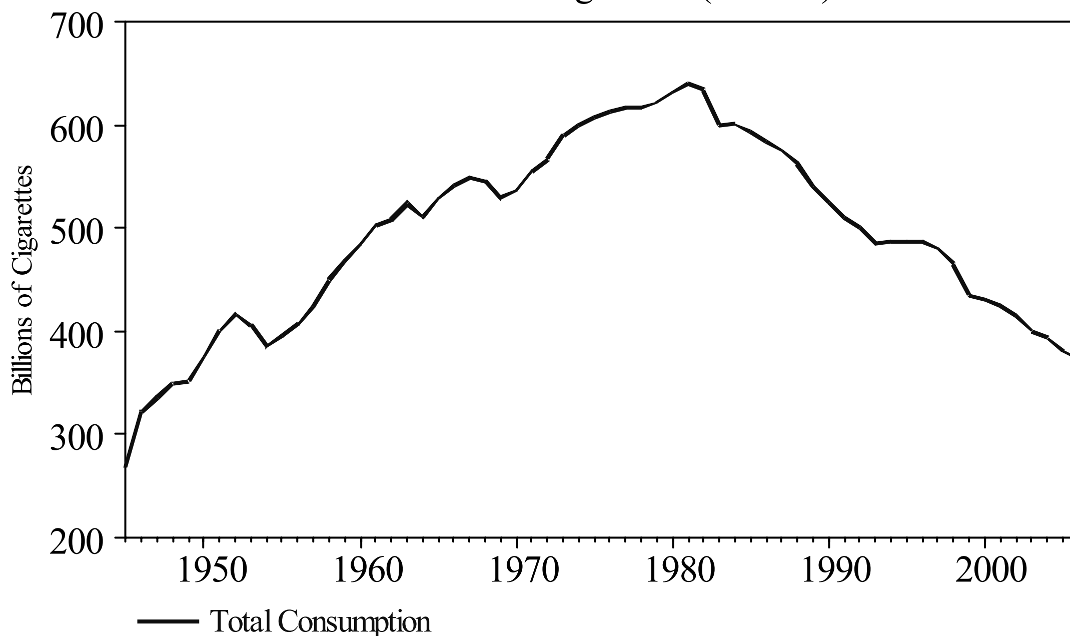
[1] On November 4, 2002, **DRI•WEFA** was re-named **Global Insight**.

Disclaimer

The projections and forecasts included in this report, including, but not limited to, those regarding future cigarette consumption, are estimates, which have been prepared on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of, and no representation or warranty should be inferred from, these projections and forecasts. The projections and forecasts contained in this report are based upon assumptions as to future events and, accordingly, are subject to varying degrees of uncertainty. Some assumptions inevitably will not materialize and, additionally, unanticipated events and circumstances may occur. Therefore, for example, actual cigarette consumption inevitably will vary from the projections and forecasts included in this report and the variations may be material and adverse.

Historical Cigarette Consumption

People have used tobacco products for centuries. Tobacco was first brought to Europe from America in the late 15th century and became America's major cash crop in the 17th and 18th centuries[2]. Prior to 1900, tobacco was most frequently used in pipes, cigars and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories[3] as reported by the Bureau of Alcohol Tobacco and Firearms. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion in 1900 to a peak of 640 billion in 1981[4]. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2004[5].



While the historical trend in consumption prior to 1981 was increasing, there was a decline in cigarette consumption of 9.82% during the Great Depression between 1931 and 1932. Notwithstanding this steep decline, consumption rapidly increased after 1932, and exceeded previous levels by 1934. Following the release of the Surgeon General's

[2] *Source*: "Tobacco Timeline," Gene Borio (1998).

[3] Bureau of Alcohol, Tobacco and Firearms reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.

[4] *Source*: "Tobacco Situation and Outlook". U.S. Department of Agriculture-Economic Research Service. September 1999 (USDA-ERS).

[5] *Source*: USDA-ERS. April 2005.

Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.20% between 1965 and 1981. Between 1981 and 1990, however, cigarette consumption declined at an average annual rate of 2.18%. From 1990 to 1998, the average annual rate of decline in cigarette consumption was 1.51%; but for 1998 the decline increased to 3.13% and increased further to 6.45% for 1999. These recent declines are correlated with large price increases in 1998 and 1999 following the Master Settlement Agreement ("MSA"). In 2000 and 2001, the rate of decline moderated, to 1.15% and 1.16%, respectively. More recently, coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2005 to an annual rate of 2.70%.

Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) began to decline following the Surgeon General's Report in 1964. Population growth offset this decline until 1981. The adult population grew at an average annual rate of 1.86% for the period 1965 through 1981, 1.17% from 1981 to 1990 and 1.02% from 1990 to 1999. Adult per capita cigarette consumption declined at an average annual rate of 0.65% for the period 1965 to 1981, 3.31% for the period 1981 to 1990 and 2.47% for the period 1990 to 1998. In 1998 the per capita decline in cigarette consumption was 4.21% and in 1999 the decline accelerated to 7.50%. These sharp declines are correlated with large price increases in 1998 and 1999 following the MSA. All percentages are based upon compound annual growth rates.

The following table sets forth United States domestic cigarette consumption for the nine years ended December 31, 2006[6]. The data in this table vary from statistics on cigarette shipments in the United States. While our Report is based on consumption, payments made under the MSA dated November 23, 1998 between certain cigarette manufacturers and certain settling states are computed based in part on shipments in or to the fifty United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

[6] *Source:* USDA-ERS; 2004, 2005, 2006, estimates by Global Insight. USDA estimates for 2004, 2005, and 2006 diverge significantly from estimates based on independent data from the industry and from the US Tobacco and Tax Bureau. In 2004, the manufacturers report domestic shipments of 394.5 billion,, and the TTB reports a total of 397.7 billion. These contrast with a USDA estimate of 388 billion. In 2005, the manufacturers report 381.7 billion, TTB reports 381.1 billion, and USDA 376 billion. In 2006, the manufacturers report 372.5 billion, TTB reports 380.9 billion, and USDA 371 billion, subject to revision.

U.S. Cigarette Consumption

Year Ended December 31,	Consumption (Billions of Cigarettes)	Percentage Change
2006	373est	-2.01
2005	381est	-3.05
2004	393est	-1.75
2003	400	-3.61
2002	415	-2.35
2001	425	-1.16
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according to reports of the manufacturers, the three leading manufacturers accounted for 86.8% of U.S. shipments in 2006. These top companies were Philip Morris, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. These companies commanded 49.2%, 27.8%, and 9.7%, respectively of the domestic market in 2006. The market share of the leading manufacturers has declined from over 96% in 1998 due to inroads by smaller manufacturers and importers following the Master Settlement Agreement.

The United States government has raised revenue through tobacco taxes since the Civil War. Although the federal excise taxes have risen through the years, excise taxes as a percentage of total federal revenue have fallen from 3.4% in 1950 to approximately 0.42% today. In fiscal year 2006, the federal government received $7.7 billion in excise tax revenue from tobacco sales. In addition, state and local governments also raise significant revenues, $14.0 billion in 2006, from excise and sales taxes. Cigarettes constitute the majority of these sales, which include cigars and other tobacco products. U.S. consumers spent $86.7 billion on tobacco products in 2003.[7]

Survey of the Economic Literature on Smoking

Many organizations have conducted studies on United States cigarette consumption. These studies have utilized a variety of methods to estimate levels of smoking, including interviews and/or written questionnaires. Although these studies have tended to produce varying estimates of consumption levels due to a number of factors, including different survey methods and different definitions of smoking, taken together such studies provide

[7] Ibid.

a general approximation of consumption levels and trends. Set forth below is a brief summary of some of the more recent studies on cigarette consumption levels.

Incidence of Smoking

Approximately 45.1 million American adults were current smokers in 2005, representing approximately 20.9% of the population age 18 and older, according to a Centers for Disease Control and Prevention ("CDC") study[8] released in October, 2006. This survey defines "current smokers" as those persons who have smoked at least 100 cigarettes in their lifetime and who smoked every day or some days at the time of the survey. Although the percentage of adults who smoke (incidence) declined from 42.4% in 1965 to 25.5% in 1990,[9] the incidence rate declined relatively slowly through the following decade. The decline has accelerated since 2002, when the incidence rate was 22.5%
.

Youth Smoking

Certain studies have focused in whole or in part on youth cigarette consumption. Surveys of youth typically define a "current smoker" as a person who has smoked a cigarette on one or more of the 30 days preceding the survey. The CDC's Youth Risk Behavior Survey estimated that from 1991 to 1999 incidence among high school students (grades 9 through 12) rose from 27.5% to 34.8%, representing an increase of 26.5%. By 2003, the incidence had fallen to 21.9%, a decline of 37.1% over four years. The prevalence was unchanged from 2003 to 2005.[10]

In 2004, the CDC's National Youth Tobacco Survey, formerly done by the American Legacy Foundation, reported that the percentage of middle school students who were current users of cigarettes declined from 9.8% in 2002 to 8.1% in 2004. Among high school students there was no significant change, with 22.3% as current users.[11]

According to the Monitoring the Future Study, a school-based study of cigarette consumption and drug use conducted by the Institute for Social Research at the University of Michigan, smoking incidence over the prior 30 days among tenth and twelfth graders was lower in 2006 than in 2005, continuing trends that began in 1996. Among those students in eighth grade, incidence declined after having increased slightly in 2005 following eight consecutive years of decline. Smoking incidence in all grades is well below where it was in 1991, having fallen below that mark in 2001 for eighth graders and in 2002 for tenth and twelfth graders.

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[8] *Source*: CDC. Morbidity and Mortality Weekly Report. "Tobacco Use Among Adults – United States, 2005". October 20, 2006.
[9] *Source*: CDC. Office on Smoking and Health.
[10] *Source*: CDC. Morbidity and Mortality Weekly Report. "Cigarette Use Among High School Students --- United States, 1991-2005". July 7, 2006.
[11] CDC. Morbidity and Mortality Weekly Report. "Tobacco Use, Access, and Exposure to Tobacco in Media Among Middle and High School Students in the United States, 2004". April 1, 2005.

Prevalence of Cigarette Use Among 8th, 10th, and 12th Graders

Grade	1991 (%)	2005 (%)	2006 (%)	'05-'06 Change (%)	'91-'06 Change (%)
8th	14.3	9.3	8.7	-6.5	-39.2
10th	20.8	14.9	14.5	-2.7	-30.3
12th	28.3	23.2	21.6	-6.9	-23.7

A report from the New York City Youth Risk Behavior Survey finds that smoking among New York City high school students decreased by 52% from 1997 to 2005.[12] Over this period New York City has raised excise taxes to the highest in the nation and instituted a comprehensive indoor smoking ban.

The 2004 National Survey on Drug Abuse and Health (formerly called National Household Survey on Drug Abuse) conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services estimated that approximately 59.9 million Americans age 12 and older were current cigarette smokers (defined by this survey to mean they had smoked cigarettes at least once during the 30 days prior to the interview). This estimate represents an incidence rate of 24.9%, which is a decrease from 25.4% in 2003 and 26.0% in 2002. The same survey found that an estimated 11.9% of youths age 12 to 17 were current cigarette smokers in 2004, down from 12.2% in 2003 and 13.0% in 2002.

New Jersey recently raised the minimum legal age to purchase cigarettes from 18 to 19 years. Three states, Alabama, Alaska, and Utah, also set the minimum age at 19.

Price Elasticity of Cigarette Demand

The price elasticity of demand reflects the impact of changes in price on the demand for a product. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5.[13] (In other words, as the price of cigarettes increases by 1.0% the quantity demanded decreases by 0.3% to 0.5%.) A few researchers have estimated price elasticity as high as -1.23. Research focused on youth smoking has found price elasticity levels of up to -1.41.

Two studies published by the National Bureau of Economic Research examine the price elasticity of youth smoking. In their study on youth smoking in the United States, Gruber and Zinman estimate an elasticity of smoking participation (defined as smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to

[12] New York City Department of Health and Mental Hygiene. "Smoking among New York City Public High School Students". NYC Vital Signs. February 2006.
[13] Chalpouka FJ,Warner KE:P.5.

1997.[14] That is, a 1% increase in cigarette prices would result in a decrease of 0.67% in the number of those seniors who smoked. The study's findings state that the drop in cigarette prices in the early 1990's can explain 26% of the upward trend in youth smoking during the same period. The study also found that price has little effect on the smoking habits of younger teens (8th grade through 11th grade), but that youth access restrictions have a significant impact on limiting the extent to which younger teens smoke. Tauras and Chaloupka also found an inverse relationship between price and cigarette consumption among high school seniors.[15] The price elasticity of cessation for males averaged 1.12 and for females averaged 1.19 in this study. These estimates imply that a 1% increase in the real price of cigarettes will result in an increase in the probability of smoking cessation for high school senior males and females of 1.12% and 1.19%, respectively. A study utilizing more recent data, from 1975 to 2003, by Grossman, estimated an elasticity of smoking participation of just -0.12.[16] Nevertheless it concludes that price increases subsequent to the 1998 MSA explain almost all of the 12% drop in youth smoking over that time.

In another study, Czart et al. (2001) looked at several factors which they felt could influence smoking among college students. These factors included price, school policies regarding tobacco use on campus, parental education levels, student income, student marital status, sorority/fraternity membership, and state policies regarding smoking. The authors considered two ways in which smoking behavior could be affected: (1) smoking participation; and (2) the amount of cigarettes consumed per smoker. The results of the study suggest that, (1) the average estimated price elasticity of smoking participation is –0.26, and (2), the average conditional demand elasticity is –0.62. These results indicate that a 1% increase in cigarette prices, will reduce smoking participation among college students by 0.26% and will reduce the level of smoking among current college students by 0.62%.[17]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[18] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least one to five cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticities of initiation are –0.27 for any smoking, -0.81 for smoking at least one to five cigarettes, and –0.96 for smoking at least one-half pack of cigarettes. These results above indicate that a

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[14] *Source*: Gruber, Jonathon and Zinman, Jonathon. "Youth Smoking in the U.S.:Evidence and Implications". Working Paper No. W7780. National Bureau of Economic Research. 2000.
[15] Source: Tauras, John A. and Chaloupka, Frank, J.. "Determinants of Smoking Cessation: An Analysis of Young Adult Men and Women". Working Paper No. W7262. National Bureau of Economic Research. 1999.
[16] Michael Grossman. "Individual Behaviors and Substance Use: The Role of Price". Working Paper No. W10948. National Bureau of Economic Research. December 2004.
[17] Czart et al. "The impact of prices and control policies on cigarette smoking among college students". Contemporary Economic Policy. Western Economic Association. Copyright April 2001.
[18] Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press. Copyright 2001.

10% increase in the price of cigarettes will decrease the probability of smoking initiation between approximately 3% and 10% depending on how initiation is defined. In a related study, Powell et al. (2003) estimated a price elasticity of youth smoking participation of –0.46, implying that a 1% increase in price leads to a 0.46% reduction in smoking participation.[19]

In conclusion, economic research suggests the demand for cigarettes is price inelastic, with an elasticity generally found to be between –0.3 and -0.5.

Nicotine Replacement Products

Nicotine replacement products, such as Nicorette Gum and Nicoderm patches, are used to aid those who are attempting to quit smoking. Before 1996, these products were only available with a doctor's prescription. Currently, they are available as over-the-counter products. One study, by Hu et al., examines the effects of nicotine replacement products on cigarette consumption in the United States.[20] One of the results of the study found that, "a 0.076% reduction in cigarette consumption is associated with the availability of nicotine patches after 1992." In October 2002, the FDA approved the Commit lozenge for over-the-counter sale. This product is similar to the gum and patch nicotine replacement products. It is unclear whether it offers a significant advantage over those other products.[21] NicoBloc, a liquid applied to cigarettes which blocks tar and nicotine from being inhaled, is another new cessation product on the market since 2003. Zyban is a non-nicotine drug that has been available since 2000. It has been shown to be effective when combined with intensive behavioral support.[22]

Several new drugs may also appear on the market in the near future. The Food and Drug Administration (FDA) has approved varenicline, a Pfizer product marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. Tests indicate that it is more effective as a cessation aid than Zyban. Pfizer has introduced Chantix with a novel marketing program, GETQUIT, an integrated consumer support system which emphasizes personalized treatment advice with regular phone and e-mail contact.

On May 14, 2005, Cytos Biotechnology AG announced the successful completion of Phase II testing of a virus-based vaccine, genetically engineered to attract an immune system response against nicotine and its effects. The company now plans to begin Phase III trials. Nabi Biopharmaceuticals is in Phase IIB clinical trials for NicVAX, a vaccine to

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[19] Powell et al. "Peer Effects, Tobacco Control Policies, and Youth Smoking Behavior". Impacteen. February 2003.

[20] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. http:\\tc.bmjjournals.com.

[21] Niaura, Raymond and Abrams, David B. "Smoking Cessation: Progress, Priorities, and Prospectus". Journal of Consulting and Clinical Psychology. June 2002.

[22] Roddy, Elin. "Bupropion and Other Non-nicotine Pharmacotherapies". *British Medical Journal.* 28 February 2004.

prevent and treat nicotine addiction. It triggers antibodies that bind with Nicotine molecules. On March 9, 2006, NicVAX received Fast Track Designation from the FDA, which is intended to expedite its review process. The company expects to move to Phase III trials in the second half of 2007. The Xenova Group is set to begin Phase II testing of its similar vaccine, Ta-Nic. And positive results were reported in July 2006 by Somaxon Pharmaceuticals from a pilot Phase II study of Nalmefene. Nalmefene has been used for over 10 years for the reversal of opioid drug effects. The company is seeking to develop it as a treatment for impulse control disorders. It is expected that products such as these will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. Our forecast includes a strong negative trend in smoking rates which incorporates the influence of these factors.

Workplace Restrictions

In their 1996 study on the effect of workplace smoking bans on cigarette consumption, Evans, Farrelly, and Montgomery found that between 1986 and 1993 smoking participation rates among workers fell 2.6% more than non-workers.[23] Their results suggest that workplace smoking bans reduce smoking prevalence by 5 percentage points and reduce consumption by smokers nearly 10%. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day that a smoker spends working in an environment where there are smoking restrictions, the greater is the decline in the quantity of cigarettes consumed by that smoker.

Factors Affecting Cigarette Consumption

Most empirical studies have found a common set of variables that are relevant in building a model of cigarette demand. These conventional analyses usually evaluate one or more of the following factors: (i) general population growth, (ii) price increases, (iii) changes in disposable income, (iv) youth consumption, (v) trend over time, (vi) smoking bans in public places, (vii) nicotine dependence and (viii) health warnings. While some of these factors were not found to have a measurable impact on changes in demand for cigarettes, all of these factors are thought to affect smoking in some manner and to affect current levels of consumption.

General Population Growth. Global Insight forecasts that the United States population will increase from 283 million in 2000 to approximately 409 million in 2052. This forecast is consistent with the Bureau of the Census forecast based on the 2000 Census.

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[23] *Source*: Evans, William N.; Farrelly, Matthew C. and Montgomery, Edward. "Do Workplace Smoking Bans Reduce Smoking*?"*. Working Paper No. W5567. National Bureau of Economic Research. 1996.

Price Elasticity of Demand & Price Increases. Cigarette price elasticities from recent conventional research studies have generally fallen within an interval of -0.3 to -0.5. Based on Global Insight's multivariate regression analysis using data from 1965 to 2003, the long run price elasticity of consumption for the entire population is -0.33; a 1.0% increase in the price of cigarettes decreases consumption by 0.33%.

In 1998, the average price of a pack of cigarettes in nominal terms was $2.20. This increased to $2.88 per pack in 1999, representing a nominal growth in the price of cigarettes of 30.9% from 1998. During 1999, consumption declined by 6.45%. This was primarily due to a $0.45 per pack increase in November 1998 which was intended to offset the costs of the MSA and agreements with previously settled states. The cigarette manufacturers then increased wholesale prices on seven occasions between August 1999 and April 2002, with the total change aggregating to $0.82. In addition to the wholesale price increases, in 1999 New York and California each increased its state excise tax by $0.50 per pack. In 2001, five states followed suit, and in January 2002, a scheduled increase in the federal excise tax of $0.05 per pack went into effect. By June 2002 the average price per pack had reached $3.73.

Severe budget shortfalls following the 2001 recession led at least 30 states to consider cigarette excise tax increases in 2002. Ultimately 20 states and New York City imposed excise tax increases that year. These increases range from $0.07 per pack in Tennessee to $1.42 per pack in New York City. They averaged $0.47 per pack, and, when weighted by the state population boosted the nationwide average retail price by $0.18. This increased the population-weighted average state excise tax to over $0.60 per pack. The trend continued in 2003, as state fiscal difficulties persisted. Excise tax increases were enacted in 13 states, pushing the average price per pack to over $3.80. This was followed by eleven state tax increases in 2004 and eight (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee" which has the same effect on consumer prices. This report will consider any such fees as equivalent to excise taxes. In 2006 Texas passed a budget that will raise the state excise tax by $1.00 in January 2007. Also in 2006 Hawaii, New Jersey, North Carolina, and Vermont have enacted legislation which raise excise taxes. As a result the population-weighted average state excise tax increased in July to $0.932 per pack. In the November elections referenda passed in Arizona and South Dakota raising excise taxes. Increases in California and Missouri were rejected by voters. As a result of these actions the weighted average state excise tax increased to $1.038 per pack in 2007. In 2007 Iowa has increased its excise tax by $1.00, to $1.36 per pack, and Indiana and Tennessee have each passed legislation in May which will boost excise taxes. These actions will further increase the average state excise tax to $1.065. It is expected that a few other states will also enact increases in 2007 and in future years. At least eleven states, California, Connecticut, Delaware, Maine, Maryland, Michigan, Mississippi, New Hampshire, Oregon, Pennsylvania, and Wisconsin, and New York City, are now considering proposed excise tax increases. After California voters rejected a ballot initiative on November 7, 2006 that would have raised the tax from $0.87 to $3.47 per pack, California lawmakers introduced three new smoking related bills that would: (a) raise the tax by $1.90 per pack: (b)

impose a fine of $100 on anyone smoking in a car with a child under the age of 18 present; (c) and ban smoking in state parks and on beaches.

The federal excise tax has remained constant, at $0.39 per pack, since 2002. This March the U.S. Senate included a $0.61 increase in an amendment to its proposed budget for the 2008 fiscal year, which begins October 1, 2007. The amendment was designed to provide funding for the State Children's Health Insurance Program. House and Senate leaders have indicated that the excise tax is just one of many funding options for the program If enacted the federal excise tax would equal $1.00 per pack, and the total state and federal excise tax would exceed $2.00 per pack.

During much of this period, the major manufacturers refrained from wholesale price increases, and also actively pursued extensive promotional and dealer and retailer discounting programs which served to hold down retail prices. They did this in part due to the state tax increases, but primarily to maintain their market share from its erosion by a deep discount segment which grew rapidly following the MSA. The major manufacturers were finally successful in stemming the increase in the deep discount market share, which has been stable since 2003. As 2004 came to a close, the manufacturers raised list prices for the first time since 2002. Reynolds American announced selected increases and a reduction in discounts on most brands of $0.10 per pack. In June 2005 Philip Morris reduced its retail buydown by $0.05 per pack for its lead brands, and Reynolds American announced price increases, effective January 2006, of up to $0.10 per pack on many of its brands. Effective December 18, 2006, Philip Morris USA has raised its prices by $0.10 per pack. The average price in December 2006 was $4.24 per pack. Following the wholesale price increase and excise tax increases it increased to $4.42 in May 2007.

Over the longer term our forecast expects price increases to continue to exceed the general rate of inflation due to increases in the manufacturers' prices as well as further increases in excise taxes.

Premium brands are typically $0.50 to $1.00 more expensive per pack than discount brands, allowing a margin for consumers to switch to less costly discount brands in the event of price increases. The increasing availability of cigarette outlets on Indian reservations, where sales are exempt from taxes, provides another opportunity for consumers to reduce the cost of smoking. Similarly, Internet sales of cigarettes are growing rapidly, though a recent decision by credit card companies that they would not handle cigarette sales has started to have an impact and will dampen this growth. While these sales are not technically exempt from taxation, states are currently having a difficult time enforcing existing statutes and collecting excise taxes on these sales.[24] Under the MSA, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped. The availability of lower price alternatives lessens the negative impact of price increases on cigarette volume.

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[24] *Source*: United States General Accounting Office. “Internet Cigarette Sales”. GAO-02-743. August 2002.

Changes in Disposable Income. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found cigarette consumption in the United States increases as disposable income increases.[25] However, a few studies found cigarette consumption decreases as disposable income increases.[26] Based on our multivariate regression analysis the income elasticity of consumption is 0.27; a 1.0% increase in real disposable income per capita increases per capita cigarette consumption by 0.27%.

Youth Consumption. The number of teenagers who smoke is another likely determinant of future adult consumption. While this variable has been largely ignored in empirical studies of cigarette consumption,[27] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[28] One study examines the effects of youth smoking on future adult smoking.[29] The study found that between 25% and 50% of any increase or decrease in youth smoking would persist into adulthood. According to the study, several factors may alter future correlation between youth and adult smoking: there are better means for quitting smoking than in the past, and there are more workplace bans in effect that those who are currently in their teen years will face as they age.

We have compiled data from the CDC which measures the incidence of smoking in the 12-17 age group as the percentage of the population in this category that first become daily smokers. This percentage, after falling since the early 1970s, began to increase in 1990 and increased through the decade. We assume that this recent trend peaked in the late 1990s and youth smoking has resumed its longer-term decline.

Trend Over Time. Since 1964 there has been a significant decline in U.S. adult per capita cigarette consumption. The Surgeon General's health warning (1964) and numerous subsequent health warnings, together with the increased health awareness of the population over the past thirty years, may have contributed to decreases in cigarette consumption levels. If, as we assume, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. In order to capture the impact of these changing health trends and the effects of other such variables which are difficult to quantify, our analysis includes a time trend variable.

Health Warnings. Categorical variables also have been used to capture the effect of different time periods on cigarette consumption. For example, some researchers have identified the United States Surgeon General's Report in 1964 and subsequent mandatory health warnings on cigarette packages as turning points in public attitudes and knowledge of the health effects of smoking. The Cigarette Labeling and Advertising Act of 1965 required a health warning to be placed on all cigarette packages sold in the United States beginning January 1, 1966. The Public Health Smoking Act of 1969 required all cigarette packages sold in the United States to carry an updated version of the warning,

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[25] Ippolito, et al.; Fuji.
[26] Wasserman, et al.; Townsend et al.
[27] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.
[28] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."
[29] *Source*: Gruber, Jonathon and Zinman, Jonathon. "Youth Smoking in the U.S.:Evidence and Implications". Working Paper No. W7780. National Bureau of Economic Research. 2000.

stating that it was a Surgeon General's warning, beginning November 1, 1970. The Comprehensive Smoking Education Act of 1984 led to even more specific health warnings on cigarette packages. The dangers of cigarette smoking have been generally known to the public for years. Part of the negative trend in smoking identified in our model may represent the cumulative effect of various health warnings since 1966.

Five states, Alabama, Georgia, Idaho, Kentucky and West Virginia, charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. Several large corporations, including Meijer Inc., Gannett Co., American Financial Group Inc., PepsiCo Inc. and Northwest Airlines, are now charging smokers higher premiums.

Smoking Bans in Public Places. Beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. In September 2003 Alabama joined the other 49 states and the District of Columbia in requiring smoke-free indoor air to some degree or in some public places.[30]

The most comprehensive bans have been enacted since 1998 in 26 states and a number of large cities. In 1998, California imposed a comprehensive smoking ban for all indoor workplaces, including restaurants and bars. Delaware followed suit in 2002, and in 2003, Connecticut, Maine, New York, and Florida passed similar comprehensive bans, as did the cities of Boston and Dallas. Since then, Arizona, Arkansas, Colorado, the District of Columbia, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Ohio, Oregon, Rhode Island, Tennessee, Utah, Vermont, Washington, and Puerto Rico established similar bans, as did the cities of Baltimore, Chicago, Houston, and Philadelphia. The New Mexico, Washington State and Chicago restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. It is expected that these restrictions will continue to proliferate. For example, in June 2007 at least 6 states are considering legislation which would enact comprehensive bans.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of April 2, 2007, there were 2,572 municipalities with indoor smoking restrictions. Of these, 455 local governments required workplaces to be 100% smoke-free, and 100% smoke-free conditions were required for restaurants by 403 governments, and for bars by 296. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars. These numbers grew to 49 for restaurants and 32 for bars in 1998, and doubled again by 2001, to 100 and 74, respectively.[31]

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[30] *Source*: American Lung Association. "State Legislated Actions on Tobacco Issues". 2002.
[31] *Source:* American Nonsmokers' Rights Foundation. http://www.no-smoke.org. April 2007.

Based on the regression analysis using data from 1965 to 2003, the restrictions on public smoking appear to have an independent effect on per capita cigarette consumption. We estimate that the restrictions instituted beginning in the late 1970's have reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. Bauer, et al. estimate that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[32] Research in Canada, by the Ontario Tobacco Research Unit, concludes that consumption drops in workplaces where smoking is banned, by almost five cigarettes per person per day. Tauras, in a study based on a large survey of smokers, found that the more restrictive smoke-free air laws decrease average smoking, but have little influence on prevalence.[33] The study predicts that moving from no smoking restrictions at all to to the most restrictive bans reduces average smoking by from 5% to 8%.

The first extensive outdoor smoking restrictions were instituted on March 2006 in Calabasas, California. The California municipalities of Belmont, Beverly Hills, Dublin, Emeryville, and Santa Monica, have also established extensive outdoor restrictions, as have Davis County and the city of Murray in Utah. Burbank, CA is expected to follow suit, and in June 2007 an Oakland City Councilmember proposed an outdoor ban. Also, the Belmont City Council has announced that it will draft a law that restricts smoking anywhere in the city except for single-family detached homes.

In the past year, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties have banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. The beach restrictions may soon become statewide. Nassau County, New York and Volusia County, Florida are also considering park and beach bans. At least 43 colleges nationwide now prohibit smoking everywhere on campus. California and Nevada have banned smoking in state prisons. Arkansas, Louisiana, Texas, and Rockland County, NY now prohibit smoking in a car where there are children present, and similar legislation has been proposed in Arizona, California, Connecticut, Illinois, Indiana, Iowa, Kansas, Massachusetts, Montana, New Jersey, New York, Oregon, Rhode Island, South Carolina, Utah, West Virginia, and in Bangor, Maine.

In June 2006, the Office of The Surgeon General released a report, 'The Health Consequences of Involuntary Exposure to Tobacco Smoke". It is a comprehensive review of health effects of involuntary exposure to tobacco smoke. It concludes definitively that secondhand smoke causes disease and adverse respiratory effects. It also concludes that policies creating completely smoke-free environments are the most economical and efficient approaches to providing protection to non-smokers. We expect that the report will strengthen arguments in favor of further smoking restrictions across the country. Further ammunition for activists for smoke-free environments was provided by the

[32] Bauer, Hyland, Li, Steger, and Cummings. "A Longitudinal Assessment of the Impact of Smoke-Free Worksite Policies on Tobacco Use". American Journal of Public Health. June 2005

[33] Tauras, John A. "Smoke-Free Air Laws, Cigarette Prices, and Adult Cigarette Demand" Economic Inquiry, April 2006.

California Environmental Protection Agency Air Resources Board, which in 2006 declared environmental tobacco smoke to be a toxic air contaminant.

The trend variable included in our econometric analysis is likely to incorporate some part of the cumulative impact of the various smoking bans and restrictions. Our forecast assumes that the factors, which have contributed to the negative trend in smoking in the U.S. population, continue to contribute to further declines in smoking rates throughout the forecast horizon. However, should there be a proliferation of the most severe bans, such as those extensively limiting outdoor smoking, or smoking anywhere children might be affected, consumption declines would very likely accelerate.

Smokeless Tobacco Products. Smokeless tobacco products have been available for centuries. As cigarette consumption expanded in the last century, the use of smokeless products declined. Chewing tobacco and snuff are the most significant components. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and potentially spit-free. Chewing tobacco and dry snuff consumption has been declining in the U.S. in this decade, but moist snuff consumption has increased at an annual rate of more than 5% since 2002, and by 10.4% in 2006, when over 5 million consumers purchased 1.1 billion cans. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco, is explicitly targeting adult smoker conversion in its growth strategy. The industry is responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. In 2006 the three largest U.S. cigarette manufacturers entered the market. Philip Morris introduced a snuff product, Taboka, Reynolds American acquired Conwood Company, the second largest domestic producer, and introduced Camel Snus, a snuff product, and Lorillard entered into an agreement with Swedish Match North America to develop smokeless products in the U.S.

Advocates of the use of snuff as part of a harm reduction strategy point to Sweden, where 'snus', a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men.[34] The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

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[34] Foulds, Ramstrom, Burke, and Fagerstrom. "Effect of Smokelss Tobacco (Snus) on Smoking and Public Health in Sweden". Tobacco Control. Vol. 12, 2003.

Similar to the case of smoking bans, this report assumes that the trend decline in smoking projected in this forecast is sufficient to incorporate the negative impact that increasing use of snuff may have on cigarette consumption.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[35] and the American Medical Association[36] (AMA) both conclude that nicotine is an addictive drug which produces dependence. The American Psychiatric Association has determined that cigarette smoking causes nicotine dependence in smokers and nicotine withdrawal in those who stop smoking. The American Medical Association Council on Scientific Affairs found that one-third to one-half of all people who experiment with smoking become smokers.

Other Considerations. In August 1999, the CDC published Best Practices for Comprehensive Tobacco Control Programs. Citing the success of programs in California and Massachusetts, the CDC recommends comprehensive tobacco control programs to the states. On August 9, 2000, the Surgeon General issued a report, Reducing Tobacco Use ("Surgeon General's Report"), that comprehensively assesses the value and efficacy of the major approaches that have been used to reduce tobacco use. The report concludes that a comprehensive program of educational strategies, treatment of nicotine addiction, regulation of advertising, clean air regulations, restriction of minors' access to tobacco, and increased excise taxation can significantly reduce the prevalence of smoking. The Surgeon General called for increased spending on anti-smoking initiatives by states, up to 25% of their annual settlement proceeds, which is far higher than the approximately 9% allocated from the first year's settlement payments.

The Surgeon General's Report documents evidence of the effectiveness of five major modalities for reducing tobacco use. Educational strategies are shown to be effective in postponing or preventing adolescent smoking. Pharmacologic treatment of nicotine addiction, combined with behavioral support, can enhance abstinence efforts. Regulation of advertising and promotional activities of manufacturers can reduce smoking, particularly among youth. Clean air regulations and restricted minor's access contribute to lessening smoking prevalence. And excise tax increases will reduce cigarette consumption. Further support for the efficacy of such programs is provided in an analysis by Farrelly, Pechacek, and Chaloupka.[37] They estimate that tobacco control program expenditures between 1988 and 1998 resulted in a decline in cigarette sales of 3%. Tauras, et al. estimate that, had state tobacco control spending been maintained at the levels recommended by the CDC, youth smoking rates would have been from 3.3% to 13.5% lower.[38] Also, Farrelly et al. estimate that 22% of the decline in youth smoking

[35] *Source:* Surgeon General's 1988 Report. "The Health Consequences of Smoking – Nicotine Addiction".
[36] *Source*: Council on Scientific Affairs. "Reducing the Addictiveness of Cigarettes". Report to the AMA House of Delegates. June 1998.
[37] "The Impact of Tobacco Control Program Expenditures on Aggregate Cigarette Sales: 1981-1998." Working Paper No. 8691,. National Bureau of Economic Research, 2001.
[38] Tauras, Chaloupka, Farrelly, Giovino, Wakefield, Johnston, O'Malley, Kloska, and Pechacek. "State Tobacco Control Spending and Youth Smoking", *American Journal of Public Health*, February 2005.

from 1999 to 2002 was due to the national "truth" mass media campaign.[39] In 2002, New York City implemented a strategy which sharply increased excise taxes, banned smoking in bars and restaurants, distributed free nicotine patches, and expanded educational efforts. Research by Frieden et al. estimates that smoking prevalence in the City declines by 11% as a result of these measures, an effect consistent with the conclusions of the Surgeon General's Report.[40]

In May 2001 a Commission established by President Clinton in September 2000 released its final report on how to improve economic conditions in tobacco dependent economies while making sure that public health does not suffer in the process.[41] The Commission recommended moving from the current quota system to what would be called a Tobacco Equity Reduction Program (TERP). TERP would allow compensation to be rendered to quota owners for the loss in value of their quota assets as a result of a restructuring to a production permit system where permits would be issued annually to tobacco growers. Also created would be a Center for Tobacco-Dependent Communities, which would address any challenges faced during this period. Three public health proposals that were suggested by the Commission were: that states increase funding on tobacco cessation and prevention programs; that the FDA be allowed to regulate tobacco products in a “fair and equitable” manner; and that funding be included in Medicaid and Medicare coverage for smoking cessation. To be able to fund these recommendations, the Commission called for a 17-cent increase in the excise tax on all packs of cigarettes sold in the United States. The increased revenues would then be deposited into a fund and earmarked for the recommended programs. On February 13, 2003, the Interagency Committee on Smoking and Health, which reports to the U.S. Department of Health and Human Services, issued recommendations, which included raising the federal excise tax on cigarettes from $0.39 to $2.39 per pack. The purpose of the tax increase would be to discourage smoking and to fund anti-tobacco efforts.

Neither the Surgeon General’s nor the Presidential Commission’s report have resulted in a concerted nationwide program to implement their recommendations, though legislation to establish FDA regulation was re-introduced in 2005 and again on February 15, 2007 as the Family Smoking Prevention and Tobacco Control Act. The bill would give the FDA broad authority over the sale, distribution, and advertising of tobacco products. Such legislation would, among other anticipated changes, permit the FDA to strengthen warning labels, reduce nicotine levels in tobacco products, police false or misleading advertising and marketing aimed at children and would require manufacturers to provide the FDA with lists of ingredients and additives in their products, including nicotine.

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[39] Farrelly, Davis, Haviland, Messeri, and Healton."Evidence of a Dose-Response Relationship Between "truth" Antismoking Ads and Youth Smoking Prevalence". *American Journal of Public Health.* March 2005.

[40] Frieden, Mostashari, Kerker, Miller, Hajat, and Frankel. "Adult Tobacco Use Levels After Intensive Tobacco Control Measures: New York City, 2002-2003". American Journal of Public Health. June 2005.

[41] “Tobacco at a Crossroad: A Call for Action”. President’s Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production While Protecting Public Health. May 14, 2001.

Research has indicated, and our model incorporates, a negative impact on cigarette consumption due to tobacco tax increases, and a negative trend decline in levels of smoking since the Surgeon General's 1964 warning, subsequent anti-smoking initiatives, and regulations which restrict smoking. Our model and forecast acknowledges the efficacy of these activities in reducing smoking and assumes that the effectiveness of such anti-smoking efforts will continue. For instance, in 2001, Canada required cigarette labels to include large graphic depictions of adverse health consequences of smoking. Recent research suggests that these warnings have some effectiveness, as one-fifth of the participants in a survey reported smoking less as a result of the labels.[42] Similarly, the Justice Department has indicated that, as part of a lawsuit against the tobacco companies, it may seek to require graphic health warnings covering 50% of cigarette packs. In addition, it would prohibit in-store promotions and require that all advertising and packaging be black-and-white. A similar proposal is part of the World Health Organization's Framework Convention on Tobacco Control, which the U.S. may sign. As the prevalence of smoking declines, it is likely that the achievement of further declines will require either greater levels of spending, or more effective programs. This is the common economic principle of diminishing returns**.**

New York State, in 2000, mandated that manufacturers provide, beginning in 2003, only cigarettes that self-extinguish. These standards went into effect in 2004. Similar laws have been enacted in California, Illinois, Iowa, Kentucky, New Hampshire, Maryland, Massachusetts, Montana, New Jersey, Oregon, Utah, and Vermont. We do not believe that these statutes or a nationwide agreement on such standards will affect consumption noticeably. It will probably raise the cost of manufacture slightly, but we view it as a continuation of a long series of government actions that contribute to the trend decline in consumption, which has been incorporated into our model. The expense and availability of technology required in the manufacture of self-extinguishing cigarettes may put the smaller manufacturers at a slight competitive disadvantage, as their cost per pack would increase more relative to the cost per pack increase for the larger manufacturers.

Similarly, in January 2001, Vector Group Ltd. announced plans for a virtually nicotine-free cigarette. The product, Quest, was introduced on January 27, 2003. This non-addictive product might be used as a tool to quit or reduce smoking. We view this as a continuation of efforts to provide products, such as the nicotine patch, that are supposed to reduce smoking addiction. These products have likely contributed to the trend decline in consumption incorporated into our model. In our forecast, we expect such efforts to continue to reduce per capita cigarette consumption.

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[42] Hammond, Fong, McDonald, Brown, and Cameron. "Graphic Canadian Warning Labels and Adverse Outcomes: Evidence from Canadian Smokers. *American Journal of Public Health.* August 2004.

An Empirical Model of Cigarette Consumption

An econometric model is a set of mathematical equations which statistically best describes the available historical data. It can be applied, with assumptions on the projected path of independent explanatory variables, to predict the future path of the dependent variable being studied, in this case adult per capita cigarette consumption (CPC). After extensive analysis of available data measuring all of the above-mentioned factors which influence smoking, we found the following variables to be effective in building an empirical model of adult per capita cigarette consumption for the United States:

1) the real price of cigarettes (cigprice)
2) the level of real disposable income per capita (ydp96pc)
3) the impact of restrictions on smoking in public places (smokeban)
4) the trend over time in individual behavior and preferences (trend)

We used the tools of standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the U.S. Then, using that relationship, along with Global Insight's standard adult population growth, and adjustment for non-adult smoking, we projected actual cigarette consumption (in billions of cigarettes) out to 2052. It should also be noted that since our entire dataset incorporates the effect of the Surgeon General's health warning (1964), the impact of that variable too is accounted for in the forecast. Similarly the effect of nicotine dependence is incorporated into our entire dataset and influences the trend decline.

Using U.S. data from 1965 through 2003 on the variables described above, we developed the following regression equation. All of the data sources are detailed in Appendix 1 of this Report.

$$\begin{aligned} \log(\text{cpc}) = {} & 57.7 - 0.024 * \text{trend} \\ & - 0.223 * \log(\text{cigprice}) - 0.106 * \log(\text{cigprice})(-1) \\ & + 0.270 * \log(\text{ydp96pc}) - 0.020 * \text{smokeban} \end{aligned}$$

The model is estimated in logarithmic form, since that allows the easy computation of the responsiveness (or elasticity) of the dependent variable (adult per capita cigarette consumption) to changes in the various explanatory (or the right hand side) variables.

This model has an R-square in excess of 0.99, meaning that it explains more than 99 percent of the variation in U.S. adult per capita cigarette consumption over the 1965 to 2003 period. In terms of explanatory power this indicates a very strong model with a high level of statistical significance.

Our model is completed with two other equations:

(1) Total adult cigarette consumption =

cpc * U.S. adult population.

(2) Total cigarette consumption =

total adult cigarette consumption + total youth cigarette consumption.

We have measured the consumption level of cigarettes in the 12-17 age group by examining the difference between total consumption and total adult consumption. We then use the expected trend of youth smoking incidence to adjust for the volume of cigarette consumption in this age group. Youth incidence is expected to gradually decline, and our estimated consumption levels will fall to 1.6 billion in 2052.

Dependent Variable

Adult Per Capita Cigarette Consumption (CPC)

CPC measures the average annual cigarette consumption of the American adult. It is calculated by dividing total adult cigarette consumption by the size of the population 18 and above. Of the different measures of cigarette consumption available, this is considered to be the most reliable. It also directly reflects the changing behavior of individual smokers over the historical period. Data were obtained from the U.S. Department of Agriculture's (USDA) Economic Research Service.

Explanatory Variables

The Real Price of Cigarettes (CIGPRICE)

Reliable data on retail cigarette prices from the consumer price index (CPI) are only available since 1997, an inadequate time frame to build our model. However, tobacco CPI, which is available for the entire period of analysis, closely follows cigarette prices, since cigarettes constitute over 95 percent of tobacco products. We have, therefore, used the tobacco CPI in our model, as is standard. Further, we have deflated this price of cigarettes (tobacco) by the overall price level to ensure that any change in cigarette consumption is correctly attributed to a change in the price of cigarettes relative to other goods, rather than an overall change in the price level. The overall, as well as tobacco CPI, were obtained from the Bureau of Labor Statistics (BLS).

The coefficient on CIGPRICE in the regression equation measures the elasticity of cigarette consumption with respect to price. In our model this effect consists of two parts. The coefficient of –0.223 measures the short-run elasticity of cigarette demand. That is, a 1% increase in price reduces consumption by 0.223% in the current year. The second

coefficient, -0.106 relates to prices in the previous year. It indicates that, following a 1% increase, an additional decrease in cigarette consumption of 0.106% will occur. Thus, according to the data, a one percent increase in price decreases cigarette consumption by 0.329 percent in the long term. The low value of the elasticity indicates that cigarette consumption is price inelastic, or relatively unresponsive to changes in price. This coefficient is estimated such that a statistical confidence interval of 95% places its value between -0.25 and -0.41. This implies that there is a probability of 5% that the price elasticity is outside this range.

Real Disposable Income Per Capita (YDP96PC)

Real disposable income per capita measures the average income per person after tax in constant 1996 dollars. Data used were collected by the Bureau of Economic Analysis (BEA). For goods considered "normal", consumption increases as incomes rise. Hence the coefficient is positive. On the other hand if the coefficient is negative, it indicates that the good is "inferior" and less is purchased as incomes rise.

Our analysis indicates that the income elasticity of cigarettes, given by the regression coefficient on YDP96PC, is 0.27. The positive sign on the coefficient indicates that cigarettes are a normal good. Specifically, every percent increase in real disposable income per capita has raised adult per capita cigarette consumption by 0.27%. However, the low value of the elasticity indicates that the demand for cigarettes is income inelastic, or relatively unresponsive to changes in income. This coefficient (0.27) is estimated such that a statistical confidence interval of 95% places its value between 0.03 and 0.52. This implies that there is a probability of 5% that the income elasticity is outside this range.

Qualitative Variable

The qualitative variable that we have explicitly included in our model relates to the restrictions on public smoking since the 1980s (SMOKEBAN). The negative coefficient on the variable implies that smoking decreases as a result of smoking bans. The coefficient on SMOKEBAN is estimated such that a statistical confidence interval of 95% for its value is from 0 to -0.53. This implies that there is a probability of 5% that the coefficient is outside this range.

Trend and Constant Term

According to the regression equation specified above, adult cigarette consumption per capita (CPC) displays a trend decline of 2.40% per year. The trend reflects the impact of a systematic change in the underlying data that is **not** explained by the included explanatory variables. In the case of cigarette consumption, the systematic change is in public attitudes toward smoking. The trend may also reflect the cumulative impact of health warnings, advertising restrictions, and other variables which are statistically insignificant when viewed in isolation. This trend, primarily due to an increase in the health-conscious proportion of the population averse to smoking, would by itself account for 90.3% of the variation in consumption. This coefficient is estimated such that a

statistical confidence interval of 95% for its value is from 0.0195 to 0.0269 (1.95% to 2.69%). This implies that there is a probability of 5% that the trend rate of decline is outside this range.

The constant term (57.7) also reflects the impact of excluded variables, those that stay fixed over time (e.g., the health warnings on cigarette packs). It should be noted that the actual decline in CPC in any given year could be above or below the trend, depending on the values of the other explanatory variables.

Forecast Assumptions

Our forecast is based on assumptions regarding the future path of the explanatory variables in the regression equation. Projections of U.S. population and real per capita personal disposable income are standard Global Insight forecasts. Annual population growth is projected to average 0.8%, and real per capita personal disposable income is projected to increase over the long term at just over 2.1% per year.

The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the tobacco settlement. Cigarette prices increased dramatically in November 1998, as manufacturers raised prices by $0.45 per pack. Subsequent increases by the manufacturers and numerous federal and state hikes in excise taxes brought prices to an average of $3.84 per pack in 2004, to $4.04 in 2005, and to $4.18 in 2006. After a long period of fighting to maintain market share, the large cigarette manufacturers are expected to reduce discounts and other promotions. In addition many states continue to discuss excise tax increases.

Our model, intended for long-term forecasting, uses annual data to describe changes in prices and other variables. When viewed over long intervals of time, the changes will appear to be gradual. The purpose of the model is to capture these broad changes and their influence on consumption. Because cigarette manufacturing is dominated by a few firms, price changes will typically be discrete events, with jumps such as occurred on August 1999 and December 2004, followed by plateaus, rather than small and continuous changes. The exact timing during the year of price changes influences only the short-term path of consumption.

The forecast assumes that average prices will reach $4.47 per pack in 2007 and $4.68 in 2008. Our forecast assumptions have incorporated price increases in excess of general inflation in order to meet the requirements of the MSA and offset excise and other taxes. Based upon our general inflation and cost assumptions, we anticipate that the nominal price per pack of cigarettes will rise to $34.40 by 2052, which is $8.94 in 2000 dollars. Relative to other goods, cigarette prices will rise by an average of 1.9% per year over the long term. The average real increase over the 30 years ending 1998 was 1.48% per year.

Prior to the MSA, only once, in 1983, have real cigarette prices appreciated at a double digit, or greater than 10%, rate. If a 10% rate of price increase were to continue, the

annual rate of decline in cigarette consumption predicted by our model would increase to approximately 4%.

Our Base Case Forecast assumes that the incidence of youth smoking will continue to decline. By 2052 we assume that youth smoking will have declined at an average annual rate of 2.6% since 2001, or by 73% overall.

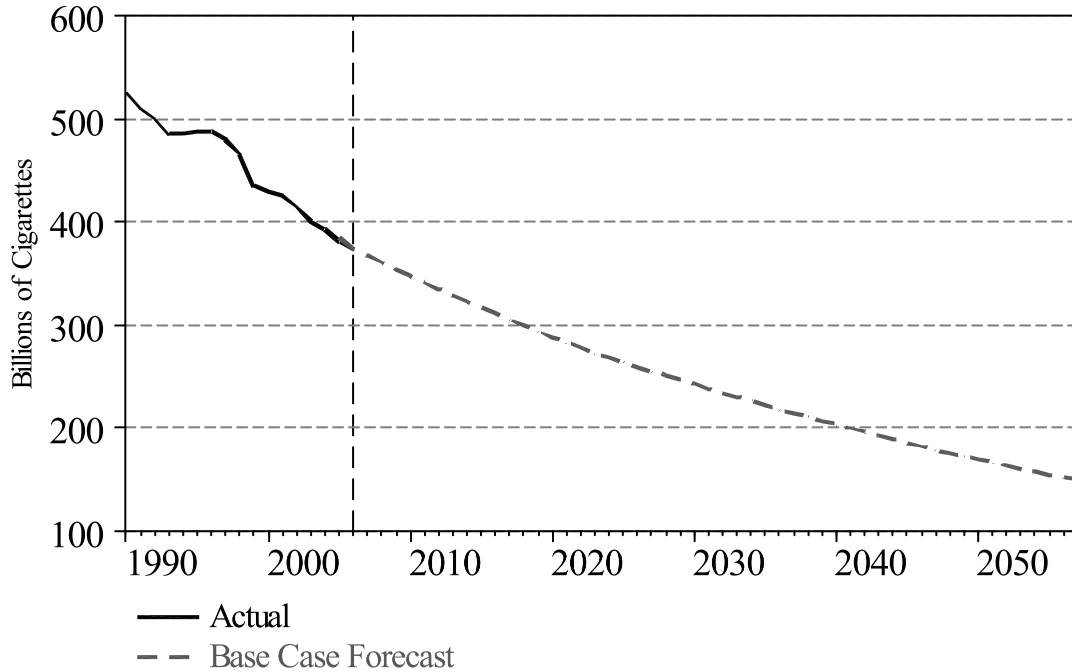
We believe the assumptions on which the Base Case Forecast are based to be reasonable.

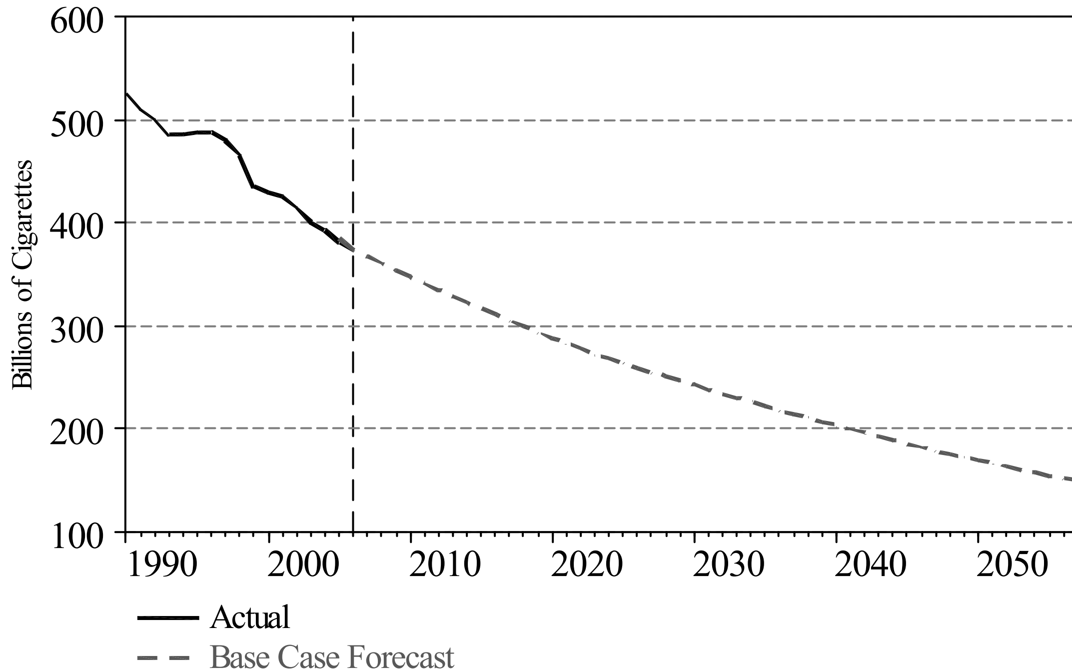
Forecast of Cigarette Consumption

After developing the regression equation specified above, we used it to project CPC for the period 2004 through 2052. Then using the standard adult population projections of Global Insight's macroeconomic model, we converted per capita consumption to aggregate adult consumption. We then added our estimate of teenage smoking volume going forward.

In using regression equations developed on the basis of historical data to project future values of the dependent variable, we must also assume that the underlying economic structure captured in the equation will remain essentially the same. While past performance is no guarantee of future patterns, it is still the best tool we have to make such projections.

The graphs below display the projected time trend of U.S. cigarette consumption. The first graph illustrates total actual and projected cigarette consumption in the United States. The second graph illustrates actual and projected CPC in the United States. For the period 1965 through 2003 the forecast line on the second graph indicates the value of CPC our model would have projected for those years.





In addition to the expected trend decline in cigarette consumption, the sharp upward shock to cigarette prices in late 1998 and 1999 contributed to a 6.45% reduction in consumption in 1999. The rate of decline has moderated considerably since that time, averaging -2.1% from 1999 to 2003. Total industry shipments for 2004 have been

reported at 394.5 billion, a 1.7% decline from 2003. The deep discount share of the market has been reported by the manufacturers as having stabilized at about 12% since 2003 and 2004. These cigarettes are produced by a large number of manufacturers, including many who participate in the MSA. After significant gains earlier in the decade, imports to the U.S. have declined from a high of 23.1 billion sticks in 2003 to 18.1 billion in 2005. In 2005 industry shipments of 381 billion cigarettes were 3.4% lower than in 2004. Part of this decline can be attributed to two extra shipping days in the leap year 2004. For 2006, industry shipments, as reported by the manufacturers, were 372.5 billion, 2.4% less than the 381.7 billion now reported for 2005. The US Tobacco and Tax Bureau (TTB) has also reported data through December 2006.[43] It reports 364.4 billion domestic shipments and 16.2 billion imported cigarettes. The total, 380.6 billion, is 0.1% fewer than in 2005. Industry shipments for the first quarter of 2007 were reported by the manufacturers as 84.3 billion, a 4.2% decline from a year earlier, and by TTB as 84.7 billion, 6.3% below a year earlier. Philip Morris attributes part of this decline to an inventory correction following 2006 shipments in advance of price increases. Other manufacturers have also reported increased trade inventories at the close of 2006.

On March 8, 2006 the National Association of Attorneys General and the American Legacy Foundation jointly announced that cigarette consumption in 2005 had fallen to 378 billion sticks. The estimate in this report, of 381 billion, is slightly higher. It is based on two sources. First, Reynolds American reported in February that the market research firm, MSAI, had estimated total industry shipments in 2005 of 381 billion. Second, the Alcohol and Tobacco Tax and Trade Bureau of the U.S. Department of Treasury reported on February 14, 2006, in their "Statistical Report – Tobacco", that U.S. manufacturers removed as taxable 362.96 billion cigarettes from production in 2005, and that imported cigarettes for consumption in 2005 totaled 18.13 billion. The total shipped for U.S. consumption is then 381.09 billion

After 2005, the rate of decline of consumption is projected to moderate and average less than 2% per year. From 2004 through 2052 the average annual rate of decline is projected to be 1.81%. On a per capita basis consumption is projected to fall at an average rate of 2.52% per year. Total consumption of cigarettes in the U.S. is projected to fall from an estimated 381 billion in 2005 to 373 billion in 2006, under 300 billion by 2018, and to under 200 billion by 2041.

Should the federal excise tax increase to $1.00 per pack, as has been proposed by the Senate, the resulting price increase, would, according to our model, lead to a sharper, one-time, consumption decline of 4.3%, or 15.5 billion cigarettes, by 2009. The difference with our Base Case forecast would be somewhat lower over the longer term, because our base case forecast assumptions incorporate the likelihood of significant excise tax increases over time.

[43] Statistical Report – Tobacco, December 2006. http:www.ttb.gov. 26-Feb-2007.

Statistical Confidence and Forecast Error

In addition to potential forecast errors due to incorrect forecast assumptions, there also exists possible error in the statistical estimation. The estimation and development of an econometric model is a statistical exercise. Thus, our parameters are estimated with some degree of error. We have provided confidence intervals for the coefficient (elasticity) estimates. For instance, there is a 2.5% probability (5%/2) that the price elasticity exceeds 0.38. There is similarly a 2.5% chance that the income elasticity is less than 0.03. But if these events were independent, the probability of both would be .025 x .025 = .000625, or .0625%, less than one tenth of one percent.

Comparison With Prior Forecasts

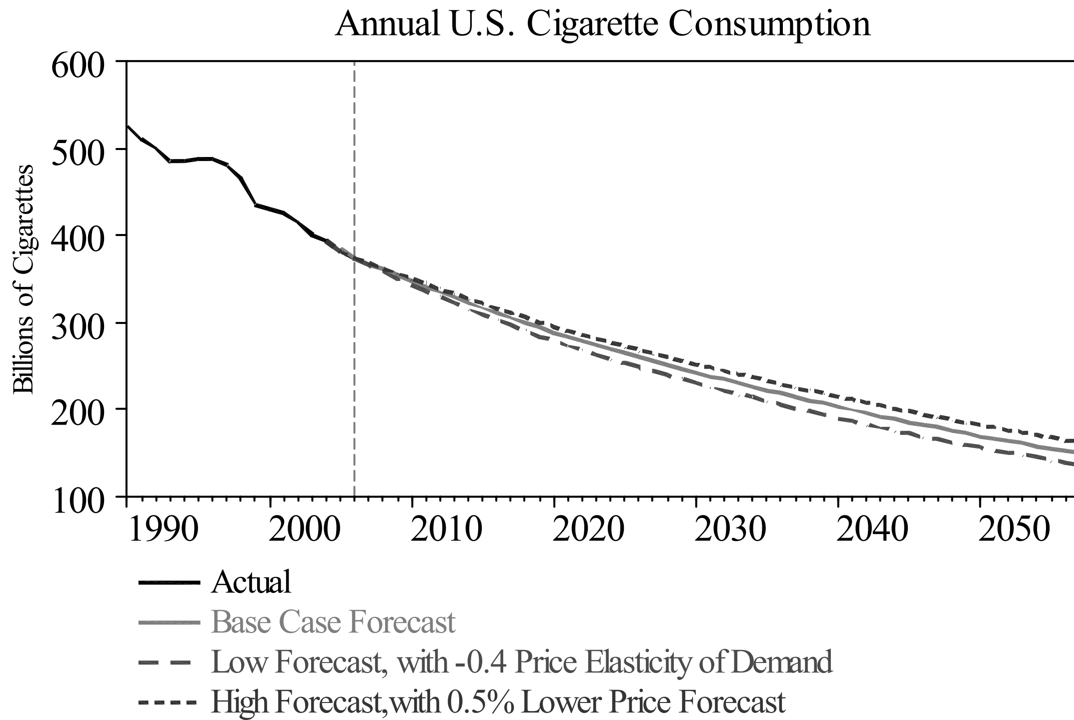
In June 2002 Global Insight, then DRI•WEFA presented a similar study, "A Forecast of U.S. Cigarette Consumption (2001-2043)." Its long run conclusions were quite similar to this study. The current forecast of consumption for the year 2043 is 4.5% less than that of the original study, 192.2 billion vs. 206.6 billion.

Alternative Forecasts

Two sources of variance may appear in the forecast derived by our model. First, as detailed in the Explanatory Variables section, there is some degree of forecast error in the parameters of the model. Second, the time paths of the explanatory variables may differ from our Base Case Forecast assumptions. Alternative forecasts are included in order to provide an interval forecast that, in our opinion, encompasses all of the likely potential realizations over time.

The high and low alternative forecasts are derived as follows. For the high scenario, we use a lower price forecast, under which prices are increasing at an annual rate 0.5% more slowly than our current base case forecast. Under this scenario, the rate of decline is moderated slightly, from an average rate of 1.81% to 1.66%, resulting in consumption of 176 billion in 2052.

In the low forecast, Low Case 1, we posit a sharper price elasticity of demand. Our estimate of the price elasticity, -0.33, is on the low end of the range when compared to that of certain other economic researchers. Recent economic research has forged a consensus that the elasticity lies between –0.3 and –0.5. We have, therefore, used a higher elasticity of –0.4, to generate the lowest consumption forecast which might be reasonably anticipated by our model. This increases the average rate of decline to 1.98% and results in cigarette consumption of 150 billion in 2052.



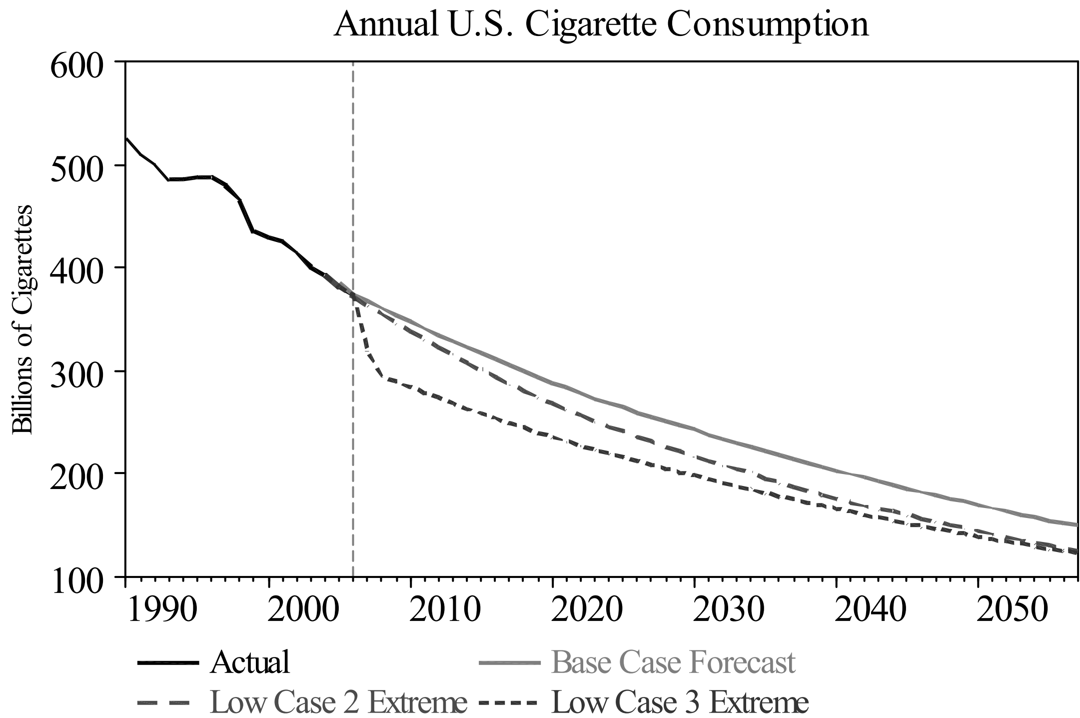
Hypothetical Stress Scenarios

The model was also tested under more extreme, and concurrently, less likely conditions. These exercises do not represent informed anticipation of possible future conditions. Rather, they are meant only to test the model under extreme conditions. First, we increased the negative response of consumer demand to recent price increases by assuming a much larger, -0.5, elasticity. This sharpens the fall in total consumption to an average annual rate of 2.14%, and results in demand of 138 billion cigarettes in 2052 (Low Case 2). This scenario would also be the result if, instead of a greater price sensitivity of smokers, we postulated an increased rate of cigarette price increase. Indeed, if cigarette prices, instead of averaging increases in real terms of 1.93% per year, accelerated to a pace of 3.38% annually, demand would also fall to 138 billion in 2052.

A second large negative stress is placed by postulating, in 2007, either an adverse federal government settlement, or tort claims of three times the size of this MSA. This would result in a real price increase of 57%, and a large decline, 18% over two years, in consumption. By 2052, consumption will have fallen to 134 billion cigarettes, an average annual rate of decline of 2.21% (Low Case 3).

Alternative Forecasts

	2052 Consumption Level (Bil.)	Average Annual Decline (%)
Base Case Forecast	163	1.81
Low Case 1	150	1.98
High Alternative	176	1.66
Low Case 2	138	2.14
Low Case 3	134	2.21



Finally, for comparative purposes we have calculated the volume of total cigarette consumption under four alternative annual rates of decline, 2.5%, 3%, 3.5% and 4%. Under these scenarios consumption in 2052 falls to 116 billion, 91 billion, 71 billion, and 56 billion respectively. These calculations are simple arithmetic examples, and are neither forecasts nor projections.

Base Case Forecast: Assumptions for Explanatory Variables

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Nominal Price Per Pack
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*Fraction*	*Billions*	*$ (Current)*
1965	4.84	4.13	1.95	0.04		
1966	4.06	0.92	1.28	0.04		
1967	3.27	0.72	1.39	0.05		
1968	3.50	1.89	1.56	0.05		
1969	2.06	0.00	1.69	0.06		
1970	3.02	2.24	2.00	0.05		
1971	3.28	0.12	2.27	0.06		
1972	3.66	2.08	2.85	0.06		
1973	5.73	-3.29	2.03	0.07		
1974	-1.62	-5.49	2.05	0.07		
1975	1.30	-1.87	2.12	0.05		
1976	2.92	-1.40	2.07	0.05		
1977	2.46	-1.60	1.91	0.07		
1978	3.58	-2.05	1.91	0.06		
1979	1.35	-4.73	2.00	0.05		
1980	0.06	-5.03	1.96	0.05		
1981	1.63	-2.11	1.73	0.06		
1982	1.20	4.80	1.64	0.05		
1983	2.35	15.84	1.46	0.04		
1984	6.63	2.10	1.48	0.05		
1985	2.45	2.31	1.16	0.05		
1986	2.21	4.84	1.38	0.06		
1987	0.83	3.36	1.23	0.05		
1988	3.32	4.83	1.26	0.05		
1989	1.82	7.64	1.35	0.05		
1990	0.72	4.71	0.89	0.06	7.96	
1991	-0.81	7.16	0.96	0.06	7.72	
1992	2.08	5.24	0.99	0.06	7.62	
1993	-0.24	0.91	1.02	0.06	7.12	
1994	1.48	-6.11	0.95	0.07	7.21	
1995	1.58	-0.21	0.85	0.07	7.76	
1996	1.77	0.18	0.89	0.08	7.54	
1997	2.30	2.31	1.27	0.08	6.58	
1998	4.63	11.03	1.15	0.08	6.30	2.20
1999	1.80	26.72	1.13	0.08	5.92	2.88
2000	3.71	7.47	1.14	0.08	5.92	3.20
2001	0.89	4.36	1.10	0.08	5.92	3.45
2002	2.06	5.76	1.02	0.08	5.91	3.71
2003	1.32	-0.64	0.96	0.08	5.87	3.77
2004	2.43	-0.75	0.96	0.08	5.84	3.84
2005	0.48	1.68	0.98	0.08	5.82	4.04
2006	2.24	1.87	0.99	0.08	5.80	4.18
2007	2.19	5.09	1.00	0.08	5.78	4.47
2008	2.22	2.71	1.00	0.08	5.77	4.68
2009	2.20	3.10	1.02	0.07	5.77	4.92
2010	2.17	2.61	1.00	0.07	5.62	5.17
2011	2.10	2.57	0.93	0.07	5.47	5.42
2012	2.02	2.52	0.88	0.07	5.32	5.71
2013	2.02	2.48	0.81	0.07	5.18	6.01
2014	2.02	2.84	0.80	0.07	5.18	6.35
2015	2.04	2.02	0.84	0.07	5.18	6.66

Base Case Forecast: Assumptions for Explanatory Variables (Cont.)

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Nominal Price Per Pack
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*Fraction*	*Billions*	*$ (Current)*
2016	2.04	2.37	0.82	0.07	5.18	7.00
2017	2.05	2.34	0.77	0.07	5.18	7.36
2018	2.05	2.31	0.76	0.07	5.18	7.74
2019	2.06	2.27	0.74	0.06	5.03	8.13
2020	2.08	1.89	0.76	0.06	4.88	8.52
2021	2.09	2.22	0.77	0.06	4.73	8.94
2022	2.10	1.85	0.77	0.06	4.59	9.36
2023	2.11	2.17	0.78	0.06	4.44	9.83
2024	2.11	1.81	0.78	0.06	4.44	10.28
2025	2.11	1.79	0.79	0.05	4.29	10.75
2026	2.11	1.78	0.79	0.05	4.14	11.24
2027	2.11	1.76	0.79	0.05	3.99	11.76
2028	2.11	1.75	0.80	0.05	3.85	12.29
2029	2.11	1.73	0.80	0.05	3.70	12.85
2030	2.11	2.02	0.80	0.05	3.70	13.47
2031	2.11	1.70	0.79	0.04	3.55	14.07
2032	2.11	1.68	0.77	0.04	3.40	14.70
2033	2.11	1.67	0.76	0.04	3.25	15.36
2034	2.11	1.66	0.75	0.04	3.11	16.04
2035	2.11	2.50	0.74	0.04	2.96	16.90
2036	2.11	1.62	0.72	0.04	2.96	17.64
2037	2.11	1.89	0.71	0.04	2.96	18.47
2038	2.11	1.59	0.70	0.04	2.96	19.28
2039	2.11	1.85	0.69	0.03	2.81	20.18
2040	2.11	1.57	0.68	0.03	2.66	21.06
2041	2.11	1.56	0.67	0.03	2.51	21.97
2042	2.11	1.81	0.66	0.03	2.37	22.99
2043	2.11	1.53	0.66	0.03	2.22	23.98
2044	2.11	1.53	0.66	0.03	2.08	25.01
2045	2.11	1.68	0.67	0.03	2.02	26.05
2046	2.11	1.66	0.68	0.03	2.02	27.14
2047	2.11	1.67	0.69	0.03	2.02	28.28
2048	2.11	1.64	0.70	0.02	2.02	29.47
2049	2.11	1.65	0.71	0.02	1.92	30.70
2050	2.11	1.67	0.70	0.02	1.82	32.00
2051	2.11	1.65	0.69	0.02	1.71	33.34
2052	2.11	1.66	0.68	0.02	1.62	34.74

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2052)

	Per Capita Consumption	Growth Rate	Total Consumption	Total Consumption	Growth Rate
		(%)	*(billions)*	*(billions of packs)*	*(%)*
1965	4259	1.53	528.70	26.44	3.42
1966	4287	0.66	541.20	27.06	2.36
1967	4280	-0.16	549.20	27.46	1.48
1968	4186	-2.20	545.70	27.29	-0.64
1969	3993	-4.61	528.90	26.45	-3.08
1970	3985	-0.20	536.40	26.82	1.42
1971	4037	1.30	555.10	27.76	3.49
1972	4043	0.15	566.80	28.34	2.11
1973	4148	2.60	589.70	29.49	4.04
1974	4141	-0.17	599.00	29.95	1.58
1975	4123	-0.43	607.20	30.36	1.37
1976	4092	-0.75	613.50	30.68	1.04
1977	4051	-1.00	617.00	30.85	0.57
1978	3967	-2.07	616.00	30.80	-0.16
1979	3861	-2.67	621.50	31.08	0.89
1980	3849	-0.31	631.50	31.58	1.61
1981	3836	-0.34	640.00	32.00	1.35
1982	3739	-2.53	634.00	31.70	-0.94
1983	3488	-6.71	600.00	30.00	-5.36
1984	3446	-1.20	600.40	30.02	0.07
1985	3370	-2.21	594.00	29.70	-1.07
1986	3274	-2.85	583.80	29.19	-1.72
1987	3197	-2.35	575.00	28.75	-1.51
1988	3096	-3.16	562.50	28.13	-2.17
1989	2926	-5.49	540.00	27.00	-4.00
1990	2826	-3.14	525.00	26.25	-2.78
1991	2727	-3.50	510.00	25.50	-2.86
1992	2647	-2.93	500.00	25.00	-1.96
1993	2542	-3.97	485.00	24.25	-3.00
1994	2524	-0.71	486.00	24.30	0.21
1995	2505	-0.75	487.00	24.35	0.21
1996	2482	-0.84	487.00	24.35	0.00
1997	2423	-2.50	480.00	24.00	-1.44
1998	2320	-4.25	465.00	23.25	-3.13
1999	2136	-7.93	435.00	21.75	-6.45
2000	2056	-3.75	430.00	21.50	-1.15
2001	2026	-1.46	425.00	21.25	-1.16
2002	1979	-2.32	415.00	20.75	-2.35
2003	1837	-7.18	400.00	20.00	-3.61
2004	1791	-2.50	393.00	19.65	-1.75
2005	1719	-3.99	381.00	19.05	-3.05
2006	1670	-2.85	373.34	18.67	-2.01
2007	1625	-2.70	366.86	18.34	-1.73
2008	1581	-2.72	360.59	18.03	-1.71
2009	1537	-2.82	353.96	17.70	-1.84
2010	1494	-2.76	347.62	17.38	-1.79
2011	1454	-2.72	341.27	17.06	-1.83
2012	1414	-2.70	334.93	16.75	-1.86
2013	1376	-2.69	328.54	16.43	-1.91
2014	1338	-2.76	322.14	16.11	-1.95
2015	1303	-2.62	316.45	15.82	-1.77

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2052) (Cont.)

	Per Capita Consumption	Growth Rate	Total Consumption	Total Consumption	Growth Rate
		(%)	*(billions)*	*(billions of packs)*	*(%)*
2016	1269	-2.61	310.82	15.54	-1.78
2017	1236	-2.63	305.06	15.25	-1.85
2018	1203	-2.62	299.41	14.97	-1.85
2019	1172	-2.61	293.71	14.69	-1.90
2020	1142	-2.53	288.43	14.42	-1.80
2021	1113	-2.56	283.17	14.16	-1.83
2022	1085	-2.51	278.11	13.91	-1.79
2023	1058	-2.54	273.09	13.65	-1.81
2024	1032	-2.49	268.43	13.42	-1.71
2025	1006	-2.45	263.84	13.19	-1.71
2026	982	-2.44	259.36	12.97	-1.70
2027	958	-2.44	254.97	12.75	-1.69
2028	934	-2.43	250.69	12.53	-1.68
2029	912	-2.43	246.48	12.32	-1.68
2030	889	-2.49	242.34	12.12	-1.68
2031	867	-2.45	238.16	11.91	-1.72
2032	846	-2.42	234.12	11.71	-1.70
2033	826	-2.41	230.14	11.51	-1.70
2034	806	-2.41	226.19	11.31	-1.72
2035	785	-2.59	221.88	11.09	-1.91
2036	766	-2.49	217.98	10.90	-1.76
2037	747	-2.45	214.19	10.71	-1.74
2038	729	-2.42	210.53	10.53	-1.71
2039	711	-2.44	206.72	10.34	-1.81
2040	694	-2.41	203.02	10.15	-1.79
2041	677	-2.38	199.44	9.97	-1.77
2042	661	-2.43	195.80	9.79	-1.83
2043	645	-2.42	192.24	9.61	-1.82
2044	640	-2.41	188.76	9.59	-1.81
2045	625	-2.42	185.34	9.27	-1.81
2046	609	-2.41	182.02	9.10	-1.79
2047	595	-2.41	178.77	8.94	-1.78
2048	580	-2.41	175.61	8.78	-1.77
2049	566	-2.41	172.52	8.63	-1.76
2050	553	-2.41	169.46	8.47	-1.77
2051	539	-2.41	166.45	8.32	-1.78
2052	526	-2.41	163.47	8.17	-1.79

Base Case Forecast and Low Case Extreme Projections

Year	Base Case Forecast			Low Case 1: -0.4 Price Elasticity of Demand			High Forecast: Lower Price Assumption		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
2006	373.34	18.67	-2.01	372.50	18.62	-2.23	373.99	18.70	-1.84
2007	366.86	18.34	-1.73	365.11	18.26	-1.98	368.10	18.40	-1.57
2008	360.59	18.03	-1.71	357.81	17.89	-2.00	362.21	18.11	-1.60
2009	353.96	17.70	-1.84	350.22	17.51	-2.12	356.09	17.80	-1.69
2010	347.62	17.38	-1.79	343.12	17.16	-2.03	350.25	17.51	-1.64
2011	341.27	17.06	-1.83	336.05	16.80	-2.06	344.41	17.22	-1.67
2012	334.93	16.75	-1.86	329.04	16.45	-2.09	338.53	16.93	-1.71
2013	328.54	16.43	-1.91	322.01	16.10	-2.14	332.58	16.63	-1.76
2014	322.14	16.11	-1.95	314.92	15.75	-2.20	326.63	16.33	-1.79
2015	316.45	15.82	-1.77	308.80	15.44	-1.95	321.35	16.07	-1.62
2016	310.82	15.54	-1.78	302.65	15.13	-1.99	316.12	15.81	-1.63
2017	305.06	15.25	-1.85	296.41	14.82	-2.06	310.76	15.54	-1.69
2018	299.41	14.97	-1.85	290.33	14.52	-2.05	305.50	15.28	-1.69
2019	293.71	14.69	-1.90	284.19	14.21	-2.11	300.15	15.01	-1.75
2020	288.43	14.42	-1.80	278.57	13.93	-1.98	295.21	14.76	-1.65
2021	283.17	14.16	-1.83	272.93	13.65	-2.03	290.26	14.51	-1.68
2022	278.11	13.91	-1.79	267.62	13.38	-1.95	285.54	14.28	-1.63
2023	273.09	13.65	-1.81	262.28	13.11	-2.00	280.84	14.04	-1.65
2024	268.43	13.42	-1.71	257.39	12.87	-1.87	276.50	13.83	-1.55
2025	263.84	13.19	-1.71	252.57	12.63	-1.87	272.21	13.61	-1.55
2026	259.36	12.97	-1.70	247.88	12.39	-1.86	268.02	13.40	-1.54
2027	254.97	12.75	-1.69	243.29	12.16	-1.85	263.90	13.19	-1.54
2028	250.69	12.53	-1.68	238.81	11.94	-1.84	259.86	12.99	-1.53
2029	246.48	12.32	-1.68	234.45	11.72	-1.83	255.91	12.80	-1.52
2030	242.34	12.12	-1.68	230.06	11.50	-1.87	251.99	12.60	-1.53
2031	238.16	11.91	-1.72	225.75	11.29	-1.87	248.05	12.40	-1.56
2032	234.12	11.71	-1.70	221.58	11.08	-1.85	244.24	12.21	-1.54
2033	230.14	11.51	-1.70	217.49	10.87	-1.85	240.46	12.02	-1.55
2034	226.19	11.31	-1.72	213.42	10.67	-1.87	236.72	11.84	-1.56
2035	221.88	11.09	-1.91	208.86	10.44	-2.14	232.56	11.63	-1.76
2036	217.98	10.90	-1.76	204.90	10.25	-1.90	228.84	11.44	-1.60
2037	214.19	10.71	-1.74	200.99	10.05	-1.91	225.23	11.26	-1.58
2038	210.53	10.53	-1.71	197.27	9.86	-1.85	221.74	11.09	-1.55
2039	206.72	10.34	-1.81	193.37	9.67	-1.98	218.06	10.90	-1.66
2040	203.02	10.15	-1.79	189.64	9.48	-1.93	214.51	10.73	-1.63
2041	199.44	9.97	-1.77	186.03	9.30	-1.91	211.05	10.55	-1.62
2042	195.80	9.79	-1.83	182.31	9.12	-2.00	207.51	10.38	-1.68
2043	192.24	9.61	-1.82	178.76	8.94	-1.95	204.09	10.20	-1.65
2044	188.76	9.59	-1.81	175.29	8.89	-1.94	200.74	10.22	-1.64
2045	185.34	9.27	-1.81	171.92	8.60	-1.93	197.44	9.87	-1.64
2046	182.02	9.10	-1.79	168.63	8.43	-1.91	194.22	9.71	-1.63
2047	178.77	8.94	-1.78	165.43	8.27	-1.90	191.08	9.55	-1.62
2048	175.61	8.78	-1.77	162.31	8.12	-1.88	188.02	9.40	-1.60
2049	172.52	8.63	-1.76	159.27	7.96	-1.87	185.02	9.25	-1.59
2050	169.46	8.47	-1.77	156.26	7.81	-1.89	182.05	9.10	-1.61
2051	166.45	8.32	-1.78	153.30	7.66	-1.89	179.11	8.96	-1.61
2052	163.47	8.17	-1.79	150.38	7.52	-1.91	176.20	8.81	-1.63

Base Case Forecast and Low Case Extreme Projections

Year	Base Case Forecast			Low Case 2: -0.5 Price Elasticity of Demand			Low Case 3: Large MSA in 2006		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
2006	373.34	18.67	-2.01	371.51	18.58	-2.49	373.34	18.67	-2.01
2007	366.86	18.34	-1.73	363.10	18.15	-2.26	319.24	15.96	-14.49
2008	360.59	18.03	-1.71	354.86	17.74	-2.27	294.49	14.72	-7.75
2009	353.96	17.70	-1.84	346.24	17.31	-2.43	289.07	14.45	-1.84
2010	347.62	17.38	-1.79	338.31	16.92	-2.29	283.90	14.20	-1.79
2011	341.27	17.06	-1.83	330.47	16.52	-2.32	278.71	13.94	-1.83
2012	334.93	16.75	-1.86	322.74	16.14	-2.34	273.53	13.68	-1.86
2013	328.54	16.43	-1.91	315.07	15.75	-2.38	268.32	13.42	-1.91
2014	322.14	16.11	-1.95	307.22	15.36	-2.49	263.09	13.15	-1.95
2015	316.45	15.82	-1.77	300.63	15.03	-2.15	258.44	12.92	-1.77
2016	310.82	15.54	-1.78	293.93	14.70	-2.23	253.84	12.69	-1.78
2017	305.06	15.25	-1.85	287.19	14.36	-2.29	249.14	12.46	-1.85
2018	299.41	14.97	-1.85	280.63	14.03	-2.28	244.52	12.23	-1.85
2019	293.71	14.69	-1.90	274.06	13.70	-2.34	239.87	11.99	-1.90
2020	288.43	14.42	-1.80	268.15	13.41	-2.16	235.56	11.78	-1.80
2021	283.17	14.16	-1.83	262.13	13.11	-2.25	231.26	11.56	-1.83
2022	278.11	13.91	-1.79	256.53	12.83	-2.14	227.13	11.36	-1.79
2023	273.09	13.65	-1.81	250.85	12.54	-2.22	223.03	11.15	-1.81
2024	268.43	13.42	-1.71	245.72	12.29	-2.05	219.23	10.96	-1.71
2025	263.84	13.19	-1.71	240.68	12.03	-2.05	215.48	10.77	-1.71
2026	259.36	12.97	-1.70	235.77	11.79	-2.04	211.81	10.59	-1.70
2027	254.97	12.75	-1.69	230.98	11.55	-2.03	208.23	10.41	-1.69
2028	250.69	12.53	-1.68	226.34	11.32	-2.01	204.74	10.24	-1.68
2029	246.48	12.32	-1.68	221.79	11.09	-2.01	201.30	10.06	-1.68
2030	242.34	12.12	-1.68	217.20	10.86	-2.07	197.91	9.90	-1.68
2031	238.16	11.91	-1.72	212.76	10.64	-2.04	194.50	9.73	-1.72
2032	234.12	11.71	-1.70	208.47	10.42	-2.02	191.20	9.56	-1.70
2033	230.14	11.51	-1.70	204.26	10.21	-2.02	187.96	9.40	-1.70
2034	226.19	11.31	-1.72	200.12	10.01	-2.03	184.73	9.24	-1.72
2035	221.88	11.09	-1.91	195.35	9.77	-2.39	181.21	9.06	-1.91
2036	217.98	10.90	-1.76	191.31	9.57	-2.07	178.02	8.90	-1.76
2037	214.19	10.71	-1.74	187.31	9.37	-2.09	174.93	8.75	-1.74
2038	210.53	10.53	-1.71	183.55	9.18	-2.01	171.94	8.60	-1.71
2039	206.72	10.34	-1.81	179.57	8.98	-2.17	168.83	8.44	-1.81
2040	203.02	10.15	-1.79	175.82	8.79	-2.09	165.81	8.29	-1.79
2041	199.44	9.97	-1.77	172.19	8.61	-2.07	162.88	8.14	-1.77
2042	195.80	9.79	-1.83	168.44	8.42	-2.18	159.90	8.00	-1.83
2043	192.24	9.61	-1.82	164.90	8.25	-2.10	157.00	7.85	-1.82
2044	188.76	9.59	-1.81	163.43	8.17	-2.09	154.16	8.35	-1.81
2045	185.34	9.42	-1.78	160.01	8.00	-2.10	151.41	7.57	-1.78
2046	182.02	9.26	-1.72	156.68	7.83	-2.08	148.81	7.44	-1.72
2047	178.77	9.10	-1.70	153.45	7.67	-2.07	146.27	7.31	-1.70
2048	175.61	8.95	-1.69	150.30	7.52	-2.05	143.80	7.19	-1.69
2049	172.52	8.79	-1.74	147.24	7.36	-2.04	141.30	7.07	-1.74
2050	169.46	8.64	-1.75	144.21	7.21	-2.06	138.83	6.94	-1.75
2051	166.45	8.49	-1.76	141.24	7.06	-2.06	136.38	6.82	-1.76
2052	163.47	8.34	-1.77	138.31	6.92	-2.07	133.97	6.70	-1.77

Alternative Constant Rate Decline Projections

Year	2.5%			3.0%		
	Cigarettes	*Packs (billions)*	*Growth Rate*	*Cigarettes*	*Packs (billions)*	*Growth Rate*
2006	371.48	18.57	-2.50	369.57	18.48	-3.00
2007	362.19	18.11	-2.50	358.48	17.92	-3.00
2008	353.13	17.66	-2.50	347.73	17.39	-3.00
2009	344.31	17.22	-2.50	337.30	16.86	-3.00
2010	335.70	16.78	-2.50	327.18	16.36	-3.00
2011	327.31	16.37	-2.50	317.36	15.87	-3.00
2012	319.12	15.96	-2.50	307.84	15.39	-3.00
2013	311.14	15.56	-2.50	298.61	14.93	-3.00
2014	303.37	15.17	-2.50	289.65	14.48	-3.00
2015	295.78	14.79	-2.50	280.96	14.05	-3.00
2016	288.39	14.42	-2.50	272.53	13.63	-3.00
2017	281.18	14.06	-2.50	264.35	13.22	-3.00
2018	274.15	13.71	-2.50	256.42	12.82	-3.00
2019	267.29	13.36	-2.50	248.73	12.44	-3.00
2020	260.61	13.03	-2.50	241.27	12.06	-3.00
2021	254.10	12.70	-2.50	234.03	11.70	-3.00
2022	247.74	12.39	-2.50	227.01	11.35	-3.00
2023	241.55	12.08	-2.50	220.20	11.01	-3.00
2024	235.51	11.78	-2.50	213.59	10.68	-3.00
2025	229.62	11.48	-2.50	207.19	10.36	-3.00
2026	223.88	11.19	-2.50	200.97	10.05	-3.00
2027	218.29	10.91	-2.50	194.94	9.75	-3.00
2028	212.83	10.64	-2.50	189.09	9.45	-3.00
2029	207.51	10.38	-2.50	183.42	9.17	-3.00
2030	202.32	10.12	-2.50	177.92	8.90	-3.00
2031	197.26	9.86	-2.50	172.58	8.63	-3.00
2032	192.33	9.62	-2.50	167.40	8.37	-3.00
2033	187.52	9.38	-2.50	162.38	8.12	-3.00
2034	182.83	9.14	-2.50	157.51	7.88	-3.00
2035	178.26	8.91	-2.50	152.78	7.64	-3.00
2036	173.81	8.69	-2.50	148.20	7.41	-3.00
2037	169.46	8.47	-2.50	143.75	7.19	-3.00
2038	165.23	8.26	-2.50	139.44	6.97	-3.00
2039	161.09	8.05	-2.50	135.26	6.76	-3.00
2040	157.07	7.85	-2.50	131.20	6.56	-3.00
2041	153.14	7.66	-2.50	127.26	6.36	-3.00
2042	149.31	7.47	-2.50	123.45	6.17	-3.00
2043	145.58	7.28	-2.50	119.74	5.99	-3.00
2044	141.94	7.10	-2.50	116.15	5.81	-3.00
2045	138.39	6.92	-2.50	112.67	5.63	-3.00
2046	134.93	6.75	-2.50	109.29	5.46	-3.00
2047	131.56	6.58	-2.50	106.01	5.30	-3.00
2048	128.27	6.41	-2.50	102.83	5.14	-3.00
2049	125.06	6.25	-2.50	99.74	4.99	-3.00
2050	121.94	6.10	-2.50	96.75	4.84	-3.00
2051	118.89	5.94	-2.50	93.85	4.69	-3.00
2052	115.92	5.80	-2.50	91.03	4.55	-3.00

Alternative Constant Rate Decline Projections (Cont)

Year	3.5%			4.0%		
	Cigarettes	*Packs (billions)*	*Growth Rate*	*Cigarettes*	*Packs (billions)*	*Growth Rate*
2006	367.67	18.38	-3.50	365.76	18.29	-4.00
2007	354.80	17.74	-3.50	351.13	17.56	-4.00
2008	342.38	17.12	-3.50	337.08	16.85	-4.00
2009	330.40	16.52	-3.50	323.60	16.18	-4.00
2010	318.83	15.94	-3.50	310.66	15.53	-4.00
2011	307.67	15.38	-3.50	298.23	14.91	-4.00
2012	296.90	14.85	-3.50	286.30	14.32	-4.00
2013	286.51	14.33	-3.50	274.85	13.74	-4.00
2014	276.48	13.82	-3.50	263.86	13.19	-4.00
2015	266.81	13.34	-3.50	253.30	12.67	-4.00
2016	257.47	12.87	-3.50	243.17	12.16	-4.00
2017	248.46	12.42	-3.50	233.44	11.67	-4.00
2018	239.76	11.99	-3.50	224.10	11.21	-4.00
2019	231.37	11.57	-3.50	215.14	10.76	-4.00
2020	223.27	11.16	-3.50	206.53	10.33	-4.00
2021	215.46	10.77	-3.50	198.27	9.91	-4.00
2022	207.92	10.40	-3.50	190.34	9.52	-4.00
2023	200.64	10.03	-3.50	182.73	9.14	-4.00
2024	193.62	9.68	-3.50	175.42	8.77	-4.00
2025	186.84	9.34	-3.50	168.40	8.42	-4.00
2026	180.30	9.02	-3.50	161.67	8.08	-4.00
2027	173.99	8.70	-3.50	155.20	7.76	-4.00
2028	167.90	8.40	-3.50	148.99	7.45	-4.00
2029	162.02	8.10	-3.50	143.03	7.15	-4.00
2030	156.35	7.82	-3.50	137.31	6.87	-4.00
2031	150.88	7.54	-3.50	131.82	6.59	-4.00
2032	145.60	7.28	-3.50	126.55	6.33	-4.00
2033	140.50	7.03	-3.50	121.48	6.07	-4.00
2034	135.59	6.78	-3.50	116.62	5.83	-4.00
2035	130.84	6.54	-3.50	111.96	5.60	-4.00
2036	126.26	6.31	-3.50	107.48	5.37	-4.00
2037	121.84	6.09	-3.50	103.18	5.16	-4.00
2038	117.58	5.88	-3.50	99.05	4.95	-4.00
2039	113.46	5.67	-3.50	95.09	4.75	-4.00
2040	109.49	5.47	-3.50	91.29	4.56	-4.00
2041	105.66	5.28	-3.50	87.64	4.38	-4.00
2042	101.96	5.10	-3.50	84.13	4.21	-4.00
2043	98.39	4.92	-3.50	80.77	4.04	-4.00
2044	94.95	4.75	-3.50	77.54	3.88	-4.00
2045	91.63	4.58	-3.50	74.43	3.72	-4.00
2046	88.42	4.42	-3.50	71.46	3.57	-4.00
2047	85.32	4.27	-3.50	68.60	3.43	-4.00
2048	82.34	4.12	-3.50	65.85	3.29	-4.00
2049	79.46	3.97	-3.50	63.22	3.16	-4.00
2050	76.68	3.83	-3.50	60.69	3.03	-4.00
2051	73.99	3.70	-3.50	58.26	2.91	-4.00
2052	71.40	3.57	-3.50	55.93	2.80	-4.00

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APPENDIX B

MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

(AS AMENDED BY THE ADDENDUM OF CLARIFICATIONS)

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MASTER SETTLEMENT AGREEMENT

This Master Settlement Agreement is made by the undersigned Settling State officials (on behalf of their respective Settling States) and the undersigned Participating Manufacturers to settle and resolve with finality all Released Claims against the Participating Manufacturers and related entities as set forth herein. This Agreement constitutes the documentation effecting this settlement with respect to each Settling State, and is intended to and shall be binding upon each Settling State and each Participating Manufacturer in accordance with the terms hereof.

I. RECITALS

WHEREAS, more than 40 States have commenced litigation asserting various claims for monetary, equitable and injunctive relief against certain tobacco product manufacturers and others as defendants, and the States that have not filed suit can potentially assert similar claims;

WHEREAS, the Settling States that have commenced litigation have sought to obtain equitable relief and damages under state laws, including consumer protection and/or antitrust laws, in order to further the Settling States' policies regarding public health, including policies adopted to achieve a significant reduction in smoking by Youth;

WHEREAS, defendants have denied each and every one of the Settling States' allegations of unlawful conduct or wrongdoing and have asserted a number of defenses to the Settling States' claims, which defenses have been contested by the Settling States;

WHEREAS, the Settling States and the Participating Manufacturers are committed to reducing underage tobacco use by discouraging such use and by preventing Youth access to Tobacco Products;

WHEREAS, the Participating Manufacturers recognize the concern of the tobacco grower community that it may be adversely affected by the potential reduction in tobacco consumption resulting from this settlement, reaffirm their commitment to work cooperatively to address concerns about the potential adverse economic impact on such community, and will, within 30 days after the MSA Execution Date, meet with the political leadership of States with grower communities to address these economic concerns;

WHEREAS, the undersigned Settling State officials believe that entry into this Agreement and uniform consent decrees with the tobacco industry is necessary in order to further the Settling States' policies designed to reduce Youth smoking, to promote the public health and to secure monetary payments to the Settling States; and

WHEREAS, the Settling States and the Participating Manufacturers wish to avoid the further expense, delay, inconvenience, burden and uncertainty of continued litigation (including appeals from any verdicts), and, therefore, have agreed to settle their respective lawsuits and potential claims pursuant to terms which will achieve for the Settling States and their citizens significant funding for the advancement of public health, the implementation of important tobacco-related public health measures, including the enforcement of the mandates and restrictions related to such measures, as well as funding for a national Foundation dedicated to significantly reducing the use of Tobacco Products by Youth;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the implementation of tobacco-related health measures and the payments to be made by the Participating Manufacturers, the release and discharge of all claims by the Settling States, and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the Settling States and the Participating Manufacturers, acting by and through their authorized agents, memorialize and agree as follows:

II. DEFINITIONS

(a) "Account" has the meaning given in the Escrow Agreement.

(b) "Adult" means any person or persons who are not Underage.

(c) "Adult-Only Facility" means a facility or restricted area (whether open-air or enclosed) where the operator ensures or has a reasonable basis to believe (such as by checking identification as required under state law, or by checking the identification of any person appearing to be under the age of 27) that no Underage person is present. A facility or restricted area need not be permanently restricted to Adults in order to constitute an Adult-Only Facility, provided that the operator ensures or has a reasonable basis to believe that no Underage person is present during the event or time period in question.

(d) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of 10 percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(e) "Agreement" means this Master Settlement Agreement, together with the exhibits hereto, as it may be amended pursuant to subsection XVIII(j).

(f) "Allocable Share" means the percentage set forth for the State in question as listed in Exhibit A hereto, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States; or, solely for the purpose of calculating payments under subsection IX(c)(2) (and corresponding payments under subsection

IX(i)), the percentage disclosed for the State in question pursuant to subsection IX(c)(2)(A) prior to June 30, 1999, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States.

(g) "Allocated Payment" means a particular Settling State's Allocable Share of the sum of all of the payments to be made by the Original Participating Manufacturers in the year in question pursuant to subsections IX(c)(1) and IX(c)(2), as such payments have been adjusted, reduced and allocated pursuant to clause "First" through the first sentence of clause "Fifth" of subsection IX(j), but before application of the other offsets and adjustments described in clauses "Sixth" through "Thirteenth" of subsection IX(j).

(h) "Bankruptcy" means, with respect to any entity, the commencement of a case or other proceeding (whether voluntary or involuntary) seeking any of (1) liquidation, reorganization, rehabilitation, receivership, conservatorship, or other relief with respect to such entity or its debts under any bankruptcy, insolvency or similar law now or hereafter in effect; (2) the appointment of a trustee, receiver, liquidator, custodian or similar official of such entity or any substantial part of its business or property; (3) the consent of such entity to any of the relief described in (1) above or to the appointment of any official described in (2) above in any such case or other proceeding involuntarily commenced against such entity; or (4) the entry of an order for relief as to such entity under the federal bankruptcy laws as now or hereafter in effect. Provided, however, that an involuntary case or proceeding otherwise within the foregoing definition shall not be a "Bankruptcy" if it is or was dismissed within 60 days of its commencement.

(i) "Brand Name" means a brand name (alone or in conjunction with any other word), trademark, logo, symbol, motto, selling message, recognizable pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any domestic brand of Tobacco Products. Provided, however, that the term "Brand Name" shall not include the corporate name of any Tobacco Product Manufacturer that does not after the MSA Execution Date sell a brand of Tobacco Products in the States that includes such corporate name.

(j) "Brand Name Sponsorship" means an athletic, musical, artistic, or other social or cultural event as to which payment is made (or other consideration is provided) in exchange for use of a Brand Name or Names (1) as part of the name of the event or (2) to identify, advertise, or promote such event or an entrant, participant or team in such event in any other way. Sponsorship of a single national or multi-state series or tour (for example, NASCAR (including any number of NASCAR races)), or of one or more events within a single national or multi-state series or tour, or of an entrant, participant, or team taking part in events sanctioned by a single approving organization (e.g., NASCAR or CART), constitutes one Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in an event that is part of a series or tour that is sponsored by such Participating Manufacturer or that is part of a series or tour in which any one or more events are sponsored by such Participating Manufacturer does not constitute a separate Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in any event (or series of events) not sponsored by such Participating Manufacturer constitutes a Brand Name Sponsorship. The term "Brand Name Sponsorship" shall not include an event in an Adult-Only Facility.

(k) "Business Day" means a day which is not a Saturday or Sunday or legal holiday on which banks are authorized or required to close in New York, New York.

(l) "Cartoon" means any drawing or other depiction of an object, person, animal, creature or any similar caricature that satisfies any of the following criteria:

(1) the use of comically exaggerated features;

(2) the attribution of human characteristics to animals, plants or other objects, or the similar use of anthropomorphic technique; or

(3) the attribution of unnatural or extrahuman abilities, such as imperviousness to pain or injury, X-ray vision, tunneling at very high speeds or transformation.

The term "Cartoon" includes "Joe Camel," but does not include any drawing or other depiction that on July 1, 1998, was in use in any State in any Participating Manufacturer's corporate logo or in any Participating Manufacturer's Tobacco Product packaging.

(m) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "Cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). Except as provided in subsections II(z) and II(mm), 0.0325 ounces of "roll-your-own" tobacco shall constitute one individual "Cigarette."

(n) "Claims" means any and all manner of civil (i.e., non-criminal): claims, demands, actions, suits, causes of action, damages (whenever incurred), liabilities of any nature including civil penalties and punitive damages, as well as costs, expenses and attorneys' fees (except as to the Original Participating Manufacturers' obligations under section XVII), known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable, or statutory.

(o) "Consent Decree" means a state-specific consent decree as described in subsection XIII(b)(1)(B) of this Agreement.

(p) "Court" means the respective court in each Settling State to which this Agreement and the Consent Decree are presented for approval and/or entry as to that Settling State.

(q) "Escrow" has the meaning given in the Escrow Agreement.

(r) "Escrow Agent" means the escrow agent under the Escrow Agreement.

(s) "Escrow Agreement" means an escrow agreement substantially in the form of Exhibit B.

(t) "Federal Tobacco Legislation Offset" means the offset described in section X.

(u) "Final Approval" means the earlier of:

(1) the date by which State-Specific Finality in a sufficient number of Settling States has occurred; or

(2) June 30, 2000.

For the purposes of this subsection (u), "State-Specific Finality in a sufficient number of Settling States" means that State-Specific Finality has occurred in both:

(A) a number of Settling States equal to at least 80% of the total number of Settling States; and

(B) Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all Settling States.

Notwithstanding the foregoing, the Original Participating Manufacturers may, by unanimous written agreement, waive any requirement for Final Approval set forth in subsections (A) or (B) hereof.

(v) "Foundation" means the foundation described in section VI.

(w) "Independent Auditor" means the firm described in subsection XI(b).

(x) "Inflation Adjustment" means an adjustment in accordance with the formulas for inflation adjustments set forth in Exhibit C.

(y) "Litigating Releasing Parties Offset" means the offset described in subsection XII(b).

(z) "Market Share" means a Tobacco Product Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes sold in the fifty United States, the District of Columbia and Puerto Rico during the applicable calendar year, as measured by excise taxes collected by the federal government and, in the case of sales in Puerto Rico, arbitrios de cigarillos collected by the Puerto Rico taxing authority. For purposes of the definition and determination of "Market Share" with respect to calculations under subsection IX(i), 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette; for purposes of the definition and determination of "Market Share" with respect to all other calculations, 0.0325 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(aa) "MSA Execution Date" means November 23, 1998.

(bb) "NAAG" means the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement.

(cc) "Non-Participating Manufacturer" means any Tobacco Product Manufacturer that is not a Participating Manufacturer.

(dd) "Non-Settling States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by the aggregate Allocable Shares of those States that are not Settling States on the date 15 days before such payment is due.

(ee) "Notice Parties" means each Participating Manufacturer, each Settling State, the Escrow Agent, the Independent Auditor and NAAG.

(ff) "NPM Adjustment" means the adjustment specified in subsection IX(d).

(gg) "NPM Adjustment Percentage" means the percentage determined pursuant to subsection IX(d).

(hh) "Original Participating Manufacturers" means the following: Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company, and the respective successors of each of the foregoing. Except as expressly provided in this Agreement, once an entity becomes an Original Participating Manufacturer, such entity shall permanently retain the status of Original Participating Manufacturer.

(ii) "Outdoor Advertising" means (1) billboards, (2) signs and placards in arenas, stadiums, shopping malls and Video Game Arcades (whether any of the foregoing are open air or enclosed) (but not including any such sign or placard located in an Adult-Only Facility), and (3) any other advertisements placed (A) outdoors, or (B) on the inside surface of a window facing outward. Provided, however, that the term "Outdoor Advertising" does not mean (1) an advertisement on the outside of a Tobacco Product manufacturing facility; (2) an individual advertisement that does not occupy an area larger than 14 square feet (and that neither is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet, nor functions solely as a segment of a larger advertising unit or series), and that is placed (A) on the outside of any retail establishment that sells Tobacco Products (other than solely through a vending machine), (B) outside (but on the property of) any such establishment, or (C) on the inside surface of a window facing

outward in any such establishment; (3) an advertisement inside a retail establishment that sells Tobacco Products (other than solely through a vending machine) that is not placed on the inside surface of a window facing outward; or (4) an outdoor advertisement at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(jj) "Participating Manufacturer" means a Tobacco Product Manufacturer that is or becomes a signatory to this Agreement, provided that (1) in the case of a Tobacco Product Manufacturer that is not an Original Participating Manufacturer, such Tobacco Product Manufacturer is bound by this Agreement and the Consent Decree (or, in any Settling State that does not permit amendment of the Consent Decree, a consent decree containing terms identical to those set forth in the Consent Decree) in all Settling States in which this Agreement and the Consent Decree binds Original Participating Manufacturers (provided, however, that such Tobacco Product Manufacturer need only become bound by the Consent Decree in those Settling States in which the Settling State has filed a Released Claim against it), and (2) in the case of a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, such Tobacco Product Manufacturer, within a reasonable period of time after signing this Agreement, makes any payments (including interest thereon at the Prime Rate) that it would have been obligated to make in the intervening period had it been a signatory as of the MSA Execution Date. "Participating Manufacturer" shall also include the successor of a Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Participating Manufacturer such entity shall permanently retain the status of Participating Manufacturer. Each Participating Manufacturer shall regularly report its shipments of Cigarettes in or to the fifty United States, the District of Columbia and Puerto Rico to Management Science Associates, Inc. (or a successor entity as set forth in subsection (mm)). Solely for purposes of calculations pursuant to subsection IX(d), a Tobacco Product Manufacturer that is not a signatory to this Agreement shall be deemed to be a "Participating Manufacturer" if the Original Participating Manufacturers unanimously consent in writing.

(kk) "Previously Settled States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by 12.4500000%, in the case of payments due in or prior to 2007; 12.2373756%, in the case of payments due after 2007 but before 2018; and 11.0666667%, in the case of payments due in or after 2018.

(ll) "Prime Rate" shall mean the prime rate as published from time to time by the Wall Street Journal or, in the event the Wall Street Journal is no longer published or no longer publishes such rate, an equivalent successor reference rate determined by the Independent Auditor.

(mm) "Relative Market Share" means an Original Participating Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers during the calendar year immediately preceding the year in which the payment at issue is due (regardless of when such payment is made), as measured by the Original Participating Manufacturers' reports of shipments of Cigarettes to Management Science Associates, Inc. (or a successor entity acceptable to both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question). A Cigarette shipped by more than one Participating Manufacturer shall be deemed to have been shipped solely by the first Participating Manufacturer to do so. For purposes of the definition and determination of "Relative Market Share," 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(nn) "Released Claims" means:

(1) for past conduct, acts or omissions (including any damages incurred in the future arising from such past conduct, acts or omissions), those Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to (A) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (B) the exposure to, or (C) research, statements, or warnings regarding, Tobacco Products (including, but not limited to, the Claims asserted in the actions identified in Exhibit D, or any comparable Claims that were, could be or could have been asserted now or in the future in those actions or in any comparable action in federal, state or local court brought by a Settling State or a Releasing Party (whether or not such Settling State or Releasing Party has brought such action)), except for claims not asserted in the actions identified in Exhibit D for outstanding liability under existing licensing (or similar) fee laws or existing tax laws (but not excepting claims for any tax liability of the Tobacco-Related Organizations or of any Released Party with respect to such Tobacco-Related Organizations, which claims are covered by the release and covenants set forth in this Agreement);

(2) for future conduct, acts or omissions, only those monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future Claims for reimbursement of health care costs allegedly associated with the use of or exposure to Tobacco Products.

(oo) "Released Parties" means all Participating Manufacturers, their past, present and future Affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any Participating Manufacturer or of any such Affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). Provided, however, that "Released Parties" does not include any person or entity (including, but not limited to, an Affiliate) that is itself a Non-Participating Manufacturer at any time after the MSA Execution Date, unless such person or entity becomes a Participating Manufacturer.

(pp) "Releasing Parties" means each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions; and also means, to the full extent of the power of the signatories hereto to release past, present and future claims, the following: (1) any Settling State's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (2) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in this settlement, (A) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of the State, as opposed solely to private or individual relief for separate and distinct injuries, or (B) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State.

(qq) "Settling State" means any State that signs this Agreement on or before the MSA Execution Date. Provided, however, that the term "Settling State" shall not include (1) the States of Mississippi, Florida, Texas and Minnesota; and (2) any State as to which this Agreement has been terminated.

(rr) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas.

(ss) "State-Specific Finality" means, with respect to the Settling State in question:

(1) this Agreement and the Consent Decree have been approved and entered by the Court as to all Original Participating Manufacturers, or, in the event of an appeal from or review of a decision of the Court to withhold its approval and entry of this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review;

(2) entry by the Court has been made of an order dismissing with prejudice all claims against Released Parties in the action as provided herein; and

(3) the time for appeal or to seek review of or permission to appeal ("Appeal") from the approval and entry as described in subsection (1) hereof and entry of such order described in subsection (2) hereof has expired; or, in the event of an Appeal from such approval and entry, the Appeal has been dismissed, or the approval and entry described in (1) hereof and the order described in subsection (2) hereof have been affirmed in all material respects by the court of last resort to which such Appeal has been taken and such dismissal or affirmance has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court).

(tt) "Subsequent Participating Manufacturer" means a Tobacco Product Manufacturer (other than an Original Participating Manufacturer) that: (1) is a Participating Manufacturer, and (2) is a signatory to this Agreement, regardless of when such Tobacco Product Manufacturer became a signatory to this Agreement. "Subsequent Participating Manufacturer" shall also include the successors of a Subsequent Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Subsequent Participating Manufacturer such entity shall permanently retain the status of Subsequent Participating Manufacturer, unless it agrees to assume the obligations of an Original Participating Manufacturer as provided in subsection XVIII(c).

(uu) "Tobacco Product Manufacturer" means an entity that after the MSA Execution Date directly (and not exclusively through any Affiliate):

(1) manufactures Cigarettes anywhere that such manufacturer intends to be sold in the States, including Cigarettes intended to be sold in the States through an importer (except where such importer is an Original Participating Manufacturer that will be responsible for the payments under this Agreement with respect to such Cigarettes as a result of the provisions of subsections II(mm) and that pays the taxes specified in subsection II(z) on such Cigarettes, and provided that the manufacturer of such Cigarettes does not market or advertise such Cigarettes in the States);

(2) is the first purchaser anywhere for resale in the States of Cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the States; or

(3) becomes a successor of an entity described in subsection (1) or (2) above.

The term "Tobacco Product Manufacturer" shall not include an Affiliate of a Tobacco Product Manufacturer unless such Affiliate itself falls within any of subsections (1) - (3) above.

(vv) "Tobacco Products" means Cigarettes and smokeless tobacco products.

(ww) "Tobacco-Related Organizations" means the Council for Tobacco Research-U.S.A., Inc., The Tobacco Institute, Inc. ("TI"), and the Center for Indoor Air Research, Inc. ("CIAR") and the successors, if any, of TI or CIAR.

(xx) "Transit Advertisements" means advertising on or within private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, transportation waiting area, train station, airport or any similar location. Notwithstanding the foregoing, the term "Transit Advertisements" does not include (1) any advertisement placed in, on or outside the premises of any retail establishment that sells Tobacco Products (other than solely through a vending machine) (except if such individual advertisement (A) occupies an area larger than 14 square feet; (B) is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet; or (C) functions solely as a segment of a larger advertising unit or series); or (2) advertising at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no

event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(yy) "Underage" means younger than the minimum age at which it is legal to purchase or possess (whichever minimum age is older) Cigarettes in the applicable Settling State.

(zz) "Video Game Arcade" means an entertainment establishment primarily consisting of video games (other than video games intended primarily for use by persons 18 years of age or older) and/or pinball machines.

(aaa) "Volume Adjustment" means an upward or downward adjustment in accordance with the formula for volume adjustments set forth in Exhibit E.

(bbb) "Youth" means any person or persons under 18 years of age.

III. PERMANENT RELIEF

(a) Prohibition on Youth Targeting. No Participating Manufacturer may take any action, directly or indirectly, to target Youth within any Settling State in the advertising, promotion or marketing of Tobacco Products, or take any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within any Settling State.

(b) Ban on Use of Cartoons. Beginning 180 days after the MSA Execution Date, no Participating Manufacturer may use or cause to be used any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

(c) Limitation of Tobacco Brand Name Sponsorships.

(1) Prohibited Sponsorships. After the MSA Execution Date, no Participating Manufacturer may engage in any Brand Name Sponsorship in any State consisting of:

(A) concerts; or

(B) events in which the intended audience is comprised of a significant percentage of Youth; or

(C) events in which any paid participants or contestants are Youth; or

(D) any athletic event between opposing teams in any football, basketball, baseball, soccer or hockey league.

(2) Limited Sponsorships.

(A) No Participating Manufacturer may engage in more than one Brand Name Sponsorship in the States in any twelve-month period (such period measured from the date of the initial sponsored event).

(B) Provided, however, that

(i) nothing contained in subsection (2)(A) above shall require a Participating Manufacturer to breach or terminate any sponsorship contract in existence as of August 1, 1998 (until the earlier of (x) the current term of any existing contract, without regard to any renewal or option that may be exercised by such Participating Manufacturer or (y) three years after the MSA Execution Date); and

(ii) notwithstanding subsection (1)(A) above, Brown & Williamson Tobacco Corporation may sponsor either the GPC country music festival or the Kool jazz festival as its one annual Brand Name Sponsorship permitted pursuant to subsection (2)(A) as well as one Brand Name Sponsorship permitted pursuant to subsection (2)(B)(i).

(3) Related Sponsorship Restrictions. With respect to any Brand Name Sponsorship permitted under this subsection (c):

(A) advertising of the Brand Name Sponsorship event shall not advertise any Tobacco Product (other than by using the Brand Name to identify such Brand Name Sponsorship event);

(B) no Participating Manufacturer may refer to a Brand Name Sponsorship event or to a celebrity or other person in such an event in its advertising of a Tobacco Product;

(C) nothing contained in the provisions of subsection III(e) of this Agreement shall apply to actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to the provisions of subsections (2)(A) and (2)(B)(i); the Brand Name Sponsorship permitted by subsection (2)(B)(ii) shall be subject to the restrictions of subsection III(e) except that such restrictions shall not prohibit use of the Brand Name to identify the Brand Name Sponsorship;

(D) nothing contained in the provisions of subsections III(f) and III(i) shall apply to apparel or other merchandise: (i) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsections (2)(A) or (2)(B)(i) by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise; or (ii) used at the site of a Brand Name Sponsorship permitted pursuant to subsection (2)(A) or (2)(B)(i) (during such event) that are not distributed (by sale or otherwise) to any member of the general public; and

(E) nothing contained in the provisions of subsection III(d) shall: (i) apply to the use of a Brand Name on a vehicle used in a Brand Name Sponsorship; or (ii) apply to Outdoor Advertising advertising the Brand Name Sponsorship, to the extent that such Outdoor Advertising is placed at the site of a Brand Name Sponsorship no more than 90 days before the start of the initial sponsored event, is removed within 10 days after the end of the last sponsored event, and is not prohibited by subsection (3)(A) above.

(4) Corporate Name Sponsorships. Nothing in this subsection (c) shall prevent a Participating Manufacturer from sponsoring or causing to be sponsored any athletic, musical, artistic, or other social or cultural event, or any entrant, participant or team in such event (or series of events) in the name of the corporation which manufactures Tobacco Products, provided that the corporate name does not include any Brand Name of domestic Tobacco Products.

(5) Naming Rights Prohibition. No Participating Manufacturer may enter into any agreement for the naming rights of any stadium or arena located within a Settling State using a Brand Name, and shall not otherwise cause a stadium or arena located within a Settling State to be named with a Brand Name.

(6) Prohibition on Sponsoring Teams and Leagues. No Participating Manufacturer may enter into any agreement pursuant to which payment is made (or other consideration is provided) by such Participating Manufacturer to any football, basketball, baseball, soccer or hockey league (or any team involved in any such league) in exchange for use of a Brand Name.

(d) Elimination of Outdoor Advertising and Transit Advertisements. Each Participating Manufacturer shall discontinue Outdoor Advertising and Transit Advertisements advertising Tobacco Products within the Settling States as set forth herein.

(1) Removal. Except as otherwise provided in this section, each Participating Manufacturer shall remove from within the Settling States within 150 days after the MSA Execution Date all of its (A) billboards (to the extent that such billboards constitute Outdoor Advertising) advertising Tobacco Products; (B) signs and placards (to the extent that such signs and placards constitute Outdoor Advertising) advertising Tobacco Products in arenas, stadiums, shopping malls and Video Game Arcades; and (C) Transit Advertisements advertising Tobacco Products.

(2) Prohibition on New Outdoor Advertising and Transit Advertisements. No Participating Manufacturer may, after the MSA Execution Date, place or cause to be placed any new Outdoor Advertising advertising Tobacco Products or new Transit Advertisements advertising Tobacco Products within any Settling State.

(3) Alternative Advertising. With respect to those billboards required to be removed under subsection (1) that are leased (as opposed to owned) by any Participating Manufacturer, the Participating Manufacturer will allow the Attorney General of the Settling State within which such billboards are located to substitute, at the Settling State's option, alternative advertising intended to discourage the use of Tobacco Products by Youth and their exposure to second-hand smoke for the remaining term of the applicable contract (without regard to any renewal or option term that may be exercised by such Participating Manufacturer). The Participating Manufacturer will bear the cost of the lease through the end of such remaining term. Any other costs associated with such alternative advertising will be borne by the Settling State.

(4) Ban on Agreements Inhibiting Anti-Tobacco Advertising. Each Participating Manufacturer agrees that it will not enter into any agreement that prohibits a third party from selling, purchasing or displaying advertising discouraging the use of Tobacco Products or exposure to second-hand smoke. In the event and to the extent that any Participating Manufacturer has entered into an agreement containing any such prohibition, such Participating Manufacturer agrees to waive such prohibition in such agreement.

(5) Designation of Contact Person. Each Participating Manufacturer that has Outdoor Advertising or Transit Advertisements advertising Tobacco Products within a Settling State shall, within 10 days after the MSA Execution Date, provide the Attorney General of such Settling State with the name of a contact person to whom the Settling State may direct inquiries during the time such Outdoor Advertising and Transit Advertisements are being eliminated, and from whom the Settling State may obtain periodic reports as to the progress of their elimination.

(6) Adult-Only Facilities. To the extent that any advertisement advertising Tobacco Products located within an Adult-Only Facility constitutes Outdoor Advertising or a Transit Advertisement, this subsection (d) shall not apply to such advertisement, provided such advertisement is not visible to persons outside such Adult-Only Facility.

(e) Prohibition on Payments Related to Tobacco Products and Media. No Participating Manufacturer may, beginning 30 days after the MSA Execution Date, make, or cause to be made, any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any motion picture, television show, theatrical production or other live performance, live or recorded performance of music, commercial film or video, or video game ("Media"); provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; or (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults.

(f) Ban on Tobacco Brand Name Merchandise. Beginning July 1, 1999, no Participating Manufacturer may, within any Settling State, market, distribute, offer, sell, license or cause to be marketed, distributed, offered, sold or licensed (including, without limitation, by catalogue or direct mail), any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this subsection shall (1) require any Participating Manufacturer to breach or

terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed, or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; or (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public.

(g) Ban on Youth Access to Free Samples. After the MSA Execution Date, no Participating Manufacturer may, within any Settling State, distribute or cause to be distributed any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Agreement, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

(h) Ban on Gifts to Underage Persons Based on Proofs of Purchase. Beginning one year after the MSA Execution Date, no Participating Manufacturer may provide or cause to be provided to any person without sufficient proof that such person is an Adult any item in exchange for the purchase of Tobacco Products, or the furnishing of credits, proofs-of-purchase, or coupons with respect to such a purchase. For purposes of the preceding sentence only, (1) a driver's license or other government-issued identification (or legible photocopy thereof), the validity of which is certified by the person to whom the item is provided, shall by itself be deemed to be a sufficient form of proof of age; and (2) in the case of items provided (or to be redeemed) at retail establishments, a Participating Manufacturer shall be entitled to rely on verification of proof of age by the retailer, where such retailer is required to obtain verification under applicable federal, state or local law.

(i) Limitation on Third-Party Use of Brand Names. After the MSA Execution Date, no Participating Manufacturer may license or otherwise expressly authorize any third party to use or advertise within any Settling State any Brand Name in a manner prohibited by this Agreement if done by such Participating Manufacturer itself. Each Participating Manufacturer shall, within 10 days after the MSA Execution Date, designate a person (and provide written notice to NAAG of such designation) to whom the Attorney General of any Settling State may provide written notice of any such third-party activity that would be prohibited by this Agreement if done by such Participating Manufacturer itself. Following such written notice, the Participating Manufacturer will promptly take commercially reasonable steps against any such non-de minimis third-party activity. Provided, however, that nothing in this subsection shall require any Participating Manufacturer to (1) breach or terminate any licensing agreement or other contract in existence as of July 1, 1998 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); or (2) retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer.

(j) Ban on Non-Tobacco Brand Names. No Participating Manufacturer may, pursuant to any agreement requiring the payment of money or other valuable consideration, use or cause to be used as a brand name of any Tobacco Product any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this subsection, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

(k) Minimum Pack Size of Twenty Cigarettes. No Participating Manufacturer may, beginning 60 days after the MSA Execution Date and through and including December 31, 2001, manufacture or cause to be manufactured for sale in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). No Participating Manufacturer may, beginning 150 days after the MSA Execution Date and through and including December 31, 2001, sell or distribute in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). Each Participating Manufacturer further agrees that following the MSA Execution Date it shall not oppose, or cause to be opposed (including through any third party or Affiliate), the passage by any Settling State of any legislative proposal or administrative rule applicable to all Tobacco Product Manufacturers and all retailers of Tobacco Products prohibiting the manufacture and sale of any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

(l) Corporate Culture Commitments Related to Youth Access and Consumption. Beginning 180 days after the MSA Execution Date each Participating Manufacturer shall:

promulgate or reaffirm corporate principles that express and explain its commitment to comply with the provisions of this Agreement and the reduction of use of Tobacco Products by Youth, and clearly and regularly communicate to its employees and customers its commitment to assist in the reduction of Youth use of Tobacco Products;

designate an executive level manager (and provide written notice to NAAG of such designation) to identify methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products; and

encourage its employees to identify additional methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products.

(m) Limitations on Lobbying. Following State-Specific Finality in a Settling State:

(1) No Participating Manufacturer may oppose, or cause to be opposed (including through any third party or Affiliate), the passage by such Settling State (or any political subdivision thereof) of those state or local legislative proposals or administrative rules described in Exhibit F hereto intended by their terms to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products. Provided, however, that the foregoing does not prohibit any Participating Manufacturer from (A) challenging enforcement of, or suing for declaratory or injunctive relief with respect to, any such legislation or rule on any grounds; (B) continuing, after State-Specific Finality in such Settling State, to oppose or cause to be opposed, the passage during the legislative session in which State-Specific Finality in such Settling State occurs of any specific state or local legislative proposals or administrative rules introduced prior to the time of State-Specific Finality in such Settling State; (C) opposing, or causing to be opposed, any excise tax or income tax provision or user fee or other payments relating to Tobacco Products or Tobacco Product Manufacturers; or (D) opposing, or causing to be opposed, any state or local legislative proposal or administrative rule that also includes measures other than those described in Exhibit F.

(2) Each Participating Manufacturer shall require all of its officers and employees engaged in lobbying activities in such Settling State after State-Specific Finality, contract lobbyists engaged in lobbying activities in such Settling State after State-Specific Finality, and any other third parties who engage in lobbying activities in such Settling State after State-Specific Finality on behalf of such Participating Manufacturer ("lobbyist" and "lobbying activities" having the meaning such terms have under the law of the Settling State in question) to certify in writing to the Participating Manufacturer that they:

(A) will not support or oppose any state, local or federal legislation, or seek or oppose any governmental action, on behalf of the Participating Manufacturer without the Participating Manufacturer's express authorization (except where such advance express authorization is not reasonably practicable);

(B) are aware of and will fully comply with this Agreement and all laws and regulations applicable to their lobbying activities, including, without limitation, those related to disclosure of financial contributions. Provided, however, that if the Settling State in question has in existence no laws or regulations relating to disclosure of financial contributions regarding lobbying activities, then each Participating Manufacturer shall, upon request of the Attorney General of such Settling State, disclose to such Attorney General any payment to a lobbyist that the Participating Manufacturer knows or has reason to know will be used to influence legislative or administrative actions of the state or local government relating to Tobacco Products or their use. Disclosures made pursuant to the preceding sentence shall be filed in writing with the Office of the Attorney General on the first day of February and the first day of August of each year for any and all payments made during the six month period ending on the last day of the preceding December and June, respectively, with the following information: (1) the name, address, telephone number and e-mail address (if any) of the recipient; (2) the amount of each payment; and (3) the aggregate amount of all payments described in this subsection (2)(B) to the recipient in the calendar year; and

(C) have reviewed and will fully abide by the Participating Manufacturer's corporate principles promulgated pursuant to this Agreement when acting on behalf of the Participating Manufacturer.

(3) No Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) in Congress or any other forum legislation or rules that would preempt, override, abrogate or diminish such Settling State's rights or recoveries under this Agreement. Except as specifically provided in this Agreement, nothing herein shall be deemed to restrain any Settling State or Participating Manufacturer from advocating terms of any national settlement or taking any other positions on issues relating to tobacco.

(n) Restriction on Advocacy Concerning Settlement Proceeds. After the MSA Execution Date, no Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) the diversion of any proceeds of this settlement to any program or use that is neither tobacco-related nor health-related in connection with the approval of this Agreement or in any subsequent legislative appropriation of settlement proceeds.

(o) Dissolution of The Tobacco Institute, Inc., the Council for Tobacco Research-U.S.A., Inc. and the Center for Indoor Air Research, Inc.

(1) The Council for Tobacco Research-U.S.A., Inc. ("CTR") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to the plan of dissolution previously negotiated and agreed to between the Attorney General of the State of New York and CTR, cease all operations and be dissolved in accordance with the laws of the State of New York (and with the preservation of all applicable privileges held by any member company of CTR).

(2) The Tobacco Institute, Inc. ("TI") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to a plan of dissolution to be negotiated by the Attorney General of the State of New York and the Original Participating Manufacturers in accordance with Exhibit G hereto, cease all operations and be dissolved in

accordance with the laws of the State of New York and under the authority of the Attorney General of the State of New York (and with the preservation of all applicable privileges held by any member company of TI).

(3) Within 45 days after Final Approval, the Center for Indoor Air Research, Inc. ("CIAR") shall cease all operations and be dissolved in a manner consistent with applicable law and with the preservation of all applicable privileges (including, without limitation, privileges held by any member company of CIAR).

(4) The Participating Manufacturers shall direct the Tobacco-Related Organizations to preserve all records that relate in any way to issues raised in smoking-related health litigation.

(5) The Participating Manufacturers may not reconstitute CTR or its function in any form.

(6) The Participating Manufacturers represent that they have the authority to and will effectuate subsections (1) through (5) hereof.

(p) Regulation and Oversight of New Tobacco-Related Trade Associations.

(1) A Participating Manufacturer may form or participate in new tobacco-related trade associations (subject to all applicable laws), provided such associations agree in writing not to act in any manner contrary to any provision of this Agreement. Each Participating Manufacturer agrees that if any new tobacco-related trade association fails to so agree, such Participating Manufacturer will not participate in or support such association.

(2) Any tobacco-related trade association that is formed or controlled by one or more of the Participating Manufacturers after the MSA Execution Date shall adopt by-laws governing the association's procedures and the activities of its members, board, employees, agents and other representatives with respect to the tobacco-related trade association. Such by-laws shall include, among other things, provisions that:

(A) each officer of the association shall be appointed by the board of the association, shall be an employee of such association, and during such officer's term shall not be a director of or employed by any member of the association or by an Affiliate of any member of the association;

(B) legal counsel for the association shall be independent, and neither counsel nor any member or employee of counsel's law firm shall serve as legal counsel to any member of the association or to a manufacturer of Tobacco Products that is an Affiliate of any member of the association during the time that it is serving as legal counsel to the association; and

(C) minutes describing the substance of the meetings of the board of directors of the association shall be prepared and shall be maintained by the association for a period of at least five years following their preparation.

(3) Without limitation on whatever other rights to access they may be permitted by law, for a period of seven years from the date any new tobacco-related trade association is formed by any of the Participating Manufacturers after the MSA Execution Date the antitrust authorities of any Settling State may, for the purpose of enforcing this Agreement, upon reasonable cause to believe that a violation of this Agreement has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days):

(A) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of such association insofar as they pertain to such believed violation; and

(B) interview the association's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation.

Documents and information provided to Settling State antitrust authorities shall be kept confidential by and among such authorities, and shall be utilized only by the Settling States and only for the purpose of enforcing this Agreement or the criminal law. The inspection and discovery rights provided to the Settling States pursuant to this subsection shall be coordinated so as to avoid repetitive and excessive inspection and discovery.

(q) Prohibition on Agreements to Suppress Research. No Participating Manufacturer may enter into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in this subsection shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

(r) Prohibition on Material Misrepresentations. No Participating Manufacturer may make any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Nothing in this subsection shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

IV. PUBLIC ACCESS TO DOCUMENTS

(a) After the MSA Execution Date, the Original Participating Manufacturers and the Tobacco-Related Organizations will support an application for the dissolution of any protective orders entered in each Settling State's lawsuit identified in Exhibit D with respect only to those documents, indices and privilege logs that have been produced as of the MSA Execution Date to such Settling State and (1) as to which defendants have made no claim, or have withdrawn any claim, of attorney-client privilege, attorney work-product protection, common interest/joint defense privilege (collectively, "privilege"), trade-secret protection, or confidential or proprietary business information; and (2) that are not inappropriate for public disclosure because of personal privacy interests or contractual rights of third parties that may not be abrogated by the Original Participating Manufacturers or the Tobacco-Related Organizations.

(b) Notwithstanding State-Specific Finality, if any order, ruling or recommendation was issued prior to September 17, 1998 rejecting a claim of privilege or trade-secret protection with respect to any document or documents in a lawsuit identified in Exhibit D, the Settling State in which such order, ruling or recommendation was made may, no later than 45 days after the occurrence of State-Specific Finality in such Settling State, seek public disclosure of such document or documents by application to the court that issued such order, ruling or recommendation and the court shall retain jurisdiction for such purposes. The Original Participating Manufacturers and Tobacco-Related Organizations do not consent to, and may object to, appeal from or otherwise oppose any such application for disclosure. The Original Participating Manufacturers and Tobacco-Related Organizations will not assert that the settlement of such lawsuit has divested the court of jurisdiction or that such Settling State lacks standing to seek public disclosure on any applicable ground.

(c) The Original Participating Manufacturers will maintain at their expense their Internet document websites accessible through "TobaccoResolution.com" or a similar website until June 30, 2010. The Original Participating Manufacturers will maintain the documents that currently appear on their respective websites and will add additional documents to their websites as provided in this section IV.

(d) Within 180 days after the MSA Execution Date, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of the following documents, except as provided in subsections IV(e) and IV(f) below:

(1) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in any action identified in Exhibit D or any action identified in section 2 of Exhibit H that was filed by an Attorney General. Among these documents, each Original Participating Manufacturer and Tobacco-Related Organization will give the highest priority to (A) the documents that were listed by the State of Washington as trial exhibits in the State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King); and (B) the documents as to which such Original Participating Manufacturer or Tobacco-Related Organization withdrew any claim of privilege as a result of the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County);

(2) all documents that can be identified as having been produced by, and copies of transcripts of depositions given by, such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in the litigation matters specified in section 1 of Exhibit H; and

(3) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date and listed by the plaintiffs as trial exhibits in the litigation matters specified in section 2 of Exhibit H.

(e) Unless copies of such documents are already on its website, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of documents produced in any production of documents that takes place on or after the date 30 days before the MSA Execution Date in any federal or state court civil action concerning smoking and health. Copies of any documents required to be placed on a website pursuant to this subsection will be placed on such website within the later of 45 days after the MSA Execution Date or within 45 days after the production of such documents in any federal or state court action concerning smoking and health. This obligation will continue until June 30, 2010. In placing such newly produced documents on its website, each Original Participating Manufacturer or Tobacco-Related Organization will identify, as part of its index to be created pursuant to subsection IV(h), the action in which it produced such documents and the date on which such documents were added to its website.

(f) Nothing in this section IV shall require any Original Participating Manufacturer or Tobacco-Related Organization to place on its website or otherwise disclose documents that: (1) it continues to claim to be privileged, a trade secret, confidential or proprietary business information, or that contain other information not appropriate for public disclosure because of personal privacy interests or contractual rights of third parties; or (2) continue to be subject to any protective order, sealing order or other order or ruling that prevents or limits a litigant from disclosing such documents.

(g) Oversized or multimedia records will not be required to be placed on the Website, but each Original Participating Manufacturers and Tobacco-Related Organizations will make any such records available to the public by placing copies of them in the document depository established in The State of Minnesota, et al. v. Philip Morris Incorporated, et al., C1-94-8565 (County of Ramsey, District Court, 2d Judicial Cir.).

(h) Each Original Participating Manufacturer will establish an index and other features to improve searchable access to the document images on its website, as set forth in Exhibit I.

(i) Within 90 days after the MSA Execution Date, the Original Participating Manufacturers will furnish NAAG with a project plan for completing the Original Participating Manufacturers' obligations under subsection IV(h) with respect to documents currently on their websites and documents being placed on their websites pursuant to subsection IV(d). NAAG may engage a computer consultant at the Original Participating Manufacturers' expense for a period not to exceed two years and at a cost not to exceed $100,000. NAAG's computer consultant may review such plan and make recommendations consistent with this Agreement. In addition, within 120 days after the completion of the Original Participating Manufacturers' obligations under subsection IV(d), NAAG's computer consultant may make final recommendations with respect to the websites consistent with this Agreement. In preparing these recommendations, NAAG's computer consultant may seek input from Settling State officials, public health organizations and other users of the websites.

(j) The expenses incurred pursuant to subsection IV(i), and the expenses related to documents of the Tobacco-Related Organizations, will be severally shared among the Original Participating Manufacturers (allocated among them according to their Relative Market Shares). All other expenses incurred under this section will be borne by the Original Participating Manufacturer that incurs such expense.

V. TOBACCO CONTROL AND UNDERAGE USE LAWS

Each Participating Manufacturer agrees that following State-Specific Finality in a Settling State it will not initiate, or cause to be initiated, a facial challenge against the enforceability or constitutionality of such Settling State's (or such Settling State's political subdivisions') statutes, ordinances and administrative rules relating to tobacco control enacted prior to June 1, 1998 (other than a statute, ordinance or rule challenged in any lawsuit listed in Exhibit M).

VI. ESTABLISHMENT OF A NATIONAL FOUNDATION

(a) Foundation Purposes. The Settling States believe that a comprehensive, coordinated program of public education and study is important to further the remedial goals of this Agreement. Accordingly, as part of the settlement of claims described herein, the payments specified in subsections VI(b), VI(c), and IX(e) shall be made to a charitable foundation, trust or similar organization (the "Foundation") and/or to a program to be operated within the Foundation (the "National Public Education Fund"). The purposes of the Foundation will be to support (1) the study of and programs to reduce Youth Tobacco Product usage and Youth substance abuse in the States, and (2) the study of and educational programs to prevent diseases associated with the use of Tobacco Products in the States.

(b) Base Foundation Payments. On March 31, 1999, and on March 31 of each subsequent year for a period of nine years thereafter, each Original Participating Manufacturer shall severally pay its Relative Market Share of $25,000,000 to fund the Foundation. The payments to be made by each of the Original Participating Manufacturers pursuant to this subsection (b) shall be subject to no adjustments, reductions, or offsets, and shall be paid to the Escrow Agent (to be credited to the Subsection VI(b) Account), who shall disburse such payments to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State.

(c) National Public Education Fund Payments.

(1) Each Original Participating Manufacturer shall severally pay its Relative Market Share of the following base amounts on the following dates to the Escrow Agent for the benefit of the Foundation's National Public Education Fund to be used for the purposes and as described in subsections VI(f)(1), VI(g) and VI(h) below: $250,000,000 on March 31, 1999; $300,000,000 on March 31, 2000; $300,000,000 on March 31, 2001; $300,000,000 on March 31, 2002; and $300,000,000 on March 31, 2003, as such amounts are modified in accordance with this subsection (c). The payment due on March 31, 1999 pursuant to this subsection (c)(1) is to be credited to the Subsection VI(c) Account (First). The payments due on or after March 31, 2000 pursuant to this subsection VI(c)(1) are to be credited to the Subsection VI(c) Account (Subsequent).

(2) The payments to be made by the Original Participating Manufacturers pursuant to this subsection (c), other than the payment due on March 31, 1999, shall be subject to the Inflation Adjustment, the Volume Adjustment and the offset for miscalculated or disputed payments described in subsection XI(i).

(3) The payment made pursuant to this subsection (c) on March 31, 1999 shall be disbursed by the Escrow Agent to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State. Each remaining payment pursuant to this subsection (c) shall be disbursed by the Escrow Agent to the Foundation only when State-Specific Finality has occurred in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date.

(4) In addition to the payments made pursuant to this subsection (c), the National Public Education Fund will be funded (A) in accordance with subsection IX(e), and (B) through monies contributed by other entities directly to the Foundation and designated for the National Public Education Fund ("National Public Education Fund Contributions").

(5) The payments made by the Original Participating Manufacturers pursuant to this subsection (c) and/or subsection IX(e) and monies received from all National Public Education Fund Contributions will be deposited and invested in accordance with the laws of the state of incorporation of the Foundation.

(d) Creation and Organization of the Foundation. NAAG, through its executive committee, will provide for the creation of the Foundation. The Foundation shall be organized exclusively for charitable, scientific, and educational purposes within the meaning of Internal Revenue Code section 501(c)(3). The organizational documents of the Foundation shall specifically incorporate the provisions of this Agreement relating to the Foundation, and will provide for payment of the Foundation's administrative expenses from the funds paid pursuant to subsection VI(b) or VI(c). The Foundation shall be governed by a board of directors. The board of directors shall be comprised of eleven directors. NAAG, the National Governors' Association ("NGA"), and the National Conference of State Legislatures ("NCSL") shall each select from its membership two directors. These six directors shall select the five additional directors. One of these five additional directors shall have expertise in public health issues. Four of these five additional directors shall have expertise in medical, child psychology, or public health disciplines. The board of directors shall be nationally geographically diverse.

(e) Foundation Affiliation. The Foundation shall be formally affiliated with an educational or medical institution selected by the board of directors.

(f) Foundation Functions. The functions of the Foundation shall be:

(1) carrying out a nationwide sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products;

(2) developing and disseminating model advertising and education programs to counter the use by Youth of substances that are unlawful for use or purchase by Youth, with an emphasis on reducing Youth smoking; monitoring and testing the effectiveness of such model programs; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs, as appropriate;

(3) developing and disseminating model classroom education programs and curriculum ideas about smoking and substance abuse in the K-12 school system, including specific target programs for special at-risk populations; monitoring and testing the effectiveness of such model programs and ideas; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs or ideas, as appropriate;

(4) developing and disseminating criteria for effective cessation programs; monitoring and testing the effectiveness of such criteria; and continuing to develop and disseminate revised versions of such criteria, as appropriate;

(5) commissioning studies, funding research, and publishing reports on factors that influence Youth smoking and substance abuse and developing strategies to address the conclusions of such studies and research;

(6) developing other innovative Youth smoking and substance abuse prevention programs;

(7) providing targeted training and information for parents;

(8) maintaining a library open to the public of Foundation-funded studies, reports and other publications related to the cause and prevention of Youth smoking and substance abuse;

(9) tracking and monitoring Youth smoking and substance abuse, with a focus on the reasons for any increases or failures to decrease Youth smoking and substance abuse and what actions can be taken to reduce Youth smoking and substance abuse;

(10) receiving, controlling, and managing contributions from other entities to further the purposes described in this Agreement; and

(11) receiving, controlling, and managing such funds paid by the Participating Manufacturers pursuant to subsections VI(b) and VI(c) above.

(g) Foundation Grant-Making. The Foundation is authorized to make grants from the National Public Education Fund to Settling States and their political subdivisions to carry out sustained advertising and education programs to (1) counter the use by Youth of Tobacco Products, and (2) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products. In making such grants, the Foundation shall consider whether the Settling State or political subdivision applying for such grant:

(1) demonstrates the extent of the problem regarding Youth smoking in such Settling State or political subdivision;

(2) either seeks the grant to implement a model program developed by the Foundation or provides the Foundation with a specific plan for such applicant's intended use of the grant monies, including demonstrating such applicant's ability to develop an effective advertising/education campaign and to assess the effectiveness of such advertising/education campaign;

(3) has other funds readily available to carry out a sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products; and

(4) is a Settling State that has not severed this section VI from its settlement with the Participating Manufacturers pursuant to subsection VI(i) below, or is a political subdivision in such a Settling State.

(h) Foundation Activities. The Foundation shall not engage in, nor shall any of the Foundation's money be used to engage in, any political activities or lobbying, including, but not limited to, support of or opposition to candidates, ballot initiatives, referenda or other similar activities. The National Public Education Fund shall be used only for public education and advertising regarding the addictiveness, health effects, and social costs related to the use of tobacco products and shall not be used for any personal attack on, or vilification of, any person (whether by name or business affiliation), company, or governmental agency, whether individually or collectively. The Foundation shall work to ensure that its activities are carried out in a culturally and linguistically appropriate manner. The Foundation's activities (including the National Public Education Fund) shall be carried out solely within the States. The payments described in subsections VI(b) and VI(c) above are made at the direction and on behalf of Settling States. By making such payments in such manner, the Participating Manufacturers do not undertake and expressly disclaim any responsibility with respect to the creation, operation, liabilities, or tax status of the Foundation or the National Public Education Fund.

(i) Severance of this Section. If the Attorney General of a Settling State determines that such Settling State may not lawfully enter into this section VI as a matter of applicable state law, such Attorney General may sever this section VI from its settlement with the Participating Manufacturers by giving written notice of such severance to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k) hereof. If any Settling State exercises its right to sever this section VI, this section VI shall not be considered a part of the specific settlement between such Settling State and the Participating Manufacturers, and this section VI shall not be enforceable by or in such Settling State. The payment obligation of subsections VI(b) and VI(c) hereof shall apply regardless of a determination by one or more Settling States to sever section VI hereof; provided, however, that if all Settling States sever section VI hereof, the payment obligations of subsections (b) and (c) hereof shall be null and void. If the Attorney General of a Settling State that severed this section VI subsequently determines that such Settling State may lawfully enter into this section VI as a matter of applicable state law, such Attorney General may rescind such Settling State's previous severance of this section VI by giving written notice of such rescission to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k). If any Settling State rescinds such severance, this section VI shall be considered a part of the specific settlement between such Settling State and the Participating Manufacturers (including for purposes of subsection (g)(4)), and this section VI shall be enforceable by and in such Settling State.

VII. ENFORCEMENT

(a) Jurisdiction. Each Participating Manufacturer and each Settling State acknowledge that the Court: (1) has jurisdiction over the subject matter of the action identified in Exhibit D in such Settling State and over each Participating Manufacturer; (2) shall retain exclusive jurisdiction for the purposes of implementing and enforcing this Agreement and the Consent Decree as to such Settling State; and (3) except as provided in subsections IX(d), XI(c) and XVII(d) and Exhibit O, shall be the only court to which disputes under this Agreement or the Consent Decree are presented as to such Settling State. Provided, however, that notwithstanding the foregoing, the Escrow Court (as defined in the Escrow Agreement) shall have exclusive jurisdiction, as provided in section 15 of the Escrow Agreement, over any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, the Escrow Agreement.

(b) Enforcement of Consent Decree. Except as expressly provided in the Consent Decree, any Settling State or Released Party may apply to the Court to enforce the terms of the Consent Decree (or for a declaration construing any such term) with respect to alleged violations within such Settling State. A Settling State may not seek to enforce the Consent Decree of another Settling State; provided, however, that nothing contained herein shall affect the ability of any Settling State to (1) coordinate state enforcement actions or proceedings, or (2) file or join any amicus brief. In the event that the Court determines that any Participating Manufacturer or Settling State has violated the Consent Decree within such Settling State, the party that initiated the proceedings may request any and all relief available within such Settling State pursuant to the Consent Decree.

(c) Enforcement of this Agreement.

(1) Except as provided in subsections IX(d), XI(c), XVII(d) and Exhibit O, any Settling State or Participating Manufacturer may bring an action in the Court to enforce the terms of this Agreement (or for a declaration construing any such term ("Declaratory Order")) with respect to disputes, alleged violations or alleged breaches within such Settling State.

(2) Before initiating such proceedings, a party shall provide 30 days' written notice to the Attorney General of each Settling State, to NAAG, and to each Participating Manufacturer of its intent to initiate proceedings pursuant to this subsection. The 30-day notice period may be shortened in the event that the relevant Attorney General reasonably determines that a compelling time-sensitive public health and safety concern requires more immediate action.

(3) In the event that the Court determines that any Participating Manufacturer or Settling State has violated or breached this Agreement, the party that initiated the proceedings may request an order restraining such violation or breach, and/or ordering compliance within such Settling State (an "Enforcement Order").

(4) If an issue arises as to whether a Participating Manufacturer has failed to comply with an Enforcement Order, the Attorney General for the Settling State in question may seek an order for interpretation or for monetary, civil contempt or criminal sanctions to enforce compliance with such Enforcement Order.

(5) If the Court finds that a good-faith dispute exists as to the meaning of the terms of this Agreement or a Declaratory Order, the Court may in its discretion determine to enter a Declaratory Order rather than an Enforcement Order.

(6) Whenever possible, the parties shall seek to resolve an alleged violation of this Agreement by discussion pursuant to subsection XVIII(m) of this Agreement. In addition, in determining whether to seek an Enforcement Order, or in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation of an Enforcement Order, the Attorney General shall give good-faith consideration to whether the Participating Manufacturer that is claimed to have violated this Agreement has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless such party has been guilty of a pattern of violations of like nature.

(d) Right of Review. All orders and other judicial determinations made by any court in connection with this Agreement or any Consent Decree shall be subject to all available appellate review, and nothing in this Agreement or any Consent Decree shall be deemed to constitute a waiver of any right to any such review.

(e) Applicability. This Agreement and the Consent Decree apply only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a breach or violation of this Agreement or the Consent Decree (or any Declaratory Order or Enforcement Order issued in connection with this Agreement or the Consent Decree) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such breach or violation, and the Court shall have no jurisdiction to do so.

(f) Coordination of Enforcement. The Attorneys General of the Settling States (through NAAG) shall monitor potential conflicting interpretations by courts of different States of this Agreement and the Consent Decrees. The Settling States shall use their best efforts, in cooperation with the Participating Manufacturers, to coordinate and resolve the effects of such conflicting interpretations as to matters that are not exclusively local in nature.

(g) Inspection and Discovery Rights. Without limitation on whatever other rights to access they may be permitted by law, following State-Specific Finality in a Settling State and for seven years thereafter, representatives of the Attorney General of such Settling State may, for the purpose of enforcing this Agreement and the Consent Decree, upon reasonable cause to believe that a violation of this Agreement or the Consent Decree has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days): (1) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of each Participating Manufacturer insofar as they pertain to such believed violation; and (2) interview each Participating Manufacturer's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation. Documents and information provided to representatives of the Attorney General of such Settling State pursuant to this section VII shall be kept confidential by the Settling States, and shall be utilized only by the Settling States and only for purposes of enforcing this Agreement, the Consent Decree and the criminal law. The inspection and discovery rights provided to such Settling State pursuant to this subsection shall be coordinated through NAAG so as to avoid repetitive and excessive inspection and discovery.

VIII. CERTAIN ONGOING RESPONSIBILITIES OF THE SETTLING STATES

(a) Upon approval of the NAAG executive committee, NAAG will provide coordination and facilitation for the implementation and enforcement of this Agreement on behalf of the Attorneys General of the Settling States, including the following:

(1) NAAG will assist in coordinating the inspection and discovery activities referred to in subsections III(p)(3) and VII(g) regarding compliance with this Agreement by the Participating Manufacturers and any new tobacco-related trade associations.

(2) NAAG will convene at least two meetings per year and one major national conference every three years for the Attorneys General of the Settling States, the directors of the Foundation and three persons designated by each Participating Manufacturer. The purpose of the meetings and conference is to evaluate the success of this Agreement and coordinate efforts by the Attorneys General and the Participating Manufacturers to continue to reduce Youth smoking.

(3) NAAG will periodically inform NGA, NCSL, the National Association of Counties and the National League of Cities of the results of the meetings and conferences referred to in subsection (a)(2) above.

(4) NAAG will support and coordinate the efforts of the Attorneys General of the Settling States in carrying out their responsibilities under this Agreement.

(5) NAAG will perform the other functions specified for it in this Agreement, including the functions specified in section IV.

(b) Upon approval by the NAAG executive committee to assume the responsibilities outlined in subsection VIII(a) hereof, each Original Participating Manufacturer shall cause to be paid, beginning on December 31, 1998, and on December 31 of each year thereafter through and including December 31, 2007, its Relative Market Share of $150,000 per year to the Escrow Agent (to be credited to the Subsection VIII(b) Account), who shall disburse such monies to NAAG within 10 Business Days, to fund the activities described in subsection VIII(a).

(c) The Attorneys General of the Settling States, acting through NAAG, shall establish a fund ("The States' Antitrust/Consumer Protection Tobacco Enforcement Fund") in the form attached as Exhibit J, which will be maintained by

such Attorneys General to supplement the Settling States' (1) enforcement and implementation of the terms of this Agreement and the Consent Decrees, and (2) investigation and litigation of potential violations of laws with respect to Tobacco Products, as set forth in Exhibit J. Each Original Participating Manufacturer shall on March 31, 1999, severally pay its Relative Market Share of $50,000,000 to the Escrow Agent (to be credited to the Subsection VIII(c) Account), who shall disburse such monies to NAAG upon the occurrence of State-Specific Finality in at least one Settling State. Such funds will be used in accordance with the provisions of Exhibit J.

IX. PAYMENTS

(a) <u>All Payments Into Escrow</u>. All payments made pursuant to this Agreement (except those payments made pursuant to section XVII) shall be made into escrow pursuant to the Escrow Agreement, and shall be credited to the appropriate Account established pursuant to the Escrow Agreement. Such payments shall be disbursed to the beneficiaries or returned to the Participating Manufacturers only as provided in section XI and the Escrow Agreement. No payment obligation under this Agreement shall arise (1) unless and until the Escrow Court has approved and retained jurisdiction over the Escrow Agreement or (2) if such approval is reversed (unless and until such reversal is itself reversed). The parties agree to proceed as expeditiously as possible to resolve any issues that prevent approval of the Escrow Agreement. If any payment (other than the first initial payment under subsection IX(b)) is delayed because the Escrow Agreement has not been approved, such payment shall be due and payable (together with interest at the Prime Rate) within 10 Business Days after approval of the Escrow Agreement by the Escrow Court.

(b) <u>Initial Payments</u>. On the second Business Day after the Escrow Court approves and retains jurisdiction over the Escrow Agreement, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(b) Account (First)) its Market Capitalization Percentage (as set forth in Exhibit K) of the base amount of $2,400,000,000. On January 10, 2000, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,472,000,000. On January 10, 2001, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,546,160,000. On January 10, 2002, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,622,544,800. On January 10, 2003, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,701,221,144. The payments pursuant to this subsection (b) due on or after January 10, 2000 shall be credited to the Subsection IX(b) Account (Subsequent). The foregoing payments shall be modified in accordance with this subsection (b). The payments made by the Original Participating Manufacturers pursuant to this subsection (b) (other than the first such payment) shall be subject to the Volume Adjustment, the Non-Settling States Reduction and the offset for miscalculated or disputed payments described in subsection XI(i). The first payment due under this subsection (b) shall be subject to the Non-Settling States Reduction, but such reduction shall be determined as of the date one day before such payment is due (rather than the date 15 days before).

(c) <u>Annual Payments and Strategic Contribution Payments</u>.

(1) On April 15, 2000 and on April 15 of each year thereafter in perpetuity, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(1) Account) its Relative Market Share of the base amounts specified below, as such payments are modified in accordance with this subsection (c)(1):

Year	Base Amount
2000	$4,500,000,000
2001	$5,000,000,000
2002	$6,500,000,000
2003	$6,500,000,000
2004	$8,000,000,000
2005	$8,000,000,000
2006	$8,000,000,000
2007	$8,000,000,000
2008	$8,139,000,000
2009	$8,139,000,000
2010	$8,139,000,000
2011	$8,139,000,000
2012	$8,139,000,000
2013	$8,139,000,000
2014	$8,139,000,000
2015	$8,139,000,000
2016	$8,139,000,000
2017	$8,139,000,000
2018 and each year thereafter	$9,000,000,000

The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(1) shall be subject to the Inflation Adjustment, the Volume Adjustment, the Previously Settled States Reduction, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal

Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8).

(2) On April 15, 2008 and on April 15 of each year thereafter through 2017, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(2) Account) its Relative Market Share of the base amount of $861,000,000, as such payments are modified in accordance with this subsection (c)(2). The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be subject to the Inflation Adjustment, the Volume Adjustment, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8). Such payments shall also be subject to the Non-Settling States Reduction; provided, however, that for purposes of payments due pursuant to this subsection (c)(2) (and corresponding payments by Subsequent Participating Manufacturers under subsection IX(i)), the Non-Settling States Reduction shall be derived as follows: (A) the payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be allocated among the Settling States on a percentage basis to be determined by the Settling States pursuant to the procedures set forth in Exhibit U, and the resulting allocation percentages disclosed to the Escrow Agent, the Independent Auditor and the Original Participating Manufacturers not later than June 30, 1999; and (B) the Non-Settling States Reduction shall be based on the sum of the Allocable Shares so established pursuant to subsection (c)(2)(A) for those States that were Settling States as of the MSA Execution Date and as to which this Agreement has terminated as of the date 15 days before the payment in question is due.

(d) <u>Non-Participating Manufacturer Adjustment</u>.

(1) <u>Calculation of NPM Adjustment for Original Participating Manufacturers</u>. To protect the public health gains achieved by this Agreement, certain payments made pursuant to this Agreement shall be subject to an NPM Adjustment. Payments by the Original Participating Manufacturers to which the NPM Adjustment applies shall be adjusted as provided below:

(A) Subject to the provisions of subsections (d)(1)(C), (d)(1)(D) and (d)(2) below, each Allocated Payment shall be adjusted by subtracting from such Allocated Payment the product of such Allocated Payment amount multiplied by the NPM Adjustment Percentage. The "NPM Adjustment Percentage" shall be calculated as follows:

(i) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is less than or equal to 0 (zero), then the NPM Adjustment Percentage shall equal zero.

(ii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 0 (zero) and less than or equal to 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the product of (x) such Market Share Loss and (y) 3 (three).

(iii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the sum of (x) 50 percentage points and (y) the product of (*1*) the Variable Multiplier and (*2*) the result of such Market Share Loss minus 16 2/3 percentage points.

(B) Definitions:

(i) "Base Aggregate Participating Manufacturer Market Share" means the result of (x) the sum of the applicable Market Shares (the applicable Market Share to be that for 1997) of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due minus (y) 2 (two) percentage points.

(ii) "Actual Aggregate Participating Manufacturer Market Share" means the sum of the applicable Market Shares of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question is due).

(iii) "Market Share Loss" means the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) the Actual Aggregate Participating Manufacturer Market Share.

(iv) "Variable Multiplier" equals 50 percentage points divided by the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) 16 2/3 percentage points.

(C) On or before February 2 of each year following a year in which there was a Market Share Loss greater than zero, a nationally recognized firm of economic consultants (the "Firm") shall determine whether the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall apply. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were not a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall not apply. The Original Participating Manufacturers, the Settling States, and the Attorneys General for the Settling States shall cooperate to ensure that the determination described in this subsection (1)(C) is timely made. The Firm shall be acceptable to (and the principals responsible for this assignment shall be acceptable to) both the Original Participating Manufacturers and a majority of those Attorneys General who are both the

Attorney General of a Settling State and a member of the NAAG executive committee at the time in question (or in the event no such firm or no such principals shall be acceptable to such parties, National Economic Research Associates, Inc., or its successors by merger, acquisition or otherwise ("NERA"), acting through a principal or principals acceptable to such parties, if such a person can be identified and, if not, acting through a principal or principals identified by NERA, or a successor firm selected by the CPR Institute for Dispute Resolution). As soon as practicable after the MSA Execution Date, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of making the foregoing determination, and the Firm shall provide written notice to each Settling State, to NAAG, to the Independent Auditor and to each Participating Manufacturer of such determination. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable. The reasonable fees and expenses of the Firm shall be paid by the Original Participating Manufacturers according to their Relative Market Shares. Only the Participating Manufacturers and the Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (1)(C).

(D) No NPM Adjustment shall be made with respect to a payment if the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico in the year immediately preceding the year in which the payment in question is due by those Participating Manufacturers that had become Participating Manufacturers prior to 14 days after the MSA Execution Date is greater than the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico in 1997 by such Participating Manufacturers (and any of their Affiliates that made such shipments in 1997, as demonstrated by certified audited statements of such Affiliates' shipments, and that do not continue to make such shipments after the MSA Execution Date because the responsibility for such shipments has been transferred to one of such Participating Manufacturers). Measurements of shipments for purposes of this subsection (D) shall be made in the manner prescribed in subsection II(mm); in the event that such shipment data is unavailable for any Participating Manufacturer for 1997, such Participating Manufacturer's shipment volume for such year shall be measured in the manner prescribed in subsection II(z).

(2) Allocation among Settling States of NPM Adjustment for Original Participating Manufacturers.

(A) The NPM Adjustment set forth in subsection (d)(1) shall apply to the Allocated Payments of all Settling States, except as set forth below.

(B) A Settling State's Allocated Payment shall not be subject to an NPM Adjustment: (i) if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year; or (ii) if such Settling State enacted the Model Statute (as defined in subsection (2)(E) below) for the first time during the calendar year immediately preceding the year in which the payment in question is due, continuously had the Model Statute in full force and effect during the last six months of such calendar year, and diligently enforced the provisions of such statute during the period in which it was in full force and effect.

(C) The aggregate amount of the NPM Adjustments that would have applied to the Allocated Payments of those Settling States that are not subject to an NPM Adjustment pursuant to subsection (2)(B) shall be reallocated among all other Settling States pro rata in proportion to their respective Allocable Shares (the applicable Allocable Shares being those listed in Exhibit A), and such other Settling States' Allocated Payments shall be further reduced accordingly.

(D) This subsection (2)(D) shall apply if the amount of the NPM Adjustment applied pursuant to subsection (2)(A) to any Settling State plus the amount of the NPM Adjustments reallocated to such Settling State pursuant to subsection (2)(C) in any individual year would either (i) exceed such Settling State's Allocated Payment in that year, or (ii) if subsection (2)(F) applies to the Settling State in question, exceed 65% of such Settling State's Allocated Payment in that year. For each Settling State that has an excess as described in the preceding sentence, the excess amount of NPM Adjustment shall be further reallocated among all other Settling States whose Allocated Payments are subject to an NPM Adjustment and that do not have such an excess, pro rata in proportion to their respective Allocable Shares, and such other Settling States' Allocated Payments shall be further reduced accordingly. The provisions of this subsection (2)(D) shall be repeatedly applied in any individual year until either (i) the aggregate amount of NPM Adjustments has been fully reallocated or (ii) the full amount of the NPM Adjustments subject to reallocation under subsection (2)(C) or (2)(D) cannot be fully reallocated in any individual year as described in those subsections because (x) the Allocated Payment in that year of each Settling State that is subject to an NPM Adjustment and to which subsection (2)(F) does not apply has been reduced to zero, and (y) the Allocated Payment in that year of each Settling State to which subsection (2)(F) applies has been reduced to 35% of such Allocated Payment.

(E) A "Qualifying Statute" means a Settling State's statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement. Each Participating Manufacturer and each Settling State agree that the model statute in the form set forth in Exhibit T (the "Model Statute"), if enacted without modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, shall constitute a Qualifying Statute. Each Participating Manufacturer agrees to support the enactment of such Model Statute if such Model

Statute is introduced or proposed (i) without modification or addition (except for particularized procedural or technical requirements), and (ii) not in conjunction with any other legislative proposal.

(F) If a Settling State (i) enacts the Model Statute without any modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, (ii) uses its best efforts to keep the Model Statute in full force and effect by, among other things, defending the Model Statute fully in any litigation brought in state or federal court within such Settling State (including litigating all available appeals that may affect the effectiveness of the Model Statute), and (iii) otherwise complies with subsection (2)(B), but a court of competent jurisdiction nevertheless invalidates or renders unenforceable the Model Statute with respect to such Settling State, and but for such ruling the Settling State would have been exempt from an NPM Adjustment under subsection (2)(B), then the NPM Adjustment (including reallocations pursuant to subsections (2)(C) and (2)(D)) shall still apply to such Settling State's Allocated Payments but in any individual year shall not exceed 65% of the amount of such Allocated Payments.

(G) In the event a Settling State proposes and/or enacts a statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that is not the Model Statute and asserts that such statute, regulation, law and/or rule is a Qualifying Statute, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of determining whether or not such statute, regulation, law and/or rule constitutes a Qualifying Statute. The Firm shall make the foregoing determination within 90 days of a written request to it from the relevant Settling State (copies of which request the Settling State shall also provide to all Participating Manufacturers and the Independent Auditor), and the Firm shall promptly thereafter provide written notice of such determination to the relevant Settling State, NAAG, all Participating Manufacturers and the Independent Auditor. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable; provided, however, (i) that such determination shall be of no force and effect with respect to a proposed statute, regulation, law and/or rule that is thereafter enacted with any modification or addition; and (ii) that the Settling State in which the Qualifying Statute was enacted and any Participating Manufacturer may at any time request that the Firm reconsider its determination as to this issue in light of subsequent events (including, without limitation, subsequent judicial review, interpretation, modification and/or disapproval of a Settling State's Qualifying Statute, and the manner and/or the effect of enforcement of such Qualifying Statute). The Original Participating Manufacturers shall severally pay their Relative Market Shares of the reasonable fees and expenses of the Firm. Only the Participating Manufacturers and Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (2)(G).

(H) Except as provided in subsection (2)(F), in the event a Qualifying Statute is enacted within a Settling State and is thereafter invalidated or declared unenforceable by a court of competent jurisdiction, otherwise rendered not in full force and effect, or, upon reconsideration by the Firm pursuant to subsection (2)(G) determined not to constitute a Qualifying Statute, then such Settling State's Allocated Payments shall be fully subject to an NPM Adjustment unless and until the requirements of subsection (2)(B) have been once again satisfied.

(3) Allocation of NPM Adjustment among Original Participating Manufacturers. The portion of the total amount of the NPM Adjustment to which the Original Participating Manufacturers are entitled in any year that can be applied in such year consistent with subsection IX(d)(2) (the "Available NPM Adjustment") shall be allocated among them as provided in this subsection IX(d)(3).

(A) The "Base NPM Adjustment" shall be determined for each Original Participating Manufacturer in such year as follows:

(i) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied exceed or are equal to their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal 0 (zero).

(ii) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied are less than their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal the result of (x) the difference between such Original Participating Manufacturer's Relative Market Share in such preceding year and its 1997 Relative Market Share multiplied by both (y) the number of individual Cigarettes (expressed in thousands of units) shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such preceding year (determined in accordance with subsection II(mm)) and (z) $20 per each thousand units of Cigarettes (as this number is adjusted pursuant to subsection IX(d)(3)(C) below).

(iii) For those Original Participating Manufacturers whose Base NPM Adjustment, if calculated pursuant to subsection (ii) above, would exceed $300 million (as this number is adjusted pursuant to subsection IX(d)(3)(C) below), the Base NPM Adjustment shall equal $300 million (or such adjusted number, as provided in subsection IX(d)(3)(C) below).

(B) The share of the Available NPM Adjustment each Original Participating Manufacturer is entitled to shall be calculated as follows:

(i) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year is less than or equal to the sum of the Base NPM Adjustments of all Original Participating

Manufacturers in such year, then such Available NPM Adjustment shall be allocated among those Original Participating Manufacturers whose Base NPM Adjustment is not equal to 0 (zero) pro rata in proportion to their respective Base NPM Adjustments.

(ii) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year exceeds the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then (x) the difference between such Available NPM Adjustment and such sum of the Base NPM Adjustments shall be allocated among the Original Participating Manufacturers pro rata in proportion to their Relative Market Shares (the applicable Relative Market Shares to be those in the year immediately preceding such year), and (y) each Original Participating Manufacturer's share of such Available NPM Adjustment shall equal the sum of *(1)* its Base NPM Adjustment for such year, and *(2)* the amount allocated to such Original Participating Manufacturer pursuant to clause (x).

(iii) If an Original Participating Manufacturer's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(3)(B)(i) or IX(d)(3)(B)(ii) exceeds such Original Participating Manufacturer's payment amount to which such NPM Adjustment applies (as such payment amount has been determined pursuant to step B of clause "Seventh" of subsection IX(j)), then *(1)* such Original Participating Manufacturer's share of the Available NPM Adjustment shall equal such payment amount, and *(2)* such excess shall be reallocated among the other Original Participating Manufacturers pro rata in proportion to their Relative Market Shares.

(C) Adjustments:

(i) For calculations made pursuant to this subsection IX(d)(3) (if any) with respect to payments due in the year 2000, the number used in subsection IX(d)(3)(A)(ii)(z) shall be $20 and the number used in subsection IX(d)(3)(A)(iii) shall be $300 million. Each year thereafter, both these numbers shall be adjusted upward or downward by multiplying each of them by the quotient produced by dividing (x) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such year, by (y) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such immediately preceding year.

(ii) For purposes of this subsection, the average revenue per Cigarette of all the Original Participating Manufacturers in any year shall equal (x) the aggregate revenues of all the Original Participating Manufacturers from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico after Federal excise taxes and after payments pursuant to this Agreement and the tobacco litigation Settlement Agreements with the States of Florida, Mississippi, Minnesota and Texas (as such revenues are reported to the United States Securities and Exchange Commission ("SEC") for such year (either independently by the Original Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of the Original Participating Manufacturers) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with United States generally accepted accounting principles and audited by a nationally recognized accounting firm), divided by (y) the aggregate number of the individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such year (determined in accordance with subsection II(mm)).

(D) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied both (x) the Relative Market Share of Lorillard Tobacco Company (or of its successor) ("Lorillard") was less than or equal to 20.0000000%, and (y) the number of individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by Lorillard (determined in accordance with subsection II(mm)) (for purposes of this subsection (D), "Volume") was less than or equal to 70 billion, Lorillard's and Philip Morris Incorporated's (or its successor's) ("Philip Morris") shares of the Available NPM Adjustment calculated pursuant to subsections (3)(A)-(C) above shall be further reallocated between Lorillard and Philip Morris as follows (this subsection (3)(D) shall not apply in the year in which either of the two conditions specified in this sentence is not satisfied):

(i) Notwithstanding subsections (A)-(C) of this subsection (d)(3), but subject to further adjustment pursuant to subsections (D)(ii) and (D)(iii) below, Lorillard's share of the Available NPM Adjustment shall equal its Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding the year in which such NPM Adjustment is applied). The dollar amount of the difference between the share of the Available NPM Adjustment Lorillard is entitled to pursuant to the preceding sentence and the share of the Available NPM Adjustment it would be entitled to in the same year pursuant to subsections (d)(3)(A)-(C) shall be reallocated to Philip Morris and used to decrease or increase, as the case may be, Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C).

(ii) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied either (x) Lorillard's Relative Market Share was greater than 15.0000000% (but did not exceed 20.0000000%), or (y) Lorillard's Volume was greater than 50 billion (but did not exceed 70 billion), or both, Lorillard's share of the Available NPM Adjustment calculated pursuant to subsection (d)(3)(D)(i) shall be reduced by a percentage equal to the greater of *(1)* 10.0000000% for each percentage point (or fraction thereof) of excess of such Relative Market Share over 15.0000000% (if any), or (2) 2.5000000% for each billion (or fraction thereof) of excess of such Volume over 50 billion (if any). The dollar amount by which Lorillard's share of the Available NPM Adjustment is reduced in any year pursuant to this subsection (D)(ii) shall be reallocated to Philip Morris and used to increase Philip Morris's share of the Available NPM Adjustment in such year.

(iii) In the event that in any year a reallocation of the shares of the Available NPM Adjustment between Lorillard and Philip Morris pursuant to this subsection (d)(3)(D) results in Philip Morris's share of the Available NPM Adjustment in such year exceeding the greater of (x) Philip Morris's Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding such year), or (y) Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C), Philip Morris's share of the Available NPM Adjustment in such year shall be reduced to equal the greater of (x) or (y) above. In such instance, the dollar amount by which Philip Morris's share of the Available NPM Adjustment is reduced pursuant to the preceding sentence shall be reallocated to Lorillard and used to increase Lorillard's share of the Available NPM Adjustment in such year.

(iv) In the event that either Philip Morris or Lorillard is treated as a Non-Participating Manufacturer for purposes of this subsection IX(d)(3) pursuant to subsection XVIII(w)(2)(A), this subsection (3)(D) shall not be applied, and the Original Participating Manufacturers' shares of the Available NPM Adjustment shall be determined solely as described in subsections (3)(A)-(C).

(4) <u>NPM Adjustment for Subsequent Participating Manufacturers</u>. Subject to the provisions of subsection IX(i)(3), a Subsequent Participating Manufacturer shall be entitled to an NPM Adjustment with respect to payments due from such Subsequent Participating Manufacturer in any year during which an NPM Adjustment is applicable under subsection (d)(1) above to payments due from the Original Participating Manufacturers. The amount of such NPM Adjustment shall equal the product of (A) the NPM Adjustment Percentage for such year multiplied by (B) the sum of the payments due in the year in question from such Subsequent Participating Manufacturer that correspond to payments due from Original Participating Manufacturers pursuant to subsection IX(c) (as such payment amounts due from such Subsequent Participating Manufacturer have been adjusted and allocated pursuant to clauses "First" through "Fifth" of subsection IX(j)). The NPM Adjustment to payments by each Subsequent Participating Manufacturer shall be allocated and reallocated among the Settling States in a manner consistent with subsection (d)(2) above.

(e) <u>Supplemental Payments</u>. Beginning on April 15, 2004, and on April 15 of each year thereafter in perpetuity, in the event that the sum of the Market Shares of the Participating Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question would be due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question would be due) equals or exceeds 99.0500000%, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(e) Account) for the benefit of the Foundation its Relative Market Share of the base amount of $300,000,000, as such payments are modified in accordance with this subsection (e). Such payments shall be utilized by the Foundation to fund the national public education functions of the Foundation described in subsection VI(f)(1), in the manner described in and subject to the provisions of subsections VI(g) and VI(h). The payments made by the Original Participating Manufacturers pursuant to this subsection shall be subject to the Inflation Adjustment, the Volume Adjustment, the Non-Settling States Reduction, and the offset for miscalculated or disputed payments described in subsection XI(i).

(f) <u>Payment Responsibility</u>. The payment obligations of each Participating Manufacturer pursuant to this Agreement shall be the several responsibility only of that Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any Affiliate of such Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any other Participating Manufacturer. Provided, however, that no provision of this Agreement shall waive or excuse liability under any state or federal fraudulent conveyance or fraudulent transfer law. Any Participating Manufacturer whose Market Share (or Relative Market Share) in any given year equals zero shall have no payment obligations under this Agreement in the succeeding year.

(g) <u>Corporate Structures</u>. Due to the particular corporate structures of R.J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("B&W") with respect to their non-domestic tobacco operations, Reynolds and B&W shall be severally liable for their respective shares of each payment due pursuant to this Agreement up to (and their liability hereunder shall not exceed) the full extent of their assets used in and earnings derived from, the manufacture and/or sale in the States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of their other assets or earnings to satisfy such obligations.

(h) <u>Accrual of Interest</u>. Except as expressly provided otherwise in this Agreement, any payment due hereunder and not paid when due (or payments requiring the accrual of interest under subsection XI(d)) shall accrue interest from and including the date such payment is due until (but not including) the date paid at the Prime Rate plus three percentage points.

(i) <u>Payments by Subsequent Participating Manufacturers</u>.

(1) A Subsequent Participating Manufacturer shall have payment obligations under this Agreement only in the event that its Market Share in any calendar year exceeds the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share (subject to the provisions of subsection (i)(4)). In the year following any such calendar year, such Subsequent Participating Manufacturer shall make payments corresponding to those due in that same following year from the Original Participating Manufacturers pursuant to subsections VI(c) (except for the payment due on March 31, 1999), IX(c)(1), IX(c)(2) and IX(e). The amounts of such corresponding payments by a Subsequent Participating Manufacturer are in addition to the corresponding payments that are due from the Original Participating Manufacturers and shall be determined as described in subsections (2) and (3) below. Such payments by a Subsequent Participating Manufacturer shall (A) be due on the same dates as the corresponding payments are due from Original Participating Manufacturers; (B) be for the same

purpose as such corresponding payments; and (C) be paid, allocated and distributed in the same manner as such corresponding payments.

(2) The base amount due from a Subsequent Participating Manufacturer on any given date shall be determined by multiplying (A) the corresponding base amount due on the same date from all of the Original Participating Manufacturers (as such base amount is specified in the corresponding subsection of this Agreement and is adjusted by the Volume Adjustment (except for the provisions of subsection (B)(ii) of Exhibit E), but before such base amount is modified by any other adjustments, reductions or offsets) by (B) the quotient produced by dividing (i) the result of (x) such Subsequent Participating Manufacturer's applicable Market Share (the applicable Market Share being that for the calendar year immediately preceding the year in which the payment in question is due) minus (y) the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share, by (ii) the aggregate Market Shares of the Original Participating Manufacturers (the applicable Market Shares being those for the calendar year immediately preceding the year in which the payment in question is due).

(3) Any payment due from a Subsequent Participating Manufacturer under subsections (1) and (2) above shall be subject (up to the full amount of such payment) to the Inflation Adjustment, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8), to the extent that such adjustments, reductions or offsets would apply to the corresponding payment due from the Original Participating Manufacturers. Provided, however, that all adjustments and offsets to which a Subsequent Participating Manufacturer is entitled may only be applied against payments by such Subsequent Participating Manufacturer, if any, that are due within 12 months after the date on which the Subsequent Participating Manufacturer becomes entitled to such adjustment or makes the payment that entitles it to such offset, and shall not be carried forward beyond that time even if not fully used.

(4) For purposes of this subsection (i), the 1997 (or 1998, as applicable) Market Share (and 125 percent thereof) of those Subsequent Participating Manufacturers that either (A) became a signatory to this Agreement more than 60 days after the MSA Execution Date or (B) had no Market Share in 1997 (or 1998, as applicable), shall equal zero.

(j) Order of Application of Allocations, Offsets, Reductions and Adjustments. The payments due under this Agreement shall be calculated as set forth below. The "base amount" referred to in clause "First" below shall mean (1) in the case of payments due from Original Participating Manufacturers, the base amount referred to in the subsection establishing the payment obligation in question; and (2) in the case of payments due from a Subsequent Participating Manufacturer, the base amount referred to in subsection (i)(2) for such Subsequent Participating Manufacturer. In the event that a particular adjustment, reduction or offset referred to in a clause below does not apply to the payment being calculated, the result of the clause in question shall be deemed to be equal to the result of the immediately preceding clause. (If clause "First" is inapplicable, the result of clause "First" will be the base amount of the payment in question prior to any offsets, reductions or adjustments.)

First: the Inflation Adjustment shall be applied to the base amount of the payment being calculated;

Second: the Volume Adjustment (other than the provisions of subsection (B)(iii) of Exhibit E) shall be applied to the result of clause "First";

Third: the result of clause "Second" shall be reduced by the Previously Settled States Reduction;

Fourth: the result of clause "Third" shall be reduced by the Non-Settling States Reduction;

Fifth: in the case of payments due under subsections IX(c)(1) and IX(c)(2), the results of clause "Fourth" for each such payment due in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together to form such Settling State's Allocated Payment. In the case of payments due under subsection IX(i) that correspond to payments due under subsections IX(c)(1) or IX(c)(2), the results of clause "Fourth" for all such payments due from a particular Subsequent Participating Manufacturer in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together. (In the case of all other payments made pursuant to this Agreement, this clause "Fifth" is inapplicable.);

Sixth: the NPM Adjustment shall be applied to the results of clause "Fifth" pursuant to subsections IX(d)(1) and (d)(2) (or, in the case of payments due from the Subsequent Participating Manufacturers, pursuant to subsection IX(d)(4));

Seventh: in the case of payments due from the Original Participating Manufacturers to which clause "Fifth" (and therefore clause "Sixth") does not apply, the result of clause "Fourth" shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares. In the case of payments due from the Original Participating Manufacturers to which clause "Fifth" applies: (A) the Allocated Payments of all Settling States determined pursuant to clause "Fifth" (prior to reduction pursuant to clause "Sixth") shall be added together; (B) the resulting sum shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares and subsection (B)(iii) of Exhibit E hereto (if such subsection is applicable); (C) the Available NPM Adjustment (as determined pursuant to clause "Sixth") shall be allocated among the Original Participating Manufacturers pursuant to subsection IX(d)(3); (D) the respective result of step (C) above for each Original Participating Manufacturer shall be subtracted from the respective result of step (B) above

for such Original Participating Manufacturer; and (E) the resulting payment amount due from each Original Participating Manufacturer shall then be allocated among the Settling States in proportion to the respective results of clause "Sixth" for each Settling State. The offsets described in clauses "Eighth" through "Twelfth" shall then be applied separately against each Original Participating Manufacturer's resulting payment shares (on a Settling State by Settling State basis) according to each Original Participating Manufacturer's separate entitlement to such offsets, if any, in the calendar year in question. (In the case of payments due from Subsequent Participating Manufacturers, this clause "Seventh" is inapplicable.)

Eighth: the offset for miscalculated or disputed payments described in subsection XI(i) (and any carry-forwards arising from such offset) shall be applied to the results of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or to the results of clause "Sixth" (in the case of payments due from Subsequent Participating Manufacturers);

Ninth: the Federal Tobacco Legislation Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eighth";

Tenth: the Litigating Releasing Parties Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Ninth";

Eleventh: the offset for claims over pursuant to subsection XII(a)(4)(B) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Tenth";

Twelfth: the offset for claims over pursuant to subsection XII(a)(8) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eleventh"; and

Thirteenth: in the case of payments to which clause "Fifth" applies, the Settling States' allocated shares of the payments due from each Participating Manufacturer (as such shares have been determined in step (E) of clause "Seventh" in the case of payments from the Original Participating Manufacturers or in clause "Sixth" in the case of payments from the Subsequent Participating Manufacturers, and have been reduced by clauses "Eighth" through "Twelfth") shall be added together to state the aggregate payment obligation of each Participating Manufacturer with respect to the payments in question. (In the case of a payment to which clause "Fifth" does not apply, the aggregate payment obligation of each Participating Manufacturer with respect to the payment in question shall be stated by the results of clause "Eighth.")

X. EFFECT OF FEDERAL TOBACCO-RELATED LEGISLATION

(a) If federal tobacco-related legislation is enacted after the MSA Execution Date and on or before November 30, 2002, and if such legislation provides for payment(s) by any Original Participating Manufacturer (whether by settlement payment, tax or any other means), all or part of which are actually made available to a Settling State ("Federal Funds"), each Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any and all amounts that are paid by such Original Participating Manufacturer pursuant to such legislation and actually made available to such Settling State (except as described in subsections (b) and (c) below). Such offset shall be applied against the applicable Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of such Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment and has been reduced by offset, if any, pursuant to the offset for miscalculated or disputed payments). Such offset shall be made against such Original Participating Manufacturer's share of the first Allocated Payment due after such Federal Funds are first available for receipt by such Settling State. In the event that such offset would in any given year exceed such Original Participating Manufacturer's share of such Allocated Payment: (1) the offset to which such Original Participating Manufacturer is entitled under this section in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment, and (2) all amounts not offset by reason of subsection (1) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(b) The offset described in subsection (a) shall apply only to that portion of Federal Funds, if any, that are either unrestricted as to their use, or restricted to any form of health care or to any use related to tobacco (including, but not limited to, tobacco education, cessation, control or enforcement) (other than that portion of Federal Funds, if any, that is specifically applicable to tobacco growers or communities dependent on the production of tobacco or Tobacco Products). Provided, however, that the offset described in subsection (a) shall not apply to that portion of Federal Funds, if any, whose receipt by such Settling State is conditioned upon or appropriately allocable to:

(1) the relinquishment of rights or benefits under this Agreement (including the Consent Decree); or

(2) actions or expenditures by such Settling State, unless:

(A) such Settling State chooses to undertake such action or expenditure;

(B) such actions or expenditures do not impose significant constraints on public policy choices; or

(C) such actions or expenditures are both: (i) related to health care or tobacco (including, but not limited to, tobacco education, cessation, control or enforcement) and (ii) do not require such Settling State to expend state matching funds in an amount that is significant in relation to the amount of the Federal Funds made available to such Settling State.

(c) Subject to the provisions of subsection IX(i)(3), Subsequent Participating Manufacturers shall be entitled to the offset described in this section X to the extent that they are required to pay Federal Funds that would give rise to an offset under subsections (a) and (b) if paid by an Original Participating Manufacturer.

(d) Nothing in this section X shall (1) reduce the payments to be made to the Settling States under this Agreement other than those described in subsection IX(c) (or corresponding payments under subsection IX(i)) of this Agreement; or (2) alter the Allocable Share used to determine each Settling State's share of the payments described in subsection IX(c) (or corresponding payments under subsection IX(i)) of this Agreement. Nothing in this section X is intended to or shall reduce the total amounts payable by the Participating Manufacturers to the Settling States under this Agreement by an amount greater than the amount of Federal Funds that the Settling States could elect to receive.

XI. CALCULATION AND DISBURSEMENT OF PAYMENTS

(a) Independent Auditor to Make All Calculations.

(1) Beginning with payments due in the year 2000, an Independent Auditor shall calculate and determine the amount of all payments owed pursuant to this Agreement, the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the Participating Manufacturers and among the Settling States, and shall perform all other calculations in connection with the foregoing (including, but not limited to, determining Market Share, Relative Market Share, Base Aggregate Participating Manufacturer Market Share and Actual Aggregate Participating Manufacturer Market Share). The Independent Auditor shall promptly collect all information necessary to make such calculations and determinations. Each Participating Manufacturer and each Settling State shall provide the Independent Auditor, as promptly as practicable, with information in its possession or readily available to it necessary for the Independent Auditor to perform such calculations. The Independent Auditor shall agree to maintain the confidentiality of all such information, except that the Independent Auditor may provide such information to Participating Manufacturers and the Settling States as set forth in this Agreement. The Participating Manufacturers and the Settling States agree to maintain the confidentiality of such information.

(2) Payments due from the Original Participating Manufacturers prior to January 1, 2000 (other than the first payment due pursuant to subsection IX(b)) shall be based on the 1998 Relative Market Shares of the Original Participating Manufacturers or, if the Original Participating Manufacturers are unable to agree on such Relative Market Shares, on their 1997 Relative Market Shares specified in Exhibit Q.

(b) Identity of Independent Auditor. The Independent Auditor shall be a major, nationally recognized, certified public accounting firm jointly selected by agreement of the Original Participating Manufacturers and those Attorneys General of the Settling States who are members of the NAAG executive committee, who shall jointly retain the power to replace the Independent Auditor and appoint its successor. Fifty percent of the costs and fees of the Independent Auditor (but in no event more than $500,000 per annum), shall be paid by the Fund described in Exhibit J hereto, and the balance of such costs and fees shall be paid by the Original Participating Manufacturers, allocated among them according to their Relative Market Shares. The agreement retaining the Independent Auditor shall provide that the Independent Auditor shall perform the functions specified for it in this Agreement, and that it shall do so in the manner specified in this Agreement.

(c) Resolution of Disputes. Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge. Each of the two sides to the dispute shall select one arbitrator. The two arbitrators so selected shall select the third arbitrator. The arbitration shall be governed by the United States Federal Arbitration Act.

(d) General Provisions as to Calculation of Payments.

(1) Not less than 90 days prior to the scheduled due date of any payment due pursuant to this Agreement ("Payment Due Date"), the Independent Auditor shall deliver to each other Notice Party a detailed itemization of all information required by the Independent Auditor to complete its calculation of (A) the amount due from each Participating Manufacturer with respect to such payment, and (B) the portion of such amount allocable to each entity for whose benefit such payment is to be made. To the extent practicable, the Independent Auditor shall specify in such itemization which Notice Party is requested to produce which information. Each Participating Manufacturer and each Settling State shall use its best efforts to promptly supply all of the required information that is within its possession or is readily available to it to the Independent Auditor, and in any event not less than 50 days prior to such Payment Due Date. Such best efforts obligation shall be continuing in the case of information that comes within the possession of, or becomes readily available to, any Settling State or Participating Manufacturer after the date 50 days prior to such Payment Due Date.

(2) Not less than 40 days prior to the Payment Due Date, the Independent Auditor shall deliver to each other Notice Party (A) detailed preliminary calculations ("Preliminary Calculations") of the amount due from each Participating Manufacturer and of the amount allocable to each entity for whose benefit such payment is to be made, showing all applicable offsets, adjustments, reductions and carry-forwards and setting forth all the information on which the Independent Auditor relied in preparing such Preliminary Calculations, and (B) a statement of any information still required by the Independent Auditor to complete its calculations.

(3) Not less than 30 days prior to the Payment Due Date, any Participating Manufacturer or any Settling State that disputes any aspect of the Preliminary Calculations (including, but not limited to, disputing the methodology that the Independent Auditor employed, or the information on which the Independent Auditor relied, in preparing such calculations) shall notify each other Notice Party of such dispute, including the reasons and basis therefor.

(4) Not less than 15 days prior to the Payment Due Date, the Independent Auditor shall deliver to each other Notice Party a detailed recalculation (a "Final Calculation") of the amount due from each Participating Manufacturer, the amount allocable to each entity for whose benefit such payment is to be made, and the Account to which such payment is to be credited, explaining any changes from the Preliminary Calculation. The Final Calculation may include estimates of amounts in the circumstances described in subsection (d)(5).

(5) The following provisions shall govern in the event that the information required by the Independent Auditor to complete its calculations is not in its possession by the date as of which the Independent Auditor is required to provide either a Preliminary Calculation or a Final Calculation.

(A) If the information in question is not readily available to any Settling State, any Original Participating Manufacturer or any Subsequent Participating Manufacturer, the Independent Auditor shall employ an assumption as to the missing information producing the minimum amount that is likely to be due with respect to the payment in question, and shall set forth its assumption as to the missing information in its Preliminary Calculation or Final Calculation, whichever is at issue. Any Original Participating Manufacturer, Subsequent Participating Manufacturer or Settling State may dispute any such assumption employed by the Independent Auditor in its Preliminary Calculation in the manner prescribed in subsection (d)(3) or any such assumption employed by the Independent Auditor in its Final Calculation in the manner prescribed in subsection (d)(6). If the missing information becomes available to the Independent Auditor prior to the Payment Due Date, the Independent Auditor shall promptly revise its Preliminary Calculation or Final Calculation (whichever is applicable) and shall promptly provide the revised calculation to each Notice Party, showing the newly available information. If the missing information does not become available to the Independent Auditor prior to the Payment Due Date, the minimum amount calculated by the Independent Auditor pursuant to this subsection (A) shall be paid on the Payment Due Date, subject to disputes pursuant to subsections (d)(6) and (d)(8) and without prejudice to a later final determination of the correct amount. If the missing information becomes available to the Independent Auditor after the Payment Due Date, the Independent Auditor shall calculate the correct amount of the payment in question and shall apply any overpayment or underpayment as an offset or additional payment in the manner described in subsection (i).

(B) If the information in question is readily available to a Settling State, Original Participating Manufacturer or Subsequent Participating Manufacturer, but such Settling State, Original Participating Manufacturer or Subsequent Participating Manufacturer does not supply such information to the Independent Auditor, the Independent Auditor shall base the calculation in question on its best estimate of such information, and shall show such estimate in its Preliminary Calculation or Final Calculation, whichever is applicable. Any Original Participating Manufacturer, Subsequent Participating Manufacturer or Settling State (except the entity that withheld the information) may dispute such estimate employed by the Independent Auditor in its Preliminary Calculation in the manner prescribed in subsection (d)(3) or such estimate employed by the Independent Auditor in its Final Calculation in the manner prescribed in subsection (d)(6). If the withheld information is not made available to the Independent Auditor more than 30 days prior to the Payment Due Date, the estimate employed by the Independent Auditor (as revised by the Independent Auditor in light of any dispute filed pursuant to the preceding sentence) shall govern the amounts to be paid on the Payment Due Date, subject to disputes pursuant to subsection (d)(6) and without prejudice to a later final determination of the correct amount. In the event that the withheld information subsequently becomes available, the Independent Auditor shall calculate the correct amount and shall apply any overpayment or underpayment as an offset or additional payment in the manner described in subsection (i).

(6) Not less than five days prior to the Payment Due Date, each Participating Manufacturer and each Settling State shall deliver to each Notice Party a statement indicating whether it disputes the Independent Auditor's Final Calculation and, if so, the disputed and undisputed amounts and the basis for the dispute. Except to the extent a Participating Manufacturer or a Settling State delivers a statement indicating the existence of a dispute by such date, the amounts set forth in the Independent Auditor's Final Calculation shall be paid on the Payment Due Date. Provided, however, that (A) in the event that the Independent Auditor revises its Final Calculation within five days of the Payment Due Date as provided in subsection (5)(A) due to receipt of previously missing information, a Participating Manufacturer or Settling State may dispute such revision pursuant to the procedure set forth in this subsection (6) at any time prior to the Payment Due Date; and (B) prior to the date four years after the Payment Due Date, neither failure to dispute a calculation made by the Independent Auditor nor actual agreement with any calculation or payment to the Escrow Agent or to another payee shall waive any Participating Manufacturer's or Settling State's rights to dispute any payment (or the Independent Auditor's calculations with respect to any payment) after the Payment Due Date. No Participating Manufacturer and no Settling State shall have a right to raise any dispute with respect to any payment or calculation after the date four years after such payment's Payment Due Date.

(7) Each Participating Manufacturer shall be obligated to pay by the Payment Due Date the undisputed portion of the total amount calculated as due from it by the Independent Auditor's Final Calculation. Failure to pay such portion shall render the Participating Manufacturer liable for interest thereon as provided in subsection IX(h) of this Agreement, in addition to any other remedy available under this Agreement.

(8) As to any disputed portion of the total amount calculated to be due pursuant to the Final Calculation, any Participating Manufacturer that by the Payment Due Date pays such disputed portion into the Disputed Payments Account (as defined in the Escrow Agreement) shall not be liable for interest thereon even if the amount disputed was in fact properly due and owing. Any Participating Manufacturer that by the Payment Due Date does not pay such disputed portion into the Disputed Payments Account shall be liable for interest as provided in subsection IX(h) if the amount disputed was in fact properly due and owing.

(9) On the same date that it makes any payment pursuant to this Agreement, each Participating Manufacturer shall deliver a notice to each other Notice Party showing the amount of such payment and the Account to which such payment is to be credited.

(10) On the first Business Day after the Payment Due Date, the Escrow Agent shall deliver to each other Notice Party a statement showing the amounts received by it from each Participating Manufacturer and the Accounts credited with such amounts.

(e) General Treatment of Payments. The Escrow Agent may disburse amounts from an Account only if permitted, and only at such time as permitted, by this Agreement and the Escrow Agreement. No amounts may be disbursed to a Settling State other than funds credited to such Settling State's State-Specific Account (as defined in the Escrow Agreement). The Independent Auditor, in delivering payment instructions to the Escrow Agent, shall specify: the amount to be paid; the Account or Accounts from which such payment is to be disbursed; the payee of such payment (which may be an Account); and the Business Day on which such payment is to be made by the Escrow Agent. Except as expressly provided in subsection (f) below, in no event may any amount be disbursed from any Account prior to Final Approval.

(f) Disbursements and Charges Not Contingent on Final Approval. Funds may be disbursed from Accounts without regard to the occurrence of Final Approval in the following circumstances and in the following manner:

(1) Payments of Federal and State Taxes. Federal, state, local or other taxes imposed with respect to the amounts credited to the Accounts shall be paid from such amounts. The Independent Auditor shall prepare and file any tax returns required to be filed with respect to the escrow. All taxes required to be paid shall be allocated to and charged against the Accounts on a reasonable basis to be determined by the Independent Auditor. Upon receipt of written instructions from the Independent Auditor, the Escrow Agent shall pay such taxes and charge such payments against the Account or Accounts specified in those instructions.

(2) Payments to and from Disputed Payments Account. The Independent Auditor shall instruct the Escrow Agent to credit funds from an Account to the Disputed Payments Account when a dispute arises as to such funds, and shall instruct the Escrow Agent to credit funds from the Disputed Payments Account to the appropriate payee when such dispute is resolved with finality. The Independent Auditor shall provide the Notice Parties not less than 10 Business Days prior notice before instructing the Escrow Agent to disburse funds from the Disputed Payments Account.

(3) Payments to a State-Specific Account. Promptly following the occurrence of State-Specific Finality in any Settling State, such Settling State and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such State-Specific Finality and of the portions of the amounts in the Subsection IX(b) Account (First), Subsection IX(b) Account (Subsequent), Subsection IX(c)(1) Account and Subsection IX(c)(2) Account, respectively (as such Accounts are defined in the Escrow Agreement), that are at such time held in such Accounts for the benefit of such Settling State, and which are to be transferred to the appropriate State-Specific Account for such Settling State. If neither the Settling State in question nor any Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to make such transfer. If the Settling State in question or any Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (f)(3), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and the undisputed portion to the appropriate State-Specific Account. No amounts may be transferred or credited to a State-Specific Account for the benefit of any State as to which State-Specific Finality has not occurred or as to which this Agreement has terminated.

(4) Payments to Parties other than Particular Settling States.

(A) Promptly following the occurrence of State-Specific Finality in one Settling State, such Settling State and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of State-Specific Finality in at least one Settling State and of the amounts held in the Subsection VI(b) Account, Subsection VI(c) Account (First), and Subsection VIII(c) Account (as such Accounts are defined in the Escrow Agreement), if any. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts or disputes the occurrence of State-Specific Finality in one Settling State, by notice delivered to each Notice Party not later than ten Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in such Accounts to the Foundation or to the Fund specified in subsection VIII(c), as appropriate. If any Settling State or Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the

Independent Auditor of the notice described in the second sentence of this subsection (4)(A), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to the Foundation or to the Fund specified in subsection VIII(c), as appropriate.

(B) The Independent Auditor shall instruct the Escrow Agent to disburse funds on deposit in the Subsection VIII(b) Account and Subsection IX(e) Account (as such Accounts are defined in the Escrow Agreement) to NAAG or to the Foundation, as appropriate, within 10 Business Days after the date on which such amounts were credited to such Accounts.

(C) Promptly following the occurrence of State-Specific Finality in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date, the Settling States and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of such State-Specific Finality and of the amounts held in the Subsection VI(c) Account (Subsequent) (as such Account is defined in the Escrow Agreement), if any. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts or disputes the occurrence of such State-Specific Finality, by notice delivered to each Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in such Account to the Foundation. If any Settling State or Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (4)(C), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to the Foundation.

(5) Treatment of Payments Following Termination.

(A) As to amounts held for Settling States. Promptly upon the termination of this Agreement with respect to any Settling State (whether or not as part of the termination of this Agreement as to all Settling States) such State or any Participating Manufacturer shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection IX(b) Account (First), the Subsection IX(b) Account (Subsequent), the Subsection IX(c)(1) Account, the Subsection IX(c)(2) Account, and the State-Specific Account for the benefit of such Settling State. If neither the State in question nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If the State in question or any Participating Manufacturer disputes the amounts held in the Accounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(A), the Independent Auditor shall promptly instruct the Escrow Agent to transfer the amount disputed to the Disputed Payments Account and the undisputed portion to the Participating Manufacturers (on the basis of their respective contributions of such funds).

(B) As to amounts held for others. If this Agreement is terminated with respect to all of the Settling States, the Original Participating Manufacturers shall promptly notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection VI(b) Account, the Subsection VI(c) Account (First), the Subsection VIII(b) Account, the Subsection VIII(c) Account and the Subsection IX(e) Account. If neither any such State nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If any such State or any Participating Manufacturer disputes the amounts held in the Accounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(B), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and transfer the undisputed portion to the Participating Manufacturers (on the basis of their respective contribution of such funds).

(C) As to amounts held in the Subsection VI(c) Account (Subsequent). If this Agreement is terminated with respect to Settling States having aggregate Allocable Shares equal to more than 20% of the total aggregate Allocable Shares assigned to those States that were Settling States as of the MSA Execution Date, the Original Participating Manufacturers shall promptly notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection VI(c) Account (Subsequent) (as defined in the Escrow Agreement). If neither any such State with respect to which this Agreement has terminated nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If any such State or

any Participating Manufacturer disputes the amounts held in the Account or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(C), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and transfer the undisputed portion to the Participating Manufacturers (on the basis of their respective contribution of such funds).

(6) Determination of amounts paid or held for the benefit of each individual Settling State. For purposes of subsections (f)(3), (f)(5)(A) and (i)(2), the portion of a payment that is made or held for the benefit of each individual Settling State shall be determined: (A) in the case of a payment credited to the Subsection IX(b) Account (First) or the Subsection IX(b) Account (Subsequent), by allocating the results of clause "Eighth" of subsection IX(j) among those Settling States who were Settling States at the time that the amount of such payment was calculated, pro rata in proportion to their respective Allocable Shares; and (B) in the case of a payment credited to the Subsection IX(c)(1) Account or the Subsection IX(c)(2) Account, by the results of clause "Twelfth" of subsection IX(j) for each individual Settling State. Provided, however, that, solely for purposes of subsection (f)(3), the Settling States may by unanimous agreement agree on a different method of allocation of amounts held in the Accounts identified in this subsection (f)(6).

(g) Payments to be Made Only After Final Approval. Promptly following the occurrence of Final Approval, the Settling States and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of Final Approval and of the amounts held in the State-Specific Accounts. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts, disputes the occurrence of Final Approval or claims that this Agreement has terminated as to any Settling State for whose benefit the funds are held in a State-Specific Account, by notice delivered to each Notice Party not later than 10 Business Days after delivery by the Independent Auditor of such notice of Final Approval, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in the State-Specific Accounts to (or as directed by) the respective Settling States. If any Notice Party disputes such amounts or the occurrence of Final Approval, or claims that this Agreement has terminated as to any Settling State for whose benefit the funds are held in a State-Specific Account, by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of such notice of Final Approval, the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to (or as directed by) the respective Settling States.

(h) Applicability to Section XVII Payments. This section XI shall not be applicable to payments made pursuant to section XVII; provided, however, that the Independent Auditor shall be responsible for calculating Relative Market Shares in connection with such payments, and the Independent Auditor shall promptly provide the results of such calculation to any Original Participating Manufacturer or Settling State that requests it do so.

(i) Miscalculated or Disputed Payments.

(1) Underpayments.

(A) If information becomes available to the Independent Auditor not later than four years after a Payment Due Date, and such information shows that any Participating Manufacturer was instructed to make an insufficient payment on such date ("original payment"), the Independent Auditor shall promptly determine the additional payment owed by such Participating Manufacturer and the allocation of such additional payment among the applicable payees. The Independent Auditor shall then reduce such additional payment (up to the full amount of such additional payment) by any adjustments or offsets that were available to the Participating Manufacturer in question against the original payment at the time it was made (and have not since been used) but which such Participating Manufacturer was unable to use against such original payment because such adjustments or offsets were in excess of such original payment (provided that any adjustments or offsets used against such additional payment shall reduce on a dollar-for-dollar basis any remaining carry-forward held by such Participating Manufacturer with respect to such adjustment or offset). The Independent Auditor shall then add interest at the Prime Rate (calculated from the Payment Due Date in question) to the additional payment (as reduced pursuant to the preceding sentence), except that where the additional payment owed by a Participating Manufacturer is the result of an underpayment by such Participating Manufacturer caused by such Participating Manufacturer's withholding of information as described in subsection (d)(5)(B), the applicable interest rate shall be that described in subsection IX(h). The Independent Auditor shall promptly give notice of the additional payment owed by the Participating Manufacturer in question (as reduced and/or increased as described above) to all Notice Parties, showing the new information and all calculations. Upon receipt of such notice, any Participating Manufacturer or Settling State may dispute the Independent Auditor's calculations in the manner described in subsection (d)(3), and the Independent Auditor shall promptly notify each Notice Party of any subsequent revisions to its calculations. Not more than 15 days after receipt of such notice (or, if the Independent Auditor revises its calculations, not more than 15 days after receipt of the revisions), any Participating Manufacturer and any Settling State may dispute the Independent Auditor's calculations in the manner prescribed in subsection (d)(6). Failure to dispute the Independent Auditor's calculations in this manner shall constitute agreement with the Independent Auditor's calculations, subject to the limitations set forth in subsection (d)(6). Payment of the undisputed portion of an additional payment shall be made to the Escrow Agent not more than 20 days after receipt of the notice described in this subsection (A) (or, if the Independent Auditor revises its calculations, not more than 20 days after receipt of the revisions). Failure to pay such portion shall render the Participating Manufacturer liable for interest thereon as provided in subsection IX(h). Payment of the disputed portion shall be governed by subsection (d)(8).

(B) To the extent a dispute as to a prior payment is resolved with finality against a Participating Manufacturer: (i) in the case where the disputed amount has been paid into the Disputed Payments Account pursuant to subsection (d)(8), the Independent Auditor shall instruct the Escrow Agent to transfer such amount to the applicable payee Account(s); (ii) in the case where the disputed amount has not been paid into the Disputed Payments Account and the dispute was identified prior to the Payment Due Date in question by delivery of a statement pursuant to subsection (d)(6) identifying such dispute, the Independent Auditor shall calculate interest on the disputed amount from the Payment Due Date in question (the applicable interest rate to be that provided in subsection IX(h)) and the allocation of such amount and interest among the applicable payees, and shall provide notice of the amount owed (and the identity of the payor and payees) to all Notice Parties; and (iii) in all other cases, the procedure described in subsection (ii) shall apply, except that the applicable interest rate shall be the Prime Rate.

(2) Overpayments.

(A) If a dispute as to a prior payment is resolved with finality in favor of a Participating Manufacturer where the disputed amount has been paid into the Disputed Payments Account pursuant to subsection (d)(8), the Independent Auditor shall instruct the Escrow Agent to transfer such amount to such Participating Manufacturer.

(B) If information becomes available to the Independent Auditor not later than four years after a Payment Due Date showing that a Participating Manufacturer made an overpayment on such date, or if a dispute as to a prior payment is resolved with finality in favor of a Participating Manufacturer where the disputed amount has been paid but not into the Disputed Payments Account, such Participating Manufacturer shall be entitled to a continuing dollar-for-dollar offset as follows:

(i) offsets under this subsection (B) shall be applied only against eligible payments to be made by such Participating Manufacturer after the entitlement to the offset arises. The eligible payments shall be: in the case of offsets arising from payments under subsection IX(b) or IX(c)(1), subsequent payments under any of such subsections; in the case of offsets arising from payments under subsection IX(c)(2), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under subsection IX(c)(1); in the case of offsets arising from payments under subsection IX(e), subsequent payments under such subsection or subsection IX(c); in the case of offsets arising from payments under subsection VI(c), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under any of subsection IX(c)(1), IX(c)(2) or IX(e); in the case of offsets arising from payments under subsection VIII(b), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under either subsection IX(c)(1) or IX(c)(2); in the case of offsets arising from payments under subsection VIII(c), subsequent payments under either subsection IX(c)(1) or IX(c)(2); and, in the case of offsets arising from payments under subsection IX(i), subsequent payments under such subsection (consistent with the provisions of this subsection (B)(i)).

(ii) in the case of offsets to be applied against payments under subsection IX(c), the offset to be applied shall be apportioned among the Settling States pro rata in proportion to their respective shares of such payments, as such respective shares are determined pursuant to step E of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or clause "Sixth" (in the case of payments due from the Subsequent Participating Manufacturers) of subsection IX(j) (except where the offset arises from an overpayment applicable solely to a particular Settling State).

(iii) the total amount of the offset to which a Participating Manufacturer shall be entitled shall be the full amount of the overpayment it made, together with interest calculated from the time of the overpayment to the Payment Due Date of the first eligible payment against which the offset may be applied. The applicable interest rate shall be the Prime Rate (except that, where the overpayment is the result of a Settling State's withholding of information as described in subsection (d)(5)(B), the applicable interest rate shall be that described in subsection IX(h)).

(iv) an offset under this subsection (B) shall be applied up to the full amount of the Participating Manufacturer's share (in the case of payments due from Original Participating Manufacturers, determined as described in the first sentence of clause "Seventh" of subsection IX(j) (or, in the case of payments pursuant to subsection IX(c), step D of such clause)) of the eligible payment in question, as such payment has been adjusted and reduced pursuant to clauses "First" through "Sixth" of subsection IX(j), to the extent each such clause is applicable to the payment in question. In the event that the offset to which a Participating Manufacturer is entitled under this subsection (B) would exceed such Participating Manufacturer's share of the eligible payment against which it is being applied (or, in the case where such offset arises from an overpayment applicable solely to a particular Settling State, the portion of such payment that is made for the benefit of such Settling State), the offset shall be the full amount of such Participating Manufacturer's share of such payment and all amounts not offset shall carry forward and be offset against subsequent eligible payments until all such amounts have been offset.

(j) Payments After Applicable Condition. To the extent that a payment is made after the occurrence of all applicable conditions for the disbursement of such payment to the payee(s) in question, the Independent Auditor shall instruct the Escrow Agent to disburse such payment promptly following its deposit.

XII. SETTLING STATES' RELEASE, DISCHARGE AND COVENANT

(a) Release.

(1) Upon the occurrence of State-Specific Finality in a Settling State, such Settling State shall absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Releasing Parties directly, indirectly, derivatively or in any other capacity ever had, now have, or hereafter can, shall or may have.

(2) Notwithstanding the foregoing, this release and discharge shall not apply to any defendant in a lawsuit settled pursuant to this Agreement (other than a Participating Manufacturer) unless and until such defendant releases the Releasing Parties (and delivers to the Attorney General of the applicable Settling State a copy of such release) from any and all Claims of such defendant relating to the prosecution of such lawsuit.

(3) Each Settling State (for itself and for the Releasing Parties) further covenants and agrees that it (and the Releasing Parties) shall not after the occurrence of State-Specific Finality sue or seek to establish civil liability against any Released Party based, in whole or in part, upon any of the Released Claims, and further agrees that such covenant and agreement shall be a complete defense to any such civil action or proceeding.

(4) (A) Each Settling State (for itself and for the Releasing Parties) further agrees that, if a Released Claim by a Releasing Party against any person or entity that is not a Released Party (a "non-Released Party") results in or in any way gives rise to a claim-over (on any theory whatever other than a claim based on an express written indemnity agreement) by such non-Released Party against any Released Party (and such Released Party gives notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), the Releasing Party: (i) shall reduce or credit against any judgment or settlement such Releasing Party may obtain against such non-Released Party the full amount of any judgment or settlement such non-Released Party may obtain against the Released Party on such claim-over; and (ii) shall, as part of any settlement with such non-Released Party, obtain from such non-Released Party for the benefit of such Released Party a satisfaction in full of such non-Released Party's judgment or settlement against the Released Party.

(B) Each Settling State further agrees that in the event that the provisions of subsection (4)(A) do not fully eliminate any and all liability of any Original Participating Manufacturer (or of any person or entity that is a Released Party by virtue of its relation to any Original Participating Manufacturer) with respect to claims-over (on any theory whatever other than a claim based on an express written indemnity agreement) by any non-Released Party to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement (to the extent that such Released Party has given notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), judgment or otherwise) of such non-Released Party to any Releasing Party arising out of any Released Claim, such Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any amounts paid by such Original Participating Manufacturer (or by any person or entity that is a Released Party by virtue of its relation to such Original Participating Manufacturer) on any such liability against such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment each year, until all such amounts paid on such liability have been offset. In the event that the offset under this subsection (4) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the offset for miscalculated or disputed payments, the Federal Tobacco Legislation Offset and the Litigating Releasing Parties Offset): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of subsection (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(C) Each Settling State further agrees that, subject to the provisions of section IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection (B) above to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on liability that would give rise to an offset under such subsection if paid by an Original Participating Manufacturer.

(5) This release and covenant shall not operate to interfere with a Settling State's ability to enforce as against any Participating Manufacturer the provisions of this Agreement, or with the Court's ability to enter the Consent Decree or to maintain continuing jurisdiction to enforce such Consent Decree pursuant to the terms thereof. Provided, however, that neither subsection III(a) or III(r) of this Agreement nor subsection V(A) or V(I) of the Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

(6) The Settling States do not purport to waive or release any claims on behalf of Indian tribes.

(7) The Settling States do not waive or release any criminal liability based on federal, state or local law.

(8) Notwithstanding the foregoing (and the definition of Released Parties), this release and covenant shall not apply to retailers, suppliers or distributors to the extent of any liability arising from the sale or distribution of Tobacco Products of, or the supply of component parts of Tobacco Products to, any non-Released Party.

(A) Each Settling State (for itself and for the Releasing Parties) agrees that, if a claim by a Releasing Party against a retailer, supplier or distributor that would be a Released Claim but for the operation of the preceding sentence results in or in any way gives rise to a claim-over (on any theory whatever) by such retailer, supplier or distributor against any Released Party (and such Released Party gives notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), the Releasing Party: (i) shall reduce or credit against any judgment or settlement such Releasing Party may obtain against such retailer, supplier or distributor the full amount of any judgment or settlement such retailer, supplier or distributor may obtain against the Released Party on such claim-over; and (ii) shall, as part of any settlement with such retailer, supplier or distributor, obtain from such retailer, supplier or distributor for the benefit of such Released Party a satisfaction in full of such retailer's, supplier's or distributor's judgment or settlement against the Released Party.

(B) Each Settling State further agrees that in the event that the provisions of subsection (8)(A) above do not fully eliminate any and all liability of any Original Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship to an Original Participating Manufacturer) with respect to claims-over (on any theory whatever) by any such retailer, supplier or distributor to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement (to the extent that such Released Party has given notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), judgment or otherwise) of such retailer, supplier or distributor to any Releasing Party arising out of any claim that would be a Released Claim but for the operation of the first sentence of this subsection (8), such Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any amounts paid by such Original Participating Manufacturer (or by any person or entity that is a Released Party by virtue of its relation to such Original Participating Manufacturer) on any such liability against such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment each year, until all such amounts paid on such liability have been offset. In the event that the offset under this subsection (8) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the offset for miscalculated or disputed payments, the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offset for claims-over under subsection XII(a)(4)(B)): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of clause (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(C) Each Settling State further agrees that, subject to the provisions of subsection IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection (B) above to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on liability that would give rise to an offset under such subsection if paid by an Original Participating Manufacturer.

(9) Notwithstanding any provision of law, statutory or otherwise, which provides that a general release does not extend to claims which the creditor does not know or suspect to exist in its favor at the time of executing the release, which if known by it must have materially affected its settlement with the debtor, the releases set forth in this section XII release all Released Claims against the Released Parties, whether known or unknown, foreseen or unforeseen, suspected or unsuspected, that the Releasing Parties may have against the Released Parties, and the Releasing Parties understand and acknowledge the significance and consequences of waiver of any such provision and hereby assume full responsibility for any injuries, damages or losses that the Releasing Parties may incur.

(b) Released Claims Against Released Parties. If a Releasing Party (or any person or entity enumerated in subsection II(pp), without regard to the power of the Attorney General to release claims of such person or entity) nonetheless attempts to maintain a Released Claim against a Released Party, such Released Party shall give written notice of such potential claim to the Attorney General of the applicable Settling State within 30 days of receiving notice of such potential claim (or within 30 days after the MSA Execution Date, whichever is later) (unless such potential claim is being maintained by such Settling State). The Released Party may offer the release and covenant as a complete defense. If it is determined at any point in such action that the release of such claim is unenforceable or invalid for any reason (including, but not limited to, lack of authority to release such claim), the following provisions shall apply:

(1) The Released Party shall take all ordinary and reasonable measures to defend the action fully. The Released Party may settle or enter into a stipulated judgment with respect to the action at any time in its sole discretion, but in such event the offset described in subsection (b)(2) or (b)(3) below shall apply only if the Released Party obtains the relevant Attorney General's consent to such settlement or stipulated judgment, which consent shall not be unreasonably withheld. The Released Party shall not be entitled to the offset described in subsection (b)(2) or (b)(3) below if such Released Party failed to take ordinary and reasonable measures to defend the action fully.

(2) The following provisions shall apply where the Released Party is an Original Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship with an Original Participating Manufacturer):

(A) In the event of a settlement or stipulated judgment, the settlement or stipulated amount shall give rise to a continuing offset as such amount is actually paid against the full amount of such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment until such time as the settlement or stipulated amount is fully credited on a dollar-for-dollar basis.

(B) Judgments (other than a default judgment) against a Released Party in such an action shall, upon payment of such judgment, give rise to an immediate and continuing offset against the full amount of such Original Participating Manufacturer's share (determined as described in subsection (A)) of the applicable Settling State's Allocated Payment, until such time as the judgment is fully credited on a dollar-for-dollar basis.

(C) Each Settling State reserves the right to intervene in such an action (unless such action was brought by the Settling State) to the extent authorized by applicable law in order to protect the Settling State's interest under this Agreement. Each Participating Manufacturer agrees not to oppose any such intervention.

(D) In the event that the offset under this subsection (b)(2) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the Federal Tobacco Legislation Offset and the offset for miscalculated or disputed payments): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection (2) in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of clause (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(3) The following provisions shall apply where the Released Party is a Subsequent Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship with a Subsequent Participating Manufacturer): Subject to the provisions of subsection IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset as described in subsections (2)(A)-(C) above against payments it otherwise would owe under section IX(i) to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on a settlement, stipulated judgment or judgment that would give rise to an offset under such subsections if paid by an Original Participating Manufacturer.

XIII. CONSENT DECREES AND DISMISSAL OF CLAIMS

(a) Within 10 days after the MSA Execution Date (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit), each Settling State and each Participating Manufacturer that is a party in any of the lawsuits identified in Exhibit D shall jointly move for a stay of all proceedings in such Settling State's lawsuit with respect to the Participating Manufacturers and all other Released Parties (except any proceeding seeking public disclosure of documents pursuant to subsection IV(b)). Such stay of a Settling State's lawsuit shall be dissolved upon the earlier of the occurrence of State-Specific Finality or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Not later than December 11, 1998 (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit):

(1) each Settling State that is a party to a lawsuit identified in Exhibit D and each Participating Manufacturer will:

(A) tender this Agreement to the Court in such Settling State for its approval; and

(B) tender to the Court in such Settling State for entry a consent decree conforming to the model consent decree attached hereto as Exhibit L (revisions or changes to such model consent decree shall be limited to the extent required by state procedural requirements to reflect accurately the factual setting of the case in question, but shall not include any substantive revision to the duties or obligations of any Settling State or Participating Manufacturer, except by agreement of all Original Participating Manufacturers); and

(2) each Settling State shall seek entry of an order of dismissal of claims dismissing with prejudice all claims against the Participating Manufacturers and any other Released Party in such Settling State's action identified in Exhibit D. Provided, however, that the Settling State is not required to seek entry of such an order in such Settling State's action against such a Released Party (other than a Participating Manufacturer) unless and until such Released Party has released the Releasing Parties (and delivered to the Attorney General of such Settling State a copy of such release) (which release shall be effective upon the occurrence of State-Specific Finality in such Settling State, and shall recite that in the event this Agreement is terminated with respect to such Settling State pursuant to subsection XVIII(u)(1) the Released Party agrees that the order of dismissal shall be null and void and of no effect) from any and all Claims of such Released Party relating to the prosecution of such action as provided in subsection XII(a)(2).

XIV. PARTICIPATING MANUFACTURERS' DISMISSAL OF RELATED LAWSUITS

(a) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will dismiss without prejudice (and without costs and fees) the lawsuit(s) listed in Exhibit M pending in such Settling State in which the Participating Manufacturer is a plaintiff. Within 10 days after the MSA Execution Date, each Participating Manufacturer and each Settling State that is a party in any of the lawsuits listed in Exhibit M shall jointly move for a stay of all proceedings in such lawsuit. Such stay of a lawsuit against a Settling State shall be dissolved upon the earlier of the occurrence of State-Specific Finality in such Settling State or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will release and discharge any and all monetary Claims against such Settling State and any of such Settling State's officers, employees, agents, administrators, representatives, officials acting in their official capacity, agencies, departments, commissions, divisions and counsel relating to or in connection with the lawsuit(s) commenced by the Attorney General of such Settling State identified in Exhibit D.

(c) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will release and discharge any and all monetary Claims against all subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts) of such Settling State, and any of their officers, employees, agents, administrators, representatives, officials acting in their official capacity, agencies, departments, commissions, divisions and counsel arising out of Claims that have been waived and released with continuing full force and effect pursuant to section XII of this Agreement.

XV. VOLUNTARY ACT OF THE PARTIES

The Settling States and the Participating Manufacturers acknowledge and agree that this Agreement is voluntarily entered into by each Settling State and each Participating Manufacturer as the result of arm's-length negotiations, and each Settling State and each Participating Manufacturer was represented by counsel in deciding to enter into this Agreement. Each Participating Manufacturer further acknowledges that it understands that certain provisions of this Agreement may require it to act or refrain from acting in a manner that could otherwise give rise to state or federal constitutional challenges and that, by voluntarily consenting to this Agreement, it (and the Tobacco-Related Organizations (or any trade associations formed or controlled by any Participating Manufacturer)) waives for purposes of performance of this Agreement any and all claims that the provisions of this Agreement violate the state or federal constitutions. Provided, however, that nothing in the foregoing shall constitute a waiver as to the entry of any court order (or any interpretation thereof) that would operate to limit the exercise of any constitutional right except to the extent of the restrictions, limitations or obligations expressly agreed to in this Agreement or the Consent Decree.

XVI. CONSTRUCTION

(a) No Settling State or Participating Manufacturer shall be considered the drafter of this Agreement or any Consent Decree, or any provision of either, for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter.

(b) Nothing in this Agreement shall be construed as approval by the Settling States of any Participating Manufacturer's business organizations, operations, acts or practices, and no Participating Manufacturer may make any representation to the contrary.

XVII. RECOVERY OF COSTS AND ATTORNEYS' FEES

(a) The Original Participating Manufacturers agree that, with respect to any Settling State in which the Court has approved this Agreement and the Consent Decree, they shall severally reimburse the following "Governmental Entities": (1) the office of the Attorney General of such Settling State; (2) the office of the governmental prosecuting authority for any political subdivision of such Settling State with a lawsuit pending against any Participating Manufacturer as of July 1, 1998 (as identified in Exhibit N) that has released such Settling State and such Participating Manufacturer(s) from any and all Released Claims (a "Litigating Political Subdivision"); and (3) other appropriate agencies of such Settling State and such Litigating Political Subdivision, for reasonable costs and expenses incurred in connection with the litigation or resolution of claims asserted by or against the Participating Manufacturers in the actions set forth in Exhibits D, M and N; provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers would reimburse their own counsel or agents (but not including costs and expenses relating to lobbying activities).

(b) The Original Participating Manufacturers further agree severally to pay the Governmental Entities in any Settling State in which State-Specific Finality has occurred an amount sufficient to compensate such Governmental Entities for time reasonably expended by attorneys and paralegals employed in such offices in connection with the litigation or resolution of claims asserted against or by the Participating Manufacturers in the actions identified in Exhibits D, M and N (but not including time relating to lobbying activities), such amount to be calculated based upon hourly rates equal to the market rate in such Settling State for private attorneys and paralegals of equivalent experience and seniority.

(c) Such Governmental Entities seeking payment pursuant to subsection (a) and/or (b) shall provide the Original Participating Manufacturers with an appropriately documented statement of all costs, expenses and attorney and paralegal time for which payment is sought, and, solely with respect to payments sought pursuant to subsection (b), shall do so no earlier than the date on which State-Specific Finality occurs in such Settling State. All amounts to be paid pursuant to

subsections (a) and (b) shall be subject to reasonable verification if requested by any Original Participating Manufacturer; provided, however, that nothing contained in this subsection (c) shall constitute, cause, or require the performance of any act that would constitute any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint prosecution privilege. All such amounts to be paid pursuant to subsections (a) and (b) shall be subject to an aggregate cap of $150 million for all Settling States, shall be paid promptly following submission of the appropriate documentation (and the completion of any verification process), shall be paid separately and apart from any other amounts due pursuant to this Agreement, and shall be paid severally by each Original Participating Manufacturer according to its Relative Market Share. All amounts to be paid pursuant to subsection (b) shall be paid to such Governmental Entities in the order in which State-Specific Finality has occurred in such Settling States (subject to the $150 million aggregate cap).

(d) The Original Participating Manufacturers agree that, upon the occurrence of State-Specific Finality in a Settling State, they will severally pay reasonable attorneys' fees to the private outside counsel, if any, retained by such Settling State (and each Litigating Political Subdivision, if any, within such Settling State) in connection with the respective actions identified in Exhibits D, M and N and who are designated in Exhibit S for each Settling State by the relevant Attorney General (and for each Litigating Political Subdivision, as later certified in writing to the Original Participating Manufacturers by the relevant governmental prosecuting authority of each Litigating Political Subdivision) as having been retained by and having represented such Settling State (or such Litigating Political Subdivision), in accordance with the terms described in the Model Fee Payment Agreement attached as Exhibit O.

XVIII. MISCELLANEOUS

(a) Effect of Current or Future Law. If any current or future law includes obligations or prohibitions applying to Tobacco Product Manufacturers related to any of the provisions of this Agreement, each Participating Manufacturer shall comply with this Agreement unless compliance with this Agreement would violate such law.

(b) Limited Most-Favored Nation Provision.

(1) If any Participating Manufacturer enters into any future settlement agreement of other litigation comparable to any of the actions identified in Exhibit D brought by a non-foreign governmental plaintiff other than the federal government ("Future Settlement Agreement"):

(A) before October 1, 2000, on overall terms more favorable to such governmental plaintiff than the overall terms of this Agreement (after due consideration of relevant differences in population or other appropriate factors), then, unless a majority of the Settling States determines that the overall terms of the Future Settlement Agreement are not more favorable than the overall terms of this Agreement, the overall terms of this Agreement will be revised so that the Settling States will obtain treatment with respect to such Participating Manufacturer at least as relatively favorable as the overall terms provided to any such governmental plaintiff; provided, however, that as to economic terms this Agreement shall not be revised based on any such Future Settlement Agreement if such Future Settlement Agreement is entered into after: (i) the impaneling of the jury (or, in the event of a non-jury trial, the commencement of trial) in such litigation or any severed or bifurcated portion thereof; or (ii) any court order or judicial determination relating to such litigation that (x) grants judgment (in whole or in part) against such Participating Manufacturer; or (y) grants injunctive or other relief that affects the assets or on-going business activities of such Participating Manufacturer in a manner other than as expressly provided for in this Agreement; or

(B) on or after October 1, 2000, on non-economic terms more favorable to such governmental plaintiff than the non-economic terms of this Agreement, and such Future Settlement Agreement includes terms that provide for the implementation of non-economic tobacco-related public health measures different from those contained in this Agreement, then this Agreement shall be revised with respect to such Participating Manufacturer to include terms comparable to such non-economic terms, unless a majority of the Settling States elects against such revision.

(2) If any Settling State resolves by settlement Claims against any Non-Participating Manufacturer after the MSA Execution Date comparable to any Released Claim, and such resolution includes overall terms that are more favorable to such Non-Participating Manufacturer than the terms of this Agreement (including, without limitation, any terms that relate to the marketing or distribution of Tobacco Products and any term that provides for a lower settlement cost on a per pack sold basis), then the overall terms of this Agreement will be revised so that the Original Participating Manufacturers will obtain, with respect to that Settling State, overall terms at least as relatively favorable (taking into account, among other things, all payments previously made by the Original Participating Manufacturers and the timing of any payments) as those obtained by such Non-Participating Manufacturer pursuant to such resolution of Claims. The foregoing shall include but not be limited: (a) to the treatment by any Settling State of a Future Affiliate, as that term is defined in agreements between any of the Settling States and Brooke Group Ltd., Liggett & Myers Inc. and/or Liggett Group, Inc. ("Liggett"), whether or not such Future Affiliate is merged with, or its operations combined with, Liggett or any Affiliate thereof; and (b) to any application of the terms of any such agreement (including any terms subsequently negotiated pursuant to any such agreement) to a brand of Cigarettes (or tobacco-related assets) as a result of the purchase by or sale to Liggett of such brand or assets or as a result of any combination of ownership among Liggett and any entity that manufactures Tobacco Products. Provided, however, that revision of this Agreement pursuant to this subsection (2) shall not be required by virtue of the subsequent entry into this Agreement by a Tobacco Product Manufacturer that has not become a Participating Manufacturer as of the MSA Execution Date. Notwithstanding the provisions of subsection XVIII(j), the provisions of this subsection XVIII(b)(2) may be waived by (and only by) unanimous agreement of the Original Participating Manufacturers.

(3) The parties agree that if any term of this Agreement is revised pursuant to subsection (b)(1) or (b)(2) above and the substance of such term before it was revised was also a term of the Consent Decree, each affected Settling State and each affected Participating Manufacturer shall jointly move the Court to amend the Consent Decree to conform the terms of the Consent Decree to the revised terms of the Agreement.

(4) If at any time any Settling State agrees to relieve, in any respect, any Participating Manufacturer's obligation to make the payments as provided in this Agreement, then, with respect to that Settling State, the terms of this Agreement shall be revised so that the other Participating Manufacturers receive terms as relatively favorable.

(c) Transfer of Tobacco Brands. No Original Participating Manufacturer may sell or otherwise transfer or permit the sale or transfer of any of its Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses (other than a sale or transfer of Cigarette brands or Brand Names to be sold, product formulas to be used, or Cigarette businesses to be conducted, by the acquiror or transferee exclusively outside of the States) to any person or entity unless such person or entity is an Original Participating Manufacturer or prior to the sale or acquisition agrees to assume the obligations of an Original Participating Manufacturer with respect to such Cigarette brands, Brand Names, Cigarette product formulas or businesses. No Participating Manufacturer may sell or otherwise transfer any of its Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses (other than a sale or transfer of Cigarette brands or Brand Names to be sold, Cigarette product formulas to be used, or businesses to be conducted, by the acquiror or transferee exclusively outside of the States) to any person or entity unless such person or entity is or becomes prior to the sale or acquisition a Participating Manufacturer. In the event of any such sale or transfer of a Cigarette brand, Brand Name, Cigarette product formula or Cigarette business by a Participating Manufacturer to a person or entity that within 180 days prior to such sale or transfer was a Non-Participating Manufacturer, the Participating Manufacturer shall certify to the Settling States that it has determined that such person or entity has the capability to perform the obligations under this Agreement. Such certification shall not survive beyond one year following the date of any such transfer. Each Original Participating Manufacturer certifies and represents that, except as provided in Exhibit R, it (or a wholly owned Affiliate) exclusively owns and controls in the States the Brand Names of those Cigarettes that it currently manufactures for sale (or sells) in the States and that it has the capacity to enter into an effective agreement concerning the sale or transfer of such Brand Names pursuant to this subsection XVIII(c). Nothing in this Agreement is intended to create any right for a State to obtain any Cigarette product formula that it would not otherwise have under applicable law.

(d) Payments in Settlement. All payments to be made by the Participating Manufacturers pursuant to this Agreement are in settlement of all of the Settling States' antitrust, consumer protection, common law negligence, statutory, common law and equitable claims for monetary, restitutionary, equitable and injunctive relief alleged by the Settling States with respect to the year of payment or earlier years, except that no part of any payment under this Agreement is made in settlement of an actual or potential liability for a fine, penalty (civil or criminal) or enhanced damages or is the cost of a tangible or intangible asset or other future benefit.

(e) No Determination or Admission. This Agreement is not intended to be and shall not in any event be construed or deemed to be, or represented or caused to be represented as, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Agreement; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it by the Attorneys General of the Settling States and the Litigating Political Subdivisions. Each Participating Manufacturer has entered into this Agreement solely to avoid the further expense, inconvenience, burden and risk of litigation.

(f) Non-Admissibility. The settlement negotiations resulting in this Agreement have been undertaken by the Settling States and the Participating Manufacturers in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Agreement shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Agreement nor any public discussions, public statements or public comments with respect to this Agreement by any Settling State or Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Agreement.

(g) Representations of Parties. Each Settling State and each Participating Manufacturer hereby represents that this Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of them. The signatories hereto on behalf of their respective Settling States expressly represent and warrant that they have the authority to settle and release all Released Claims of their respective Settling States and any of their respective Settling States' past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions, and that such signatories are aware of no authority to the contrary. It is recognized that the Original Participating Manufacturers are relying on the foregoing representation and warranty in making the payments required by and in otherwise performing under this Agreement. The Original Participating Manufacturers shall have the right to terminate this Agreement pursuant to subsection XVIII(u) as to any Settling State as to which the foregoing representation and warranty is breached or not effectively given.

(h) Obligations Several, Not Joint. All obligations of the Participating Manufacturers pursuant to this Agreement (including, but not limited to, all payment obligations) are intended to be, and shall remain, several and not joint.

(i) Headings. The headings of the sections and subsections of this Agreement are not binding and are for reference only and do not limit, expand or otherwise affect the contents or meaning of this Agreement.

(j) Amendment and Waiver. This Agreement may be amended by a written instrument executed by all Participating Manufacturers affected by the amendment and by all Settling States affected by the amendment. The terms of any such amendment shall not be enforceable in any Settling State that is not a signatory to such amendment. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving party or parties. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, nor shall such waiver be deemed to be or construed as a waiver by any other party.

(k) Notices. All notices or other communications to any party to this Agreement shall be in writing (including, but not limited to, facsimile, telex, telecopy or similar writing) and shall be given at the addresses specified in Exhibit P (as it may be amended to reflect any additional Participating Manufacturer that becomes a party to this Agreement after the MSA Execution Date). Any Settling State or Participating Manufacturer may change or add the name and address of the persons designated to receive notice on its behalf by notice given (effective upon the giving of such notice) as provided in this subsection.

(l) Cooperation. Each Settling State and each Participating Manufacturer agrees to use its best efforts and to cooperate with each other to cause this Agreement and the Consent Decrees to become effective, to obtain all necessary approvals, consents and authorizations, if any, and to execute all documents and to take such other action as may be appropriate in connection herewith. Consistent with the foregoing, each Settling State and each Participating Manufacturer agrees that it will not directly or indirectly assist or encourage any challenge to this Agreement or any Consent Decree by any other person, and will support the integrity and enforcement of the terms of this Agreement and the Consent Decrees. Each Settling State shall use its best efforts to cause State-Specific Finality to occur as to such Settling State.

(m) Designees to Discuss Disputes. Within 14 days after the MSA Execution Date, each Settling State's Attorney General and each Participating Manufacturer shall provide written notice of its designation of a senior representative to discuss with the other signatories to this Agreement any disputes and/or other issues that may arise with respect to this Agreement. Each Settling State's Attorney General shall provide such notice of the name, address and telephone number of the person it has so designated to each Participating Manufacturer and to NAAG. Each Participating Manufacturer shall provide such notice of the name, address and telephone number of the person it has so designated to each Settling State's Attorney General, to NAAG and to each other Participating Manufacturer.

(n) Governing Law. This Agreement (other than the Escrow Agreement) shall be governed by the laws of the relevant Settling State, without regard to the conflict of law rules of such Settling State. The Escrow Agreement shall be governed by the laws of the State in which the Escrow Court is located, without regard to the conflict of law rules of such State.

(o) Severability.

(1) Sections VI, VII, IX, X, XI, XII, XIII, XIV, XVI, XVIII(b), (c), (d), (e), (f), (g), (h), (o), (p), (r), (s), (u), (w), (z), (bb), (dd), and Exhibits A, B, and E hereof ("Nonseverable Provisions") are not severable, except to the extent that severance of section VI is permitted by Settling States pursuant to subsection VI(i) hereof. The remaining terms of this Agreement are severable, as set forth herein.

(2) If a court materially modifies, renders unenforceable, or finds to be unlawful any of the Nonseverable Provisions, the NAAG executive committee shall select a team of Attorneys General (the "Negotiating Team") to attempt to negotiate an equivalent or comparable substitute term or other appropriate credit or adjustment (a "Substitute Term") with the Original Participating Manufacturers. In the event that the court referred to in the preceding sentence is located in a Settling State, the Negotiating Team shall include the Attorney General of such Settling State. The Original Participating Manufacturers shall have no obligation to agree to any Substitute Term. If any Original Participating Manufacturer does not agree to a Substitute Term, this Agreement shall be terminated in all Settling States affected by the court's ruling. The Negotiating Team shall submit any proposed Substitute Term negotiated by the Negotiating Team and agreed to by all of the Original Participating Manufacturers to the Attorneys General of all of the affected Settling States for their approval. If any affected Settling State does not approve the proposed Substitute Term, this Agreement in such Settling State shall be terminated.

(3) If a court materially modifies, renders unenforceable, or finds to be unlawful any term of this Agreement other than a Nonseverable Provision:

(A) The remaining terms of this Agreement shall remain in full force and effect.

(B) Each Settling State whose rights or obligations under this Agreement are affected by the court's decision in question (the "Affected Settling State") and the Participating Manufacturers agree to negotiate in good faith a Substitute Term. Any agreement on a Substitute Term reached between the Participating Manufacturers and the Affected Settling State shall not modify or amend the terms of this Agreement with regard to any other Settling State.

(C) If the Affected Settling State and the Participating Manufacturers are unable to agree on a Substitute Term, then they will submit the issue to non-binding mediation. If mediation fails to produce agreement to a Substitute Term, then that term shall be severed and the remainder of this Agreement shall remain in full force and effect.

(4) If a court materially modifies, renders unenforceable, or finds to be unlawful any portion of any provision of this Agreement, the remaining portions of such provision shall be unenforceable with respect to the affected Settling State unless a Substitute Term is arrived at pursuant to subsection (o)(2) or (o)(3) hereof, whichever is applicable.

(p) Intended Beneficiaries. No portion of this Agreement shall provide any rights to, or be enforceable by, any person or entity that is not a Settling State or a Released Party. No Settling State may assign or otherwise convey any right to enforce any provision of this Agreement.

(q) Counterparts. This Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered as valid signatures as of the date affixed, although the original signature pages shall thereafter be appended.

(r) Applicability. The obligations and duties of each Participating Manufacturer set forth herein are applicable only to actions taken (or omitted to be taken) within the States. This subsection (r) shall not be construed as extending the territorial scope of any obligation or duty set forth herein whose scope is otherwise limited by the terms hereof.

(s) Preservation of Privilege. Nothing contained in this Agreement or any Consent Decree, and no act required to be performed pursuant to this Agreement or any Consent Decree, is intended to constitute, cause or effect any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint defense privilege, and each Settling State and each Participating Manufacturer agrees that it shall not make or cause to be made in any forum any assertion to the contrary.

(t) Non-Release. Except as otherwise specifically provided in this Agreement, nothing in this Agreement shall limit, prejudice or otherwise interfere with the rights of any Settling State or any Participating Manufacturer to pursue any and all rights and remedies it may have against any Non-Participating Manufacturer or other non-Released Party.

(u) Termination.

(1) Unless otherwise agreed to by each of the Original Participating Manufacturers and the Settling State in question, in the event that (A) State-Specific Finality in a Settling State does not occur in such Settling State on or before December 31, 2001; or (B) this Agreement or the Consent Decree has been disapproved by the Court (or, in the event of an appeal from or review of a decision of the Court to approve this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review), and the time to Appeal from such disapproval has expired, or, in the event of an Appeal from such disapproval, the Appeal has been dismissed or the disapproval has been affirmed by the court of last resort to which such Appeal has been taken and such dismissal or disapproval has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court); or (C) this Agreement is terminated in a Settling State for whatever reason (including, but not limited to, pursuant to subsection XVIII(o) of this Agreement), then this Agreement and all of its terms (except for the non-admissibility provisions hereof, which shall continue in full force and effect) shall be canceled and terminated with respect to such Settling State, and it and all orders issued by the courts in such Settling State pursuant hereto shall become null and void and of no effect.

(2) If this Agreement is terminated with respect to a Settling State for whatever reason, then (A) the applicable statute of limitation or any similar time requirement shall be tolled from the date such Settling State signed this Agreement until the later of the time permitted by applicable law or for one year from the date of such termination, with the effect that the parties shall be in the same position with respect to the statute of limitation as they were at the time such Settling State filed its action, and (B) the parties shall jointly move the Court for an order reinstating the actions and claims dismissed pursuant to sections XIII and XIV hereof, with the effect that the parties shall be in the same position with respect to those actions and claims as they were at the time the action or claim was stayed or dismissed.

(v) Freedom of Information Requests. Upon the occurrence of State-Specific Finality in a Settling State, each Participating Manufacturer will withdraw in writing any and all requests for information, administrative applications, and proceedings brought or caused to be brought by such Participating Manufacturer pursuant to such Settling State's freedom of information law relating to the subject matter of the lawsuits identified in Exhibit D.

(w) Bankruptcy. The following provisions shall apply if a Participating Manufacturer both enters Bankruptcy and at any time thereafter is not timely performing its financial obligations as required under this Agreement:

(1) In the event that both a number of Settling States equal to at least 75% of the total number of Settling States and Settling States having aggregate Allocable Shares equal to at least 75% of the total aggregate Allocable Shares assigned to all Settling States deem (by written notice to the Participating Manufacturers other than the bankrupt Participating Manufacturer) that the financial obligations of this Agreement have been terminated and rendered null and void as to such bankrupt Participating Manufacturer (except as provided in subsection (A) below) due to a material breach by such Participating Manufacturer, whereupon, with respect to all Settling States:

(A) all agreements, all concessions, all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall be null and void as to such Participating Manufacturer. Provided, however, that (i) all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall remain in full force and effect as to all persons or entities (other than the bankrupt Participating Manufacturer itself or any person or entity that, as a result of the Bankruptcy, obtains domestic tobacco assets of such

Participating Manufacturer (unless such person or entity is itself a Participating Manufacturer)) who (but for the first sentence of this subsection (A)) would otherwise be Released Parties by virtue of their relationship with the bankrupt Participating Manufacturer; and (ii) in the event a Settling State asserts any Released Claim against a bankrupt Participating Manufacturer after the termination of this Agreement with respect to such Participating Manufacturer as described in this subsection (1) and receives a judgment, settlement or distribution arising from such Released Claim, then the amount of any payments such Settling State has previously received from such Participating Manufacturer under this Agreement shall be applied against the amount of any such judgment, settlement or distribution (provided that in no event shall such Settling State be required to refund any payments previously received from such Participating Manufacturer pursuant to this Agreement);

(B) the Settling States shall have the right to assert any and all claims against such Participating Manufacturer in the Bankruptcy or otherwise without regard to any limits otherwise provided in this Agreement (subject to any and all defenses against such claims);

(C) the Settling States may exercise all rights provided under the federal Bankruptcy Code (or other applicable bankruptcy law) with respect to their Claims against such Participating Manufacturer, including the right to initiate and complete police and regulatory actions against such Participating Manufacturer pursuant to the exceptions to the automatic stay set forth in section 362(b) of the Bankruptcy Code (provided, however, that such Participating Manufacturer may contest whether the Settling State's action constitutes a police and regulatory action); and

(D) to the extent that any Settling State is pursuing a police and regulatory action against such Participating Manufacturer as described in subsection (1)(C), such Participating Manufacturer shall not request or support a request that the Bankruptcy court utilize the authority provided under section 105 of the Bankruptcy Code to impose a discretionary stay on the Settling State's action. The Participating Manufacturers further agree that they will not request, seek or support relief from the terms of this Agreement in any proceeding before any court of law (including the federal bankruptcy courts) or an administrative agency or through legislative action, including (without limitation) by way of joinder in or consent to or acquiescence in any such pleading or instrument filed by another.

(2) Whether or not the Settling States exercise the option set forth in subsection (1) (and whether or not such option, if exercised, is valid and enforceable):

(A) In the event that the bankrupt Participating Manufacturer is an Original Participating Manufacturer, such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer for all purposes under this Agreement except (i) such Participating Manufacturer shall be treated as a Non-Participating Manufacturer (and not as an Original Participating Manufacturer or Participating Manufacturer) for all purposes with respect to subsections IX(d)(1), IX(d)(2) and IX(d)(3) (including, but not limited to, that the Market Share of such Participating Manufacturer shall not be included in Base Aggregate Participating Manufacturer Market Share or Actual Aggregate Participating Manufacturer Market Share, and that such Participating Manufacturer's volume shall not be included for any purpose under subsection IX(d)(1)(D)); (ii) such Participating Manufacturer's Market Share shall not be included as that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(e) has been achieved (provided that such Participating Manufacturer shall be treated as an Original Participating Manufacturer for all other purposes with respect to such subsection); (iii) for purposes of subsection (B)(iii) of Exhibit E, such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer, but its operating income shall be recalculated by the Independent Auditor to reflect what such income would have been had such Participating Manufacturer made the payments that would have been due under this Agreement but for the Bankruptcy; (iv) for purposes of subsection XVIII(c), such Participating Manufacturer shall not be treated as an Original Participating Manufacturer or as a Participating Manufacturer to the extent that after entry into Bankruptcy it becomes the acquiror or transferee of Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection); and (v) as to any action that by the express terms of this Agreement requires the unanimous agreement of all Original Participating Manufacturers.

(B) In the event that the bankrupt Participating Manufacturer is a Subsequent Participating Manufacturer, such Participating Manufacturer shall continue to be treated as a Subsequent Participating Manufacturer for all purposes under this Agreement except (i) such Participating Manufacturer shall be treated as a Non-Participating Manufacturer (and not as a Subsequent Participating Manufacturer or Participating Manufacturer) for all purposes with respect to subsections IX(d)(1), (d)(2) and (d)(4) (including, but not limited to, that the Market Share of such Participating Manufacturer shall not be included in Base Aggregate Participating Manufacturer Market Share or Actual Aggregate Participating Manufacturer Market Share, and that such Participating Manufacturer's volume shall not be included for any purpose under subsection IX(d)(1)(D)); (ii) such Participating Manufacturer's Market Share shall not be included as that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(e) has been achieved (provided that such Participating Manufacturer shall be treated as a Subsequent Participating Manufacturer for all other purposes with respect to such subsection); and (iii) for purposes of subsection XVIII(c), such Participating Manufacturer shall not be treated as a Subsequent Participating Manufacturer or as a Participating Manufacturer to the extent that after entry into Bankruptcy it becomes the acquiror or transferee of Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall

continue to be treated as a Subsequent Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection).

(C) Revision of this Agreement pursuant to subsection XVIII(b)(2) shall not be required by virtue of any resolution on an involuntary basis in the Bankruptcy of Claims against the bankrupt Participating Manufacturer.

(x) Notice of Material Transfers. Each Participating Manufacturer shall provide notice to each Settling State at least 20 days before consummating a sale, transfer of title or other disposition, in one transaction or series of related transactions, of assets having a fair market value equal to five percent or more (determined in accordance with United States generally accepted accounting principles) of the consolidated assets of such Participating Manufacturer.

(y) Entire Agreement. This Agreement (together with any agreements expressly contemplated hereby and any other contemporaneous written agreements) embodies the entire agreement and understanding between and among the Settling States and the Participating Manufacturers relating to the subject matter hereof and supersedes (1) all prior agreements and understandings relating to such subject matter, whether written or oral, and (2) all purportedly contemporaneous oral agreements and understandings relating to such subject matter.

(z) Business Days. Any obligation hereunder that, under the terms of this Agreement, is to be performed on a day that is not a Business Day shall be performed on the first Business Day thereafter.

(aa) Subsequent Signatories. With respect to a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, the timing of obligations under this Agreement (other than payment obligations, which shall be governed by subsection II(jj)) shall be negotiated to provide for the institution of such obligations on a schedule not more favorable to such subsequent signatory than that applicable to the Original Participating Manufacturers.

(bb) Decimal Places. Any figure or percentage referred to in this Agreement shall be carried to seven decimal places.

(cc) Regulatory Authority. Nothing in section III of this Agreement is intended to affect the legislative or regulatory authority of any local or State government.

(dd) Successors. In the event that a Participating Manufacturer ceases selling a brand of Tobacco Products in the States that such Participating Manufacturer owned in the States prior to July 1, 1998, and an Affiliate of such Participating Manufacturer thereafter and after the MSA Execution Date intentionally sells such brand in the States, such Affiliate shall be considered to be the successor of such Participating Manufacturer with respect to such brand. Performance by any such successor of the obligations under this Agreement with respect to the sales of such brand shall be subject to court-ordered specific performance.

(ee) Export Packaging. Each Participating Manufacturer shall place a visible indication on each pack of Cigarettes it manufactures for sale outside of the fifty United States and the District of Columbia that distinguishes such pack from packs of Cigarettes it manufactures for sale in the fifty United States and the District of Columbia.

(ff) Actions Within Geographic Boundaries of Settling States. To the extent that any provision of this Agreement expressly prohibits, restricts, or requires any action to be taken "within" any Settling State or the Settling States, the relevant prohibition, restriction, or requirement applies within the geographic boundaries of the applicable Settling State or Settling States, including, but not limited to, Indian country or Indian trust land within such geographic boundaries.

(gg) Notice to Affiliates. Each Participating Manufacturer shall give notice of this Agreement to each of its Affiliates.

IN WITNESS WHEREOF, each Settling State and each Participating Manufacturer, through their fully authorized representatives, have agreed to this Agreement.

[Signatures Intentionally Omitted]

EXHIBIT A
STATE ALLOCATION PERCENTAGES

State	Percentage
Alabama	1.6161308%
Alaska	0.3414187%
Arizona	1.4738845%
Arkansas	0.8280661%
California	12.7639554%
Colorado	1.3708614%
Connecticut	1.8565373%
Delaware	0.3954695%
D.C.	0.6071183%
Florida	0.0000000%
Georgia	2.4544575%
Hawaii	0.6018650%
Idaho	0.3632632%
Illinois	4.6542472%
Indiana	2.0398033%
Iowa	0.8696670%
Kansas	0.8336712%
Kentucky	1.7611586%
Louisiana	2.2553531%
Maine	0.7693505%
Maryland	2.2604570%
Massachusetts	4.0389790%
Michigan	4.3519476%
Minnesota	0.0000000%
Mississippi	0.0000000%
Missouri	2.2746011%
Montana	0.4247591%
Nebraska	0.5949833%
Nevada	0.6099351%
New Hampshire	0.6659340%
New Jersey	3.8669963%
New Mexico	0.5963897%
New York	12.7620310%
North Carolina	2.3322850%
North Dakota	0.3660138%
Ohio	5.0375098%
Oklahoma	1.0361370%
Oregon	1.1476582%
Pennsylvania	5.7468588%
Rhode Island	0.7189054%
South Carolina	1.1763519%
South Dakota	0.3489458%
Tennessee	2.4408945%
Texas	0.0000000%
Utah	0.4448869%
Vermont	0.4111851%
Virginia	2.0447451%
Washington	2.0532582%
West Virginia	0.8864604%
Wisconsin	2.0720390%
Wyoming	0.2483449%
American Samoa	0.0152170%
N. Mariana Isld.	0.0084376%
Guam	0.0219371%
U.S. Virgin Isld.	0.0173593%
Puerto Rico	1.1212774%
Total	100.0000000%

EXHIBIT B
FORM OF ESCROW AGREEMENT

This Escrow Agreement is entered into as of ______________, 1998 by the undersigned State officials (on behalf of their respective Settling States), the undersigned Participating Manufacturers and ____________________ as escrow agent (the "Escrow Agent").

WITNESSETH:

WHEREAS, the Settling States and the Participating Manufacturers have entered into a settlement agreement entitled the "Master Settlement Agreement" (the "Agreement"); and

WHEREAS, the Agreement requires the Settling States and the Participating Manufacturers to enter into this Escrow Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1. *Appointment of Escrow Agent.*

The Settling States and the Participating Manufacturers hereby appoint ____________________ to serve as Escrow Agent under this Agreement on the terms and conditions set forth herein, and the Escrow Agent, by its execution hereof, hereby accepts such appointment and agrees to perform the duties and obligations of the Escrow Agent set forth herein. The Settling States and the Participating Manufacturers agree that the Escrow Agent appointed under the terms of this Escrow Agreement shall be the Escrow Agent as defined in, and for all purposes of, the Agreement.

SECTION 2. *Definitions.*

(a) Capitalized terms used in this Escrow Agreement and not otherwise defined herein shall have the meaning given to such terms in the Agreement.

(b) "Escrow Court" means the court of the State of New York to which the Agreement is presented for approval, or such other court as agreed to by the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question.

SECTION 3. *Escrow and Accounts.*

(a) All funds received by the Escrow Agent pursuant to the terms of the Agreement shall be held and disbursed in accordance with the terms of this Escrow Agreement. Such funds and any earnings thereon shall constitute the "Escrow" and shall be held by the Escrow Agent separate and apart from all other funds and accounts of the Escrow Agent, the Settling States and the Participating Manufacturers.

(b) The Escrow Agent shall allocate the Escrow among the following separate accounts (each an "Account" and collectively the "Accounts"):

SUBSECTION VI(B) ACCOUNT

SUBSECTION VI(C) ACCOUNT (FIRST)

SUBSECTION VI(C) ACCOUNT (SUBSEQUENT)

SUBSECTION VIII(B) ACCOUNT

SUBSECTION VIII(C) ACCOUNT

SUBSECTION IX(B) ACCOUNT (FIRST)

SUBSECTION IX(B) ACCOUNT (SUBSEQUENT)

SUBSECTION IX(C)(1) ACCOUNT

SUBSECTION IX(C)(2) ACCOUNT

SUBSECTION IX(E) ACCOUNT

DISPUTED PAYMENTS ACCOUNT

STATE-SPECIFIC ACCOUNTS WITH RESPECT TO EACH SETTLING STATE IN WHICH STATE-SPECIFIC FINALITY OCCURS.

(c) All amounts credited to an Account shall be retained in such Account until disbursed therefrom in accordance with the provisions of this Escrow Agreement pursuant to (i) written instructions from the Independent Auditor; or (ii) written instructions from all of the following: all of the Original Participating Manufacturers; all of the Subsequent Participating Manufacturers that contributed to such amounts in such Account; and all of the Settling States (collectively, the "Escrow Parties"). In the event of a conflict, instructions pursuant to clause (ii) shall govern over instructions pursuant to clause (i).

(d) On the first Business Day after the date any payment is due under the Agreement, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount of such payment (or indicating that no payment was made, if such is the case), the source of such payment, the Account or Accounts to which such payment has been

credited, and the payment instructions received by the Escrow Agent from the Independent Auditor with respect to such payment.

(e) The Escrow Agent shall comply with all payment instructions received from the Independent Auditor unless before 11:00 a.m. (New York City time) on the scheduled date of payment it receives written instructions to the contrary from all of the Escrow Parties, in which event it shall comply with such instructions.

(f) On the first Business Day after disbursing any funds from an Account, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount disbursed, the date of such disbursement and the payee of the disbursed funds.

SECTION 4. *Failure of Escrow Agent to Receive Instructions.*

In the event that the Escrow Agent fails to receive any written instructions contemplated by this Escrow Agreement, the Escrow Agent shall be fully protected in refraining from taking any action required under any section of this Escrow Agreement other than Section 5 until such written instructions are received by the Escrow Agent.

SECTION 5. *Investment of Funds by Escrow Agent.*

The Escrow Agent shall invest and reinvest all amounts from time to time credited to the Accounts in either (i) direct obligations of, or obligations the principal and interest on which are unconditionally guaranteed by, the United States of America; (ii) repurchase agreements fully collateralized by securities described in clause (i) above; (iii) money market accounts maturing within 30 days of the acquisition thereof and issued by a bank or trust company organized under the laws of the United States of America or of any of the 50 States thereof (a "United States Bank") and having combined capital, surplus and undistributed profits in excess of $500,000,000; or (iv) demand deposits with any United States Bank having combined capital, surplus and undistributed profits in excess of $500,000,000. To the extent practicable, monies credited to any Account shall be invested in such a manner so as to be available for use at the times when monies are expected to be disbursed by the Escrow Agent and charged to such Account. Obligations purchased as an investment of monies credited to any Account shall be deemed at all times to be a part of such Account and the income or interest earned, profits realized or losses suffered with respect to such investments (including, without limitation, any penalty for any liquidation of an investment required to fund a disbursement to be charged to such Account), shall be credited or charged, as the case may be, to, such Account and shall be for the benefit of, or be borne by, the person or entity entitled to payment from such Account. In choosing among the investment options described in clauses (i) through (iv) above, the Escrow Agent shall comply with any instructions received from time to time from all of the Escrow Parties. In the absence of such instructions, the Escrow Agent shall invest such sums in accordance with clause (i) above. With respect to any amounts credited to a State-Specific Account, the Escrow Agent shall invest and reinvest all amounts credited to such Account in accordance with the law of the applicable Settling State to the extent such law is inconsistent with this Section 5.

SECTION 6. *Substitute Form W-9; Qualified Settlement Fund.*

Each signatory to this Escrow Agreement shall provide the Escrow Agent with a correct taxpayer identification number on a substitute Form W-9 or if it does not have such a number, a statement evidencing its status as an entity exempt from back-up withholding, within 30 days of the date hereof (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). The escrow established pursuant to this Escrow Agreement is intended to be treated as a Qualified Settlement Fund for federal tax purposes pursuant to Treas. Reg. § 1.468B-1. The Escrow Agent shall comply with all applicable tax filing, payment and reporting requirements, including, without limitation, those imposed under Treas. Reg. § 1.468B, and if requested to do so shall join in the making of the relation-back election under such regulation.

SECTION 7. *Duties and Liabilities of Escrow Agent.*

The Escrow Agent shall have no duty or obligation hereunder other than to take such specific actions as are required of it from time to time under the provisions of this Escrow Agreement, and it shall incur no liability hereunder or in connection herewith for anything whatsoever other than any liability resulting from its own gross negligence or willful misconduct. The Escrow Agent shall not be bound in any way by any agreement or contract between the Participating Manufacturers and the Settling States (whether or not the Escrow Agent has knowledge thereof) other than this Escrow Agreement, and the only duties and responsibilities of the Escrow Agent shall be the duties and obligations specifically set forth in this Escrow Agreement.

SECTION 8. *Indemnification of Escrow Agent.*

The Participating Manufacturers shall indemnify, hold harmless and defend the Escrow Agent from and against any and all losses, claims, liabilities and reasonable expenses, including the reasonable fees of its counsel, which it may suffer or incur in connection with the performance of its duties and obligations under this Escrow Agreement, except for those losses, claims, liabilities and expenses resulting solely and directly from its own gross negligence or willful misconduct.

SECTION 9. *Resignation of Escrow Agent.*

The Escrow Agent may resign at any time by giving written notice thereof to the other parties hereto, but such resignation shall not become effective until a successor Escrow Agent, selected by the Original Participating Manufacturers and the Settling States, shall have been appointed and shall have accepted such appointment in writing. If an instrument of acceptance by a successor Escrow Agent shall not have been delivered to the resigning Escrow Agent within 90 days after the giving of such notice of resignation, the resigning Escrow Agent may, at the expense of the Participating Manufacturers (to

be shared according to their pro rata Market Shares), petition the Escrow Court for the appointment of a successor Escrow Agent.

SECTION 10. *Escrow Agent Fees and Expenses.*

The Participating Manufacturers shall pay to the Escrow Agent its fees as set forth in Appendix A hereto as amended from time to time by agreement of the Original Participating Manufacturers and the Escrow Agent. The Participating Manufacturers shall pay to the Escrow Agent its reasonable fees and expenses, including all reasonable expenses, charges, counsel fees, and other disbursements incurred by it or by its attorneys, agents and employees in the performance of its duties and obligations under this Escrow Agreement. Such fees and expenses shall be shared by the Participating Manufacturers according to their pro rata Market Shares.

SECTION 11. *Notices.*

All notices, written instructions or other communications to any party or other person hereunder shall be given in the same manner as, shall be given to the same person as, and shall be effective at the same time as provided in subsection XVIII(k) of the Agreement.

SECTION 12. *Setoff; Reimbursement.*

The Escrow Agent acknowledges that it shall not be entitled to set off against any funds in, or payable from, any Account to satisfy any liability of any Participating Manufacturer. Each Participating Manufacturer that pays more than its pro rata Market Share of any payment that is made by the Participating Manufacturers to the Escrow Agent pursuant to Section 8, 9 or 10 hereof shall be entitled to reimbursement of such excess from the other Participating Manufacturers according to their pro rata Market Shares of such excess.

SECTION 13. *Intended Beneficiaries; Successors.*

No persons or entities other than the Settling States, the Participating Manufacturers and the Escrow Agent are intended beneficiaries of this Escrow Agreement, and only the Settling States, the Participating Manufacturers and the Escrow Agent shall be entitled to enforce the terms of this Escrow Agreement. Pursuant to the Agreement, the Settling States have designated NAAG and the Foundation as recipients of certain payments; for all purposes of this Escrow Agreement, the Settling States shall be the beneficiaries of such payments entitled to enforce payment thereof. The provisions of this Escrow Agreement shall be binding upon and inure to the benefit of the parties hereto and, in the case of the Escrow Agent and Participating Manufacturers, their respective successors. Each reference herein to the Escrow Agent or to a Participating Manufacturer shall be construed as a reference to its successor, where applicable.

SECTION 14. *Governing Law.*

This Escrow Agreement shall be construed in accordance with and governed by the laws of the State in which the Escrow Court is located, without regard to the conflicts of law rules of such state.

SECTION 15. *Jurisdiction and Venue.*

The parties hereto irrevocably and unconditionally submit to the continuing exclusive jurisdiction of the Escrow Court for purposes of any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, this Escrow Agreement, and the parties hereto agree not to commence any such suit, action or proceeding except in the Escrow Court. The parties hereto hereby irrevocably and unconditionally waive any objection to the laying of venue of any such suit, action or proceeding in the Escrow Court and hereby further irrevocably waive and agree not to plead or claim in the Escrow Court that any such suit, action or proceeding has been brought in an inconvenient forum.

SECTION 16. *Amendments.*

This Escrow Agreement may be amended only by written instrument executed by all of the parties hereto that would be affected by the amendment. The waiver of any rights conferred hereunder shall be effective only if made in a written instrument executed by the waiving party. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this Escrow Agreement, nor shall such waiver be deemed to be or construed as a waiver by any other party.

SECTION 17. *Counterparts.*

This Agreement may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. Delivery by facsimile of a signed counterpart shall be deemed delivery for purposes of acknowledging acceptance hereof; however, an original executed Escrow Agreement must promptly thereafter be delivered to each party.

SECTION 18. *Captions.*

The captions herein are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 19. *Conditions to Effectiveness.*

This Escrow Agreement shall become effective when each party hereto shall have signed a counterpart hereof. The parties hereto agree to use their best efforts to seek an order of the Escrow Court approving, and retaining continuing jurisdiction over, the Escrow Agreement as soon as possible, and agree that such order shall relate back to, and be deemed effective as of, the date this Escrow Agreement became effective.

SECTION 20. *Address for Payments.*

Whenever funds are under the terms of this Escrow Agreement required to be disbursed to a Settling State, a Participating Manufacturer, NAAG or the Foundation, the Escrow Agent shall disburse such funds by wire transfer to the account specified by such payee by written notice delivered to all Notice Parties in accordance with Section 11 hereof at least five Business Days prior to the date of payment. Whenever funds are under the terms of this Escrow Agreement required to be disbursed to any other person or entity, the Escrow Agent shall disburse such funds to such account as shall have been specified in writing by the Independent Auditor for such payment at least five Business Days prior to the date of payment.

SECTION 21. *Reporting.*

The Escrow Agent shall provide such information and reporting with respect to the escrow as the Independent Auditor may from time to time request.

IN WITNESS WHEREOF, the parties have executed this Escrow Agreement as of the day and year first hereinabove written.

[Signature Blocks]

Appendix A

Schedule Of Fees And Expenses

EXHIBIT C
FORMULA FOR CALCULATING INFLATION ADJUSTMENTS

(1) Any amount that, in any given year, is to be adjusted for inflation pursuant to this Exhibit (the "Base Amount") shall be adjusted upward by adding to such Base Amount the Inflation Adjustment.

(2) The Inflation Adjustment shall be calculated by multiplying the Base Amount by the Inflation Adjustment Percentage applicable in that year.

(3) The Inflation Adjustment Percentage applicable to payments due in the year 2000 shall be equal to the greater of 3% or the CPI%. For example, if the Consumer Price Index for December 1999 (as released in January 2000) is 2% higher than the Consumer Price Index for December 1998 (as released in January 1999), then the CPI% with respect to a payment due in 2000 would be 2%. The Inflation Adjustment Percentage applicable in the year 2000 would thus be 3%.

(4) The Inflation Adjustment Percentage applicable to payments due in any year after 2000 shall be calculated by applying each year the greater of 3% or the CPI% on the Inflation Adjustment Percentage applicable to payments due in the prior year. Continuing the example in subsection (3) above, if the CPI% with respect to a payment due in 2001 is 6%, then the Inflation Adjustment Percentage applicable in 2001 would be 9.1800000% (an additional 6% applied on the 3% Inflation Adjustment Percentage applicable in 2000), and if the CPI% with respect to a payment due in 2002 is 4%, then the Inflation Adjustment Percentage applicable in 2002 would be 13.5472000% (an additional 4% applied on the 9.1800000% Inflation Adjustment Percentage applicable in 2001).

(5) "Consumer Price Index" means the Consumer Price Index for All Urban Consumers as published by the Bureau of Labor Statistics of the U.S. Department of Labor (or other similar measures agreed to by the Settling States and the Participating Manufacturers).

(6) The "CPI%" means the actual total percent change in the Consumer Price Index during the calendar year immediately preceding the year in which the payment in question is due.

(7) Additional Examples.

(A) Calculating the Inflation Adjustment Percentages:

Payment Year	Hypothetical CPI%	Percentage to be applied on the Inflation Adjustment Percentage for the prior year (i.e., the greater of 3% or the CPI%)	Inflation Adjustment Percentage
2000	2.4%	3.0%	3.0000000%
2001	2.1%	3.0%	6.0900000%
2002	3.5%	3.5%	9.8031500%
2003	3.5%	3.5%	13.6462603%
2004	4.0%	4.0%	18.1921107%
2005	2.2%	3.0%	21.7378740%
2006	1.6%	3.0%	25.3900102%

(B) Applying the Inflation Adjustment:

Using the hypothetical Inflation Adjustment Percentages set forth in section (7)(A):

-- the subsection IX(c)(1) base payment amount for 2002 of $6,500,000,000 as adjusted for inflation would equal $7,137,204,750;

-- the subsection IX(c)(1) base payment amount for 2004 of $8,000,000,000 as adjusted for inflation would equal $9,455,368,856;

-- the subsection IX(c)(1) base payment amount for 2006 of $8,000,000,000 as adjusted for inflation would equal $10,031,200,816.

EXHIBIT D
LIST OF LAWSUITS

1. Alabama
Blaylock et al. v. American Tobacco Co. et al.,
Circuit Court, Montgomery County, No. CV-96-1508-PR

2. Alaska
State of Alaska v. Philip Morris, Inc., et al., Superior Court, First Judicial District of Juneau, No. 1JU-97915 CI (Alaska)

3. Arizona
State of Arizona v. American Tobacco Co., Inc., et al., Superior Court, Maricopa County, No. CV-96-14769 (Ariz.)

4. Arkansas
State of Arkansas v. The American Tobacco Co., Inc., et al., Chancery Court, 6th Division, Pulaski County, No. IJ 97-2982 (Ark.)

5. California
People of the State of California et al. v. Philip Morris, Inc., et al., Superior Court, Sacramento County, No. 97-AS-30301

6. Colorado
State of Colorado et al., v. R.J. Reynolds Tobacco Co., et al., District Court, City and County of Denver, No. 97CV3432 (Colo.)

7. Connecticut
State of Connecticut v. Philip Morris, et al., Superior Court, Judicial District of Waterbury No. X02 CV96-0148414S (Conn.)

8. Georgia
State of Georgia et al. v. Philip Morris, Inc., et al., Superior Court, Fulton County, No. CA E-61692 (Ga.)

9. Hawaii
State of Hawaii v. Brown & Williamson Tobacco Corp., et al., Circuit Court, First Circuit, No. 97-0441-01 (Haw.)

10. Idaho
State of Idaho v. Philip Morris, Inc., et al., Fourth Judicial District, Ada County, No. CVOC 9703239D (Idaho)

11. Illinois
People of the State of Illinois v. Philip Morris et al., Circuit Court of Cook County, No. 96-L13146 (Ill.)

12. Indiana
State of Indiana v. Philip Morris, Inc., et al., Marion County Superior Court, No. 49D 07-9702-CT-000236 (Ind.)

13. Iowa
State of Iowa v. R.J. Reynolds Tobacco Company et al., Iowa District Court, Fifth Judicial District, Polk County, No. CL71048 (Iowa)

14. Kansas
State of Kansas v. R.J. Reynolds Tobacco Company, et al., District Court of Shawnee County, Division 2, No. 96-CV-919 (Kan.)

15. Louisiana
Ieyoub v. The American Tobacco Company, et al., 14th Judicial District Court, Calcasieu Parish, No. 96-1209 (La.)

16. Maine
State of Maine v. Philip Morris, Inc., et al., Superior Court, Kennebec County, No. CV 97-134 (Me.)

17. Maryland
Maryland v. Philip Morris Incorporated, et al., Baltimore City Circuit Court, No. 96-122017-CL211487 (Md.)

18. Massachusetts
Commonwealth of Massachusetts v. Philip Morris Inc., et al., Middlesex Superior Court, No. 95-7378 (Mass.)

19. Michigan
Kelley v. Philip Morris Incorporated, et al., Ingham County Circuit Court, 30th Judicial Circuit, No. 96-84281-CZ (Mich.)

20. Missouri
State of Missouri v. American Tobacco Co., Inc. et al., Circuit Court, City of St. Louis, No. 972-1465 (Mo.)

21. Montana
State of Montana v. Philip Morris, Inc., et al., First Judicial Court, Lewis and Clark County, No. CDV 9700306-14 (Mont.)

22. Nebraska
State of Nebraska v. R.J. Reynolds Tobacco Co., et al., District Court, Lancaster County, No. 573277 (Neb.)

23. Nevada
Nevada v. Philip Morris, Incorporated, et al., Second Judicial Court, Washoe County, No. CV97-03279 (Nev.)

24. New Hampshire
New Hampshire v. R.J. Reynolds, Tobacco Co., et al., New Hampshire Superior Court, Merrimack County, No. 97-E-165 (N.H.)

25. New Jersey
State of New Jersey v. R.J. Reynolds Tobacco Company, et al., Superior Court, Chancery Division, Middlesex County, No. C-254-96 (N.J.)

26. New Mexico
State of New Mexico, v. The American Tobacco Co., et al., First Judicial District Court, County of Santa Fe, No. SF-1235 c (N.M.)

27. New York State
State of New York et al. v. Philip Morris, Inc., et al., Supreme Court of the State of New York, County of New York, No. 400361/97 (N.Y.)

28. Ohio
State of Ohio v. Philip Morris, Inc., et al., Court of Common Pleas, Franklin County, No. 97CVH055114 (Ohio)

29. Oklahoma
State of Oklahoma, et al. v. R.J. Reynolds Tobacco Company, et al., District Court, Cleveland County, No. CJ-96-1499-L (Okla.)

30. Oregon
State of Oregon v. The American Tobacco Co., et al., Circuit Court, Multnomah County, No. 9706-04457 (Or.)

31. Pennsylvania
Commonwealth of Pennsylvania v. Philip Morris, Inc., et al., Court of Common Pleas, Philadelphia County, April Term 1997, No. 2443

32. Puerto Rico
Rossello, et al. v. Brown & Williamson Tobacco Corporation, et al., U.S. District Court, Puerto Rico, No. 97-1910JAF

33. Rhode Island
State of Rhode Island v. American Tobacco Co., et al., Rhode Island Superior Court, Providence, No. 97-3058 (R.I.)

34. South Carolina
State of South Carolina v. Brown & Williamson Tobacco Corporation, et al., Court of Common Pleas, Fifth Judicial Circuit, Richland County, No. 97-CP-40-1686 (S.C.)

35. South Dakota
State of South Dakota, et al. v. Philip Morris, Inc., et al., Circuit Court, Hughes County, Sixth Judicial Circuit, No. 98-65 (S.D.)

36. Utah
State of Utah v. R.J. Reynolds Tobacco Company, et al., U.S. District Court, Central Division, No. 96 CV 0829W (Utah)

37. Vermont
State of Vermont v. Philip Morris, Inc., et al., Chittenden Superior Court, Chittenden County, No. 744-97 (Vt.) and 5816-98 (Vt.)

38. Washington
State of Washington v. American Tobacco Co. Inc., et al., Superior Court of Washington, King County, No. 96-2-15056O8SEA (Wash.)

39. West Virginia
McGraw, et al. v. The American Tobacco Company, et al., Kanawha County Circuit Court, No. 94-1707 (W. Va.)

40. Wisconsin
State of Wisconsin v. Philip Morris Inc., et al., Circuit Court, Branch 11, Dane County, No. 97-CV-328 (Wis.)

Additional States

For each Settling State not listed above, the lawsuit or other legal action filed by the Attorney General or Governor of such Settling State against *Participating* Manufacturers in the Court in such Settling State prior to 30 days after the MSA Execution Date asserting Released Claims.

EXHIBIT E
FORMULA FOR CALCULATING VOLUME ADJUSTMENTS

Any amount that by the terms of the Master Settlement Agreement is to be adjusted pursuant to this Exhibit E (the "Applicable Base Payment") shall be adjusted in the following manner:

(A) In the event the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico by the Original Participating Manufacturers in the Applicable Year (as defined hereinbelow) (the "Actual Volume") is greater than 475,656,000,000 Cigarettes (the "Base Volume"), the Applicable Base Payment shall be multiplied by the ratio of the Actual Volume to the Base Volume.

(B) In the event the Actual Volume is less than the Base Volume,

i. The Applicable Base Payment shall be reduced by subtracting from it the amount equal to such Applicable Base Payment multiplied both by 0.98 and by the result of (i) 1(one) minus (ii) the ratio of the Actual Volume to the Base Volume.

ii. Solely for purposes of calculating volume adjustments to the payments required under subsection IX(c)(1), if a reduction of the Base Payment due under such subsection results from the application of subparagraph (B)(i) of this Exhibit E, but the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes for the Applicable Year in the fifty United States, the District of Columbia, and Puerto Rico (the "Actual Operating Income") is greater than $7,195,340,000 (the "Base Operating Income") (such Base Operating Income being adjusted upward in accordance with the formula for inflation adjustments set forth in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996) then the amount by which such Base Payment is reduced by the application of subsection (B)(i) shall be reduced (but not below zero) by the amount calculated by multiplying (i) a percentage equal to the aggregate Allocable Shares of the Settling States in which State-Specific Finality has occurred by (ii) 25% of such increase in such operating income. For purposes of this Exhibit E, "operating income from sales of Cigarettes" shall mean operating income from sales of Cigarettes in the fifty United States, the District of Columbia, and Puerto Rico: (a) before goodwill amortization, trademark amortization, restructuring charges and restructuring related charges, minority interest, net interest expense, non-operating income and expense, general corporate expenses and income taxes; and (b) excluding extraordinary items, cumulative effect of changes in method of accounting and discontinued operations -- all as such income is reported to the United States Securities and Exchange Commission ("SEC") for the Applicable Year (either independently by the Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of such Participating Manufacturer) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with U.S. generally accepted accounting principles and audited by a nationally recognized accounting firm. For years subsequent to 1998, the determination of the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes shall not exclude any charges or expenses incurred or accrued in connection with this Agreement or any prior settlement of a tobacco and health case and shall otherwise be derived using the same principles as were employed in deriving such Original Participating Manufacturers' aggregate operating income from sales of Cigarettes in 1996.

iii. Any increase in a Base Payment pursuant to subsection (B)(ii) above shall be allocated among the Original Participating Manufacturers in the following manner:

(1) only to those Original Participating Manufacturers whose operating income from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico for the year for which the Base Payment is being adjusted is greater than their respective operating income from such sales of Cigarettes (including operating income from such sales of any of their Affiliates that do not continue to have such sales after the MSA Execution Date) in 1996 (as increased for inflation as provided in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996); and

(2) among the Original Participating Manufacturers described in paragraph (1) above in proportion to the ratio of (x) the increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of the Original Participating Manufacturer in question, to (y) the aggregate increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of those Original Participating Manufacturers described in paragraph (1) above.

(C) "Applicable Year" means the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

(D) For purposes of this Exhibit, shipments shall be measured as provided in subsection II(mm).

EXHIBIT F
POTENTIAL LEGISLATION NOT TO BE OPPOSED

1. Limitations on Youth access to vending machines.
2. Inclusion of cigars within the definition of tobacco products.
3. Enhancement of enforcement efforts to identify and prosecute violations of laws prohibiting retail sales to Youth.
4. Encouraging or supporting use of technology to increase effectiveness of age-of-purchase laws, such as, without limitation, the use of programmable scanners, scanners to read drivers' licenses, or use of other age/ID data banks.
5. Limitations on promotional programs for non-tobacco goods using tobacco products as prizes or give-aways.
6. Enforcement of access restrictions through penalties on Youth for possession or use.
7. Limitations on tobacco product advertising in or on school facilities, or wearing of tobacco logo merchandise in or on school property.
8. Limitations on non-tobacco products which are designed to look like tobacco products, such as bubble gum cigars, candy cigarettes, etc.

EXHIBIT G
OBLIGATIONS OF THE TOBACCO INSTITUTE UNDER THE MASTER SETTLEMENT AGREEMENT

(a) Upon court approval of a plan of dissolution The Tobacco Institute ("TI") will:

(1) Employees. Promptly notify and arrange for the termination of the employment of all employees; provided, however, that TI may continue to engage any employee who is (A) essential to the wind-down function as set forth in section (g) herein; (B) reasonably needed for the sole purpose of directing and supporting TI's defense of ongoing litigation; or (C) reasonably needed for the sole purpose of performing the Tobacco Institute Testing Laboratory's (the "TITL") industry-wide cigarette testing pursuant to the Federal Trade Commission (the "FTC") method or any other testing prescribed by state or federal law as set forth in section (h) herein.

(2) Employee Benefits. Fund all employee benefit and pension programs; provided, however, that unless ERISA or other federal or state law prohibits it, such funding will be accomplished through periodic contributions by the Original Participating Manufacturers, according to their Relative Market Shares, into a trust or a like mechanism, which trust or like mechanism will be established within 90 days of court approval of the plan of dissolution. An opinion letter will be appended to the dissolution plan to certify that the trust plan is not inconsistent with ERISA or employee benefit pension contracts.

(3) Leases. Terminate all leaseholds at the earliest possible date pursuant to the leases; provided, however, that TI may retain or lease anew such space (or lease other space) as needed for its wind-down activities, for TITL testing as described herein, and for subsequent litigation defense activities. Immediately upon execution of this Agreement, TI will provide notice to each of its landlords of its desire to terminate its lease with such landlord, and will request that the landlord take all steps to re-lease the premises at the earliest possible date consistent with TI's performance of its obligations hereunder. TI will vacate such leasehold premises as soon as they are re-leased or on the last day of wind-down, whichever occurs first.

(b) Assets/Debts. Within 60 days after court approval of a plan of dissolution, TI will provide to the Attorney General of New York and append to the dissolution plan a description of all of its assets, its debts, tax claims against it, claims of state and federal governments against it, creditor claims against it, pending litigation in which it is a party and notices of claims against it.

(c) Documents. Subject to the privacy protections provided by New York Public Officers Law §§ 91-99, TI will provide a copy of or otherwise make available to the State of New York all documents in its possession, excluding those that TI continues to claim to be subject to any attorney-client privilege, attorney work product protection, common interest/joint defense privilege or any other applicable privilege (collectively, "privilege") after the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County) (the "Oklahoma action"):

(1) TI will deliver to the Attorney General of the State of New York a copy of the privilege log served by it in the Oklahoma action. Upon a written request by the Attorney General, TI will deliver an updated version of its privilege log, if any such updated version exists.

(2) The disclosure of any document or documents claimed to be privileged will be governed by section IV of this Agreement.

(3) At the conclusion of the document production and privilege logging process, TI will provide a sworn affidavit that all documents in its possession have been made available to the Attorney General of New York except for documents claimed to be privileged, and that any privilege logs that already exist have been made available to the Attorney General.

(d) Remaining Assets. On mutual agreement between TI and the Attorney General of New York, a not-for-profit health or child welfare organization will be named as the beneficiary of any TI assets that remain after lawful transfers of assets and satisfaction of TI's employee benefit obligations and any other debts, liabilities or claims.

(e) Defense of Litigation. Pursuant to Section 1006 of the New York Not-for-Profit Corporations Law, TI will have the right to continue to defend its litigation interests with respect to any claims against it that are pending or threatened now or that are brought or threatened in the future. TI will retain sole discretion over all litigation decisions, including, without limitation, decisions with respect to asserting any privileges or defenses, having privileged communications and creating privileged documents, filing pleadings, responding to discovery requests, making motions, filing affidavits and briefs, conducting party and non-party discovery, retaining expert witnesses and consultants, preparing for and defending itself at trial, settling any claims asserted against it, intervening or otherwise participating in litigation to protect interests that it deems significant to its defense, and otherwise directing or conducting its defense. Pursuant to existing joint defense agreements, TI may continue to assist its current or former members in defense of any litigation brought or threatened against them. TI also may enter into any new joint defense agreement or agreements that it deems significant to its defense of pending or threatened claims. TI may continue to engage such employees as reasonably needed for the sole purpose of directing and supporting its defense of ongoing litigation. As soon as TI has no litigation pending against it, it will dissolve completely and will cease all functions consistent with the requirements of law.

(f) No public statement. Except as necessary in the course of litigation defense as set forth in section (e) above, upon court approval of a plan of dissolution, neither TI nor any of its employees or agents acting in their official capacity on behalf of TI will issue any statements, press releases, or other public statement concerning tobacco.

(g) Wind-down. After court approval of a plan of dissolution, TI will effectuate wind-down of all activities (other than its defense of litigation as described in section (e) above) expeditiously, and in no event later than 180 days after the date of court approval of the plan of dissolution. TI will provide monthly status reports to the Attorney General of New York regarding the progress of wind-down efforts and work remaining to be done with respect to such efforts.

(h) TITL. Notwithstanding any other provision of this Exhibit G or the dissolution plan, TI may perform TITL industry-wide cigarette testing pursuant to the FTC method or any other testing prescribed by state or federal law until such function is transferred to another entity, which transfer will be accomplished as soon as practicable but in no event more than 180 days after court approval of the dissolution plan.

(i) Jurisdiction. After the filing of a Certificate of Dissolution, pursuant to Section 1004 of the New York Not-for-Profit Corporation Law, the Supreme Court for the State of New York will have continuing jurisdiction over the dissolution of TI and the winding-down of TI's activities, including any litigation-related activities described in subsection (e) herein.

(j) No Determination or Admission. The dissolution of TI and any proceedings taken hereunder are not intended to be and shall not in any event be construed as, deemed to be, or represented or caused to be represented by any Settling State as, an admission or concession or evidence of any liability or any wrongdoing whatsoever on the part of TI, any of its current or former members or anyone acting on their behalf. TI specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it by the Attorneys General of the Settling States.

(k) Court Approval. The Attorney General of the State of New York and the Original Participating Manufacturers will prepare a joint plan of dissolution for submission to the Supreme Court of the State of New York, all of the terms of which will be agreed on and consented to by the Attorney General and the Original Participating Manufacturers consistent with this schedule. The Original Participating Manufacturers and their employees, as officers and directors of TI, will take whatever steps are necessary to execute all documents needed to develop such a plan of dissolution and to submit it to the court for approval. If any court makes any material change to any term or provision of the plan of dissolution agreed upon and consented to by the Attorney General and the Original Participating Manufacturers, then:

(1) the Original Participating Manufacturers may, at their election, nevertheless proceed with the dissolution plan as modified by the court; or

(2) if the Original Participating Manufacturers elect not to proceed with the court-modified dissolution plan, the Original Participating Manufacturers will be released from any obligations or undertakings under this Agreement or this schedule with respect to TI; provided, however, that the Original Participating Manufacturers will engage in good faith negotiations with the New York Attorney General to agree upon the term or terms of the dissolution plan that the court may have modified in an effort to agree upon a dissolution plan that may be resubmitted for the court's consideration.

EXHIBIT H
DOCUMENT PRODUCTION

Section 1.

(a) Philip Morris Companies, Inc., et al., v. American Broadcasting Companies, Inc., et al., At Law No. 760CL94X00816-00 (Cir. Ct., City of Richmond)

(b) Harley-Davidson v. Lorillard Tobacco Co., No. 93-947 (S.D.N.Y.)

(c) Lorillard Tobacco Co. v. Harley-Davidson, No. 93-6098 (E.D. Wis.)

(d) Brown & Williamson v. Jacobson and CBS, Inc., No. 82-648 (N.D. Ill.)

(e) The FTC investigations of tobacco industry advertising and promotion as embodied in the following cites:

46 FTC 706
48 FTC 82
46 FTC 735
47 FTC 1393
108 F. Supp. 573
55 FTC 354
56 FTC 96
79 FTC 255
80 FTC 455
Investigation #8023069
Investigation #8323222

Each Original Participating Manufacturer and Tobacco-Related Organization will conduct its own reasonable inquiry to determine what documents or deposition testimony, if any, it produced or provided in the above-listed matters.

Section 2.

(a) State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King)

(b) In re Mike Moore, Attorney General, ex rel. State of Mississippi Tobacco Litigation, No. 94-1429 (Chancery Ct., Jackson, Miss.)

(c) State of Florida v. American Tobacco Co., et al., No. CL 95-1466 AH (Fla. Cir. Ct., 15th Judicial Cir., Palm Beach Co.)

(d) State of Texas v. American Tobacco Co., et al., No. 5-96CV-91 (E.D. Tex.)

(e) Minnesota v. Philip Morris et al., No. C-94-8565 (Minn. Dist. Ct., County of Ramsey)

(f) Broin v. R.J. Reynolds, No. 91-49738 CA (22) (11th Judicial Ct., Dade County, Florida)

EXHIBIT I
INDEX AND SEARCH FEATURES FOR DOCUMENT WEBSITE

(a) Each Original Participating Manufacturer and Tobacco-Related Organization will create and maintain on its website, at its expense, an enhanced, searchable index, as described below, using Alta-Vista or functionally comparable software, for all of the documents currently on its website and all documents being placed on its website pursuant to section IV of this Agreement.

(b) The searchable indices of documents on these websites will include:

(1) all of the information contained in the 4(b) indices produced to the State Attorneys General (excluding fields specific only to the Minnesota action other than "request number");

(2) the following additional fields of information (or their substantial equivalent) to the extent such information already exists in an electronic format that can be incorporated into such an index:

Document ID	Master ID
Other Number	Document Date
Primary Type	Other Type
Person Attending	Person Noted
Person Author	Person Recipient
Person Copied	Person Mentioned
Organization Author	Organization Recipient
Organization Copied	Organization Mentioned
Organization Attending	Organization Noted
Physical Attachment 1	Physical Attachment 2
Characteristics	File Name
Site	Area
Verbatim Title	Old Brand
Primary Brand	Mentioned Brand
Page Count	

(c) Each Original Participating Manufacturer and Tobacco-Related Organization will add, if not already available, a user-friendly document retrieval feature on the Website consisting of a "view all pages" function with enhanced image viewer capability that will enable users to choose to view and/or print either "all pages" for a specific document or "page-by-page".

(d) Each Original Participating Manufacturer and Tobacco-Related Organizations will provide at its own expense to NAAG a copy set in electronic form of its website document images and its accompanying subsection IV(h) index in ASCII-delimited form for all of the documents currently on its website and all of the documents described in subsection IV(d) of this Agreement. The Original Participating Manufacturers and Tobacco-Related Organizations will not object to any subsequent distribution and/or reproduction of these copy sets.

EXHIBIT J
TOBACCO ENFORCEMENT FUND PROTOCOL

The States' Antitrust/Consumer Protection Tobacco Enforcement Fund ("Fund") is established by the Attorneys General of the Settling States, acting through NAAG, pursuant to section VIII(c) of the Agreement. The following shall be the primary and mandatory protocol for the administration of the Fund.

Section A
Fund Purpose

Section 1

The monies to be paid pursuant to section VIII(c) of the Agreement shall be placed by NAAG in a new and separate interest bearing account, denominated the States' Antitrust/ Consumer Protection Tobacco Enforcement Fund, which shall not then or thereafter be commingled with any other funds or accounts. However, nothing herein shall prevent deposits into the account so long as monies so deposited are then lawfully committed for the purpose of the Fund as set forth herein.

Section 2

A committee of three Attorneys General ("Special Committee") shall be established to determine disbursements from the account, using the process described herein. The three shall be the Attorney General of the State of Washington, the Chair of NAAG's antitrust committee, and the Chair of NAAG's consumer protection committee. In the event that an Attorney General shall hold either two or three of the above stated positions, that Attorney General may serve only in a single capacity, and shall be replaced in the remaining positions by first, the President of NAAG, next by the President-Elect of NAAG and if necessary the Vice-President of NAAG.

Section 3

The purpose of the Fund is: (1) to enforce and implement the terms of the Agreement, in particular, by partial payment of the monetary costs of the Independent Auditor as contemplated by the Agreement; and (2) to provide monetary assistance to the various states' attorneys general: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute ("Qualifying Actions"). The Special Committee shall entertain requests only from Settling States for disbursement from the fund associated with a Qualifying Action ("Grant Application").

Section B
Administration Standards Relative to Grant Applications

Section 1

The Special Committee shall not entertain any Grant Application to pay salaries or ordinary expenses of regular employees of any Attorney General's office.

Section 2

The affirmative vote of two or more of the members of the Special Committee shall be required to approve any Grant Application.

Section 3

The decision of the Special Committee shall be final and non-appealable.

Section 4

The Attorney General of the State of Washington shall be chair of the Special Committee and shall annually report to the Attorneys General on the requests for funds from the Fund and the actions of the Special Committee upon the requests.

Section 5

When a Grant Application to the Fund is made by an Attorney General who is then a member of the Special Committee, such member will be temporarily replaced on the Committee, but only for the determination of such Grant Application. The remaining members of the Special Committee shall designate an Attorney General to replace the Attorney General so disqualified, in order to consider the application.

Section 6

The Fund shall be maintained in a federally insured depository institution located in Washington, D.C. Funds may be invested in federal government-backed vehicles. The Fund shall be regularly reported on NAAG financial statements and subject to annual audit.

Section 7

Withdrawals from and checks drawn on the Fund will require at least two of three authorized signatures. The three persons so authorized shall be the executive director, the deputy director, and controller of NAAG.

Section 8

The Special Committee shall meet in person or telephonically as necessary to determine whether a grant is sought for assistance with a Qualifying Action and whether and to what extent the Grant Application is accepted. The chair of the

Special Committee shall designate the times for such meetings, so that a response is made to the Grant Application as expeditiously as practicable.

Section 9

The Special Committee may issue a grant from the Fund only when an Attorney General certifies that the monies will be used in connection with a Qualifying Action, to wit: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute. The Attorney General submitting such application shall further certify that the entire grant of monies from the Fund will be used to pay for such investigation and/or litigation. The Grant Application shall describe the nature and scope of the intended action and use of the funds which may be granted.

Section 10

To the extent permitted by law, each Attorney General whose Grant Application is favorably acted upon shall promise to pay back to the Fund all of the amounts received from the Fund in the event the state is successful in litigation or settlement of a Qualifying Action. In the event that the monetary recovery, if any, obtained is not sufficient to pay back the entire amount of the grant, the Attorney General shall pay back as much as is permitted by the recovery. In all instances where monies are granted, the Attorney General(s) receiving monies shall provide an accounting to NAAG of all disbursements received from the Fund no later than the 30th of June next following such disbursement.

Section 11

In addition to the repayments to the Fund contemplated in the preceding section, the Special Committee may deposit in the Fund any other monies lawfully committed for the precise purpose of the Fund as set forth in section A(3) above. For example, the Special Committee may at its discretion accept for deposit in the Fund a foundation grant or court-ordered award for state antitrust and/or consumer protection enforcement as long as the monies so deposited become part of and subject to the same rules, purposes and limitations of the Fund.

Section 12

The Special Committee shall be the sole and final arbiter of all Grant Applications and of the amount awarded for each such application, if any.

Section 13

The Special Committee shall endeavor to maintain the Fund for as long a term as is consistent with the purpose of the Fund. The Special Committee will limit the total amount of grants made to a single state to no more than $500,000.00. The Special Committee will not award a single grant in excess of $200,000.00, unless the grant involves more than one state, in which case, a single grant so made may not total more than $300,000.00. The Special Committee may, in its discretion and by unanimous vote, decide to waive these limitations if it determines that special circumstances exist. Such decision, however, shall not be effective unless ratified by a two-thirds majority vote of the NAAG executive committee.

Section C
Grant Application Procedures

Section 1

This Protocol shall be transmitted to the Attorneys General within 90 days after the MSA Execution Date. It may not be amended unless by recommendation of the NAAG executive committee and majority vote of the Settling States. NAAG will notify the Settling States of any amendments promptly and will transmit yearly to the attorneys general a statement of the Fund balance and a summary of deposits to and withdrawals from the Fund in the previous calendar or fiscal year.

Section 2

Grant Applications must be in writing and must be signed by the Attorney General submitting the application.

Section 3

Grant Applications must include the following:

(A) A description of the contemplated/pending action, including the scope of the alleged violation and the area (state/regional/multi-state) likely to be affected by the suspected offending conduct.

(B) A statement whether the action is actively and currently pursued by any other Attorney General or other prosecuting authority.

(C) A description of the purposes for which the monies sought will be used.

(D) The amount requested.

(E) A directive as to how disbursements from the Fund should be made, e.g., either directly to a supplier of services (consultants, experts, witnesses, and the like), to the Attorney General's office directly, or in the case of multi-state action, to one or more Attorneys General's offices designated as a recipient of the monies.

(F) A statement that the applicant Attorney(s) General will, to the extent permitted by law, pay back to the Fund all, or as much as is possible, of the monies received, upon receipt of any monetary recovery obtained in the contemplated/pending litigation or settlement of the action.

(G) A certification that no part of the grant monies will be used to pay the salaries or ordinary expenses of any regular employee of the office of the applicant(s) and that the grant will be used solely to pay for the stated purpose.

(H) A certification that an accounting will be provided to NAAG of all monies received by the applicant(s) by no later than the 30th of June next following any receipt of such monies.

Section 4

All Grant Applications shall be submitted to the NAAG office at the following address: National Association of Attorneys General, 750 1st Street, NE, Suite 1100, Washington D.C. 20002.

Section 5

The Special Committee will endeavor to act upon all complete and properly submitted Grant Applications within 30 days of receipt of said applications.

Section D
Other Disbursements from the Fund

Section 1

To enforce and implement the terms of the Agreement, the Special Committee shall direct disbursements from the Fund to comply with the partial payment obligations set forth in section XI of the Agreement relative to costs of the Independent Auditor. A report of such disbursements shall be included in the accounting given pursuant to section C(1) above.

Section E
Administrative Costs

Section 1

NAAG shall receive from the Fund on July 1, 1999 and on July 1 of each year thereafter an administrative fee of $100,000 for its administrative costs in performing its duties under the Protocol and this Agreement. The NAAG executive committee may adjust the amount of the administrative fee in extraordinary circumstances.

EXHIBIT K
MARKET CAPITALIZATION PERCENTAGES

Philip Morris Incorporated	68.0000000%
Brown & Williamson Tobacco Corporation	17.9000000%
Lorillard Tobacco Company	7.3000000%
R.J. Reynolds Tobacco Company	6.8000000%
Total	100.0000000%

EXHIBIT L
MODEL CONSENT DECREE

IN THE [XXXXXX] COURT OF THE STATE OF [XXXXXX]
IN AND FOR THE COUNTY OF [XXXXX]

-------------------------------- x   CAUSE NO. XXXXXX

STATE OF [XXXXXXXXXXX],
Plaintiff,
v.
[XXXXXX XXXXX XXXX], et al.,
Defendants.

CONSENT DECREE AND FINAL JUDGMENT

-------------------------------- x

WHEREAS, Plaintiff, the State of [name of Settling State], commenced this action on [date], [by and through its Attorney General [name]], pursuant to [her/his/its] common law powers and the provisions of [state and/or federal law];

WHEREAS, the State of [name of Settling State] asserted various claims for monetary, equitable and injunctive relief on behalf of the State of [name of Settling State] against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's complaint [and amended complaints, if any] and denied the State's allegations [and asserted affirmative defenses];

WHEREAS, the parties desire to resolve this action in a manner which appropriately addresses the State's public health concerns, while conserving the parties' resources, as well as those of the Court, which would otherwise be expended in litigating a matter of this magnitude; and

WHEREAS, the Court has made no determination of any violation of law, this Consent Decree and Final Judgment being entered prior to the taking of any testimony and without trial or final adjudication of any issue of fact or law;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED, AS FOLLOWS:

I. JURISDICTION AND VENUE

This Court has jurisdiction over the subject matter of this action and over each of the Participating Manufacturers. Venue is proper in this [county/district].

II. DEFINITIONS

The definitions set forth in the Agreement (a copy of which is attached hereto) are incorporated herein by reference.

III. APPLICABILITY

A. This Consent Decree and Final Judgment applies only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a violation of this Consent Decree and Final Judgment (or any order issued in connection herewith) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such violation, and there shall be no jurisdiction under this Consent Decree and Final Judgment to do so.

B. This Consent Decree and Final Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof. No portion of this Consent Decree and Final Judgment shall provide any rights to, or be enforceable by, any person or entity other than the State of [name of Settling State] or a Released Party. The State of [name of Settling State] may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment.

IV. VOLUNTARY ACT OF THE PARTIES

The parties hereto expressly acknowledge and agree that this Consent Decree and Final Judgment is voluntarily entered into as the result of arm's-length negotiation, and all parties hereto were represented by counsel in deciding to enter into this Consent Decree and Final Judgment.

V. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

A. Taking any action, directly or indirectly, to target Youth within the State of [name of Settling State] in the advertising, promotion or marketing of Tobacco Products, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within the State of [name of Settling State].

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of [name of Settling State] any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

C. After 30 days after the MSA Execution Date, making or causing to be made any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop within the State of [name of Settling State] any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any Media; provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults; and (4) actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) and III(c)(2)(B)(i) of the Agreement, and use of a Brand Name to identify a Brand Name Sponsorship permitted by subsection III(c)(2)(B)(ii).

D. Beginning July 1, 1999, marketing, distributing, offering, selling, licensing or causing to be marketed, distributed, offered, sold, or licensed (including, without limitation, by catalogue or direct mail), within the State of [name of Settling State], any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this section shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public; or (6) apply to apparel or other merchandise (a) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsection III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise, or (b) used at the site of a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement (during such event) that are not distributed (by sale or otherwise) to any member of the general public.

E. After the MSA Execution Date, distributing or causing to be distributed within the State of [name of Settling State] any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Consent Decree and Final Judgment, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

F. Using or causing to be used as a brand name of any Tobacco Product pursuant to any agreement requiring the payment of money or other valuable consideration, any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this provision, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

G. After 60 days after the MSA Execution Date and through and including December 31, 2001, manufacturing or causing to be manufactured for sale within the State of [name of Settling State] any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco); and, after 150 days after the MSA Execution Date and through and including December 31, 2001, selling or distributing within the State of [name of Settling State] any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

H. Entering into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in the preceding

sentence shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

I. Making any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Provided, however, that nothing in the preceding sentence shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

VI. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained by the Court for the purposes of implementing and enforcing the Agreement and this Consent Decree and Final Judgment and enabling the continuing proceedings contemplated herein. Whenever possible, the State of [name of Settling State] and the Participating Manufacturers shall seek to resolve any issue that may exist as to compliance with this Consent Decree and Final Judgment by discussion among the appropriate designees named pursuant to subsection XVIII(m) of the Agreement. The State of [name of Settling State] and/or any Participating Manufacturer may apply to the Court at any time for further orders and directions as may be necessary or appropriate for the implementation and enforcement of this Consent Decree and Final Judgment. Provided, however, that with regard to subsections V(A) and V(I) of this Consent Decree and Final Judgment, the Attorney General shall issue a cease and desist demand to the Participating Manufacturer that the Attorney General believes is in violation of either of such sections at least ten Business Days before the Attorney General applies to the Court for an order to enforce such subsections, unless the Attorney General reasonably determines that either a compelling time-sensitive public health and safety concern requires more immediate action or the Court has previously issued an Enforcement Order to the Participating Manufacturer in question for the same or a substantially similar action or activity. For any claimed violation of this Consent Decree and Final Judgment, in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation, the Attorney General shall give good-faith consideration to whether: (1) the Participating Manufacturer that is claimed to have committed the violation has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless that party has been guilty of a pattern of violations of like nature; and (2) a legitimate, good-faith dispute exists as to the meaning of the terms in question of this Consent Decree and Final Judgment. The Court in any case in its discretion may determine not to enter an order for monetary, civil contempt or criminal sanctions.

B. This Consent Decree and Final Judgment is not intended to be, and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Consent Decree and Final Judgment; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it in this action, and has stipulated to the entry of this Consent Decree and Final Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as expressly provided otherwise in the Agreement, this Consent Decree and Final Judgment shall not be modified (by this Court, by any other court or by any other means) unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions. Provided, however, that the provisions of sections III, V, VI and VII of this Consent Decree and Final Judgment shall in no event be subject to modification without the consent of the State of [name of Settling State] and all affected Participating Manufacturers. In the event that any of the sections of this Consent Decree and Final Judgment enumerated in the preceding sentence are modified by this Court, by any other court or by any other means without the consent of the State of [name of Settling State] and all affected Participating Manufacturers, then this Consent Decree and Final Judgment shall be void and of no further effect. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that the Participating Manufacturers will comply with this Consent Decree and Final Judgment as originally entered, even if the Participating Manufacturers' obligations hereunder are greater than those imposed under current or future law (unless compliance with this Consent Decree and Final Judgment would violate such law). A change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Participating Manufacturers shall not support modification of this Consent Decree and Final Judgment.

D. In any proceeding which results in a finding that a Participating Manufacturer violated this Consent Decree and Final Judgment, the Participating Manufacturer or Participating Manufacturers found to be in violation shall pay the State's costs and attorneys' fees incurred by the State of [name of Settling State] in such proceeding.

E. The remedies in this Consent Decree and Final Judgment are cumulative and in addition to any other remedies the State of [name of Settling State] may have at law or equity, including but not limited to its rights under the Agreement. Nothing herein shall be construed to prevent the State from bringing an action with respect to conduct not released pursuant to the Agreement, even though that conduct may also violate this Consent Decree and Final Judgment. Nothing in this Consent Decree and Final Judgment is intended to create any right for [name of Settling State] to obtain any Cigarette product formula that it would not otherwise have under applicable law.

F. No party shall be considered the drafter of this Consent Decree and Final Judgment for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter. Nothing in this Consent Decree and Final Judgment shall be construed as approval by the State of [name of Settling State] of the Participating Manufacturers' business organizations, operations, acts or practices, and the Participating Manufacturers shall make no representation to the contrary.

G. The settlement negotiations resulting in this Consent Decree and Final Judgment have been undertaken in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Consent Decree and Final Judgment shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Consent Decree and Final Judgment nor any public discussions, public statements or public comments with respect to this Consent Decree and Final Judgment by the State of [name of Settling State] or any Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Consent Decree and Final Judgment.

H. All obligations of the Participating Manufacturers pursuant to this Consent Decree and Final Judgment (including, but not limited to, all payment obligations) are, and shall remain, several and not joint.

I. The provisions of this Consent Decree and Final Judgment are applicable only to actions taken (or omitted to be taken) within the States. Provided, however, that the preceding sentence shall not be construed as extending the territorial scope of any provision of this Consent Decree and Final Judgment whose scope is otherwise limited by the terms thereof.

J. Nothing in subsection V(A) or V(I) of this Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

K. If the Agreement terminates in this State for any reason, then this Consent Decree and Final Judgment shall be void and of no further effect.

VII. FINAL DISPOSITION

A. The Agreement, the settlement set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein.

B. The Court finds that the person[s] signing the Agreement have full and complete authority to enter into the binding and fully effective settlement of this action as set forth in the Agreement. The Court further finds that entering into this settlement is in the best interests of the State of [name of Settling State].

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this _____ day of _____________, 1998.

EXHIBIT M
LIST OF PARTICIPATING MANUFACTURERS' LAWSUITS AGAINST THE SETTLING STATES

1. Philip Morris, Inc., et al. v. Margery Bronster, Attorney General of the State of Hawaii, In Her Official Capacity, Civ. No. 96-00722HG, United States District Court for the District of Hawaii

2. Philip Morris, Inc., et al. v. Bruce Botelho, Attorney General of the State of Alaska, In His Official Capacity, Civ. No. A97-0003CV, United States District Court for the District of Alaska

3. Philip Morris, Inc., et al. v. Scott Harshbarger, Attorney General of the Commonwealth of Massachusetts, In His Official Capacity, Civ. No. 95-12574-GAO, United States District Court for the District of Massachusetts

4. Philip Morris, Inc., et al. v. Richard Blumenthal, Attorney General of the State of Connecticut, In His Official Capacity, Civ. No. 396CV01221 (PCD), United States District Court for the District of Connecticut

5. Philip Morris, et al. v. William H. Sorrell, et al., No. 1:98-cv-132, United States District Court for the District of Vermont

EXHIBIT N
LITIGATING POLITICAL SUBDIVISIONS

1. City of New York, et al. v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of New York, Index No. 406225/96

2. County of Erie v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of Erie, Index No. I 1997/359

3. County of Los Angeles v. R.J. Reynolds Tobacco Co. et al., San Diego Superior Court, No. 707651

4. The People v. Philip Morris, Inc. et al., San Francisco Superior Court, No. 980864

5. County of Cook v. Philip Morris, Inc. et al., Circuit Court of Cook County, Ill., No. 97-L-4550

EXHIBIT O
MODEL STATE FEE PAYMENT AGREEMENT

This STATE Fee Payment Agreement (the "STATE Fee Payment Agreement") is entered into as of _________, _____ between and among the Original Participating Manufacturers and STATE Outside Counsel (as defined herein), to provide for payment of attorneys' fees pursuant to Section XVII of the Master Settlement Agreement (the "Agreement").

WITNESSETH:

WHEREAS, the State of STATE and the Original Participating Manufacturers have entered into the Agreement to settle and resolve with finality all Released Claims against the Released Parties, including the Original Participating Manufacturers, as set forth in the Agreement; and

WHEREAS, Section XVII of the Agreement provides that the Original Participating Manufacturers shall pay reasonable attorneys' fees to those private outside counsel identified in Exhibit S to the Agreement, pursuant to the terms hereof;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the mutual agreement of the State of STATE and the Original Participating Manufacturers to the terms of the Agreement and of the mutual agreement of STATE Outside Counsel and the Original Participating Manufacturers to the terms of this STATE Fee Payment Agreement, and such other consideration described herein, the Original Participating Manufacturers and STATE Outside Counsel agree as follows:

SECTION 1. *Definitions.*

All definitions contained in the Agreement are incorporated by reference herein, except as to terms specifically defined herein.

(a) "*Action*" means the lawsuit identified in Exhibit D, M or N to the Agreement that has been brought by or against the State of STATE [or Litigating Political Subdivision].

(b) "*Allocated Amount*" means the amount of any Applicable Quarterly Payment allocated to any Private Counsel (including STATE Outside Counsel) pursuant to section 17 hereof.

(c) "*Allocable Liquidated Share*" means, in the event that the sum of all Payable Liquidated Fees of Private Counsel as of any date specified in section 8 hereof exceeds the Applicable Liquidation Amount for any payment described therein, a percentage share of the Applicable Liquidation Amount equal to the proportion of (i) the amount of the Payable Liquidated Fee of STATE Outside Counsel to (ii) the sum of Payable Liquidated Fees of all Private Counsel.

(d) "*Applicable Liquidation Amount*" means, for purposes of the payments described in section 8 hereof —

(i) for the payment described in subsection (a) thereof, $125 million;

(ii) for the payment described in subsection (b) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsection (a) thereof;

(iii) for the payment described in subsection (c) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a) and (b) thereof;

(iv) for the payment described in subsection (d) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a), (b) and (c) thereof;

(v) for the payment described in subsection (e) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a), (b), (c) and (d) thereof;

(vi) for each of the first, second and third quarterly payments for any calendar year described in subsection (f) thereof, $62.5 million; and

(vii) for each of the fourth calendar quarterly payments for any calendar year described in subsection (f) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel with respect to the preceding calendar quarters of the calendar year.

(e) "*Application*" means a written application for a Fee Award submitted to the Panel, as well as all supporting materials (which may include video recordings of interviews).

(f) "*Approved Cost Statement*" means both (i) a Cost Statement that has been accepted by the Original Participating Manufacturers; and (ii) in the event that a Cost Statement submitted by STATE Outside Counsel is disputed, the determination by arbitration pursuant to subsection (b) of section 19 hereof as to the amount of the reasonable costs and expenses of STATE Outside Counsel.

(g) "*Cost Statement*" means a signed and attested statement of reasonable costs and expenses of Outside Counsel for any action identified on Exhibit D, M or N to the Agreement that has been brought by or against a Settling State or Litigating Political Subdivision.

(h) "*Designated Representative*" means the person designated in writing, by each person or entity identified in Exhibit S to the Agreement [by the Attorney General of the State of STATE or as later certified in writing by the governmental prosecuting authority of the Litigating Political Subdivision], to act as their agent in receiving payments from the Original Participating Manufacturers for the benefit of STATE Outside Counsel pursuant to sections 8, 16 and 19 hereof, as applicable.

(i) "*Director*" means the Director of the Private Adjudication Center of the Duke University School of Law or such other person or entity as may be chosen by agreement of the Original Participating Manufacturers and the Committee described in the second sentence of paragraph (b)(ii) of section 11 hereof.

(j) "*Eligible Counsel*" means Private Counsel eligible to be allocated a part of a Quarterly Fee Amount pursuant to section 17 hereof.

(k) "*Federal Legislation*" means federal legislation that imposes an enforceable obligation on Participating Defendants to pay attorneys' fees with respect to Private Counsel.

(l) "*Fee Award*" means any award of attorneys' fees by the Panel in connection with a Tobacco Case.

(m) "*Liquidated Fee*" means an attorneys' fee for Outside Counsel for any action identified on Exhibit D, M or N to the Agreement that has been brought by or against a Settling State or Litigating Political Subdivision, in an amount agreed upon by the Original Participating Manufacturers and such Outside Counsel.

(n) "*Outside Counsel*" means all those Private Counsel identified in Exhibit S to the Agreement.

(o) "*Panel*" means the three-member arbitration panel described in section 11 hereof.

(p) "*Party*" means (i) STATE Outside Counsel and (ii) an Original Participating Manufacturer.

(q) "*Payable Cost Statement*" means the unpaid amount of a Cost Statement as to which all conditions precedent to payment have been satisfied.

(r) "*Payable Liquidated Fee*" means the unpaid amount of a Liquidated Fee as to which all conditions precedent to payment have been satisfied.

(s) "*Previously Settled States*" means the States of Mississippi, Florida and Texas.

(t) "*Private Counsel*" means all private counsel for all plaintiffs in a Tobacco Case (including STATE Outside Counsel).

(u) "*Quarterly Fee Amount*" means, for purposes of the quarterly payments described in sections 16, 17 and 18 hereof —

(i) for each of the first, second and third calendar quarters of any calendar year beginning with the first calendar quarter of 1999 and ending with the third calendar quarter of 2008, $125 million;

(ii) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 1999 and ending with the fourth calendar quarter of 2003, the sum of (A) $125 million and (B) the difference, if any, between (*1*) $375 million and (2) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any;

(iii) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 2004 and ending with the fourth calendar quarter of 2008, the sum of (A) $125 million; (B) the difference between (*1*) $375 million; and (2) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any; and (C) the difference, if any, between (*1*) $250 million and (2) the product of (*a*) .2 (two tenths) and (*b*) the sum of all amounts paid in satisfaction of all Liquidated Fees of Outside Counsel pursuant to section 8 hereof, if any;

(iv) for each of the first, second and third calendar quarters of any calendar year beginning with the first calendar quarter of 2009, $125 million; and

(v) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 2009, the sum of (A) $125 million and (B) the difference, if any, between (*1*) $375 million and (2) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any.

(v) "*Related Persons*" means each Original Participating Manufacturer's past, present and future Affiliates, divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing).

(w) "*State of STATE*" means the [applicable Settling State or the Litigating Political Subdivision], any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and subdivisions.

(x) "*STATE Outside Counsel*" means all persons or entities identified in Exhibit S to the Agreement by the Attorney General of State of STATE [or as later certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] as having been retained by and having represented the STATE in connection with the Action, acting collectively by unanimous decision of all such persons or entities.

(y) "*Tobacco Case*" means any tobacco and health case (other than a non-class action personal injury case brought directly by or on behalf of a single natural person or the survivor of such person or for wrongful death, or any non-class action consolidation of two or more such cases).

(z) "*Unpaid Fee*" means the unpaid portion of a Fee Award.

SECTION 2. *Agreement to Pay Fees.*

The Original Participating Manufacturers will pay reasonable attorneys' fees to STATE Outside Counsel for their representation of the State of STATE in connection with the Action, as provided herein and subject to the *Code of Professional Responsibility* of the American Bar Association. Nothing herein shall be construed to require the Original Participating Manufacturers to pay any attorneys' fees other than (i) a Liquidated Fee or a Fee Award and (ii) a Cost Statement, as provided herein, nor shall anything herein require the Original Participating Manufacturers to pay any Liquidated Fee, Fee Award or Cost Statement in connection with any litigation other than the Action.

SECTION 3. *Exclusive Obligation of the Original Participating Manufacturers.*

The provisions set forth herein constitute the entire obligation of the Original Participating Manufacturers with respect to payment of attorneys' fees of STATE Outside Counsel (including costs and expenses) in connection with the Action and the exclusive means by which STATE Outside Counsel or any other person or entity may seek payment of fees by the Original Participating Manufacturers or Related Persons in connection with the Action. The Original Participating Manufacturers shall have no obligation pursuant to Section XVII of the Agreement to pay attorneys' fees in connection with the Action to any counsel other than STATE Outside Counsel, and they shall have no other obligation to pay attorneys' fees to or otherwise to compensate STATE Outside Counsel, any other counsel or representative of the State of STATE or the State of STATE itself with respect to attorneys' fees in connection with the Action.

SECTION 4. *Release.*

(a) Each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] hereby irrevocably releases the Original Participating Manufacturers and all Related Persons from any and all claims that such person or entity ever had, now has or hereafter can, shall or may have in any way related to the Action (including but not limited to any negotiations related to the settlement of the Action). Such release shall not be construed as a release of any person or entity as to any of the obligations undertaken herein in connection with a breach thereof.

(b) In the event that STATE Outside Counsel and the Original Participating Manufacturers agree upon a Liquidated Fee pursuant to section 7 hereof, it shall be a precondition to any payment by the Original Participating Manufacturers to the Designated Representative pursuant to section 8 hereof that each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] shall have irrevocably released all entities represented by STATE Outside Counsel in the Action, as well as all persons acting by or on behalf of such entities (including the Attorney General [or the office of the governmental prosecuting authority] and each other person or entity identified on Exhibit S to the Agreement by the Attorney General [or the office of the governmental prosecuting authority]) from any and all claims that such person or entity ever had, now has or hereafter can, shall or may have in any way related to the Action (including but not limited to any negotiations related to the settlement of the Action). Such release shall not be construed as a release of any person or entity as to any of the obligations undertaken herein in connection with a breach thereof.

SECTION 5. *No Effect on STATE Outside Counsel's Fee Contract.*

The rights and obligations, if any, of the respective parties to any contract between the State of STATE and STATE Outside Counsel shall be unaffected by this STATE Fee Payment Agreement except (a) insofar as STATE Outside Counsel grant the release described in subsection (b) of section 4 hereof; and (b) to the extent that STATE Outside Counsel receive any payments in satisfaction of a Fee Award pursuant to section 16 hereof, any amounts so received shall be credited, on a dollar-for-dollar basis, against any amount payable to STATE Outside Counsel by the State of STATE [or the Litigating Political Subdivision] under any such contract.

SECTION 6. *Liquidated Fees.*

(a) In the event that the Original Participating Manufacturers and STATE Outside Counsel agree upon the amount of a Liquidated Fee, the Original Participating Manufacturers shall pay such Liquidated Fee, pursuant to the terms hereof.

(b) The Original Participating Manufacturers' payment of any Liquidated Fee pursuant to this STATE Fee Payment Agreement shall be subject to (i) satisfaction of the conditions precedent stated in section 4 and paragraph (c)(ii) of section 7 hereof; and (ii) the payment schedule and the annual and quarterly aggregate national caps specified in sections 8 and 9 hereof, which shall apply to all payments made with respect to Liquidated Fees of all Outside Counsel.

SECTION 7. *Negotiation of Liquidated Fees.*

(a) If STATE Outside Counsel seek to be paid a Liquidated Fee, the Designated Representative shall so notify the Original Participating Manufacturers. The Original Participating Manufacturers may at any time make an offer of a Liquidated Fee to the Designated Representative in an amount set by the unanimous agreement, and at the sole discretion, of the Original Participating Manufacturers and, in any event, shall collectively make such an offer to the Designated Representative no more than 60 Business Days after receipt of notice by the Designated Representative that STATE Outside

Counsel seek to be paid a Liquidated Fee. The Original Participating Manufacturers shall not be obligated to make an offer of a Liquidated Fee in any particular amount. Within ten Business Days after receiving such an offer, STATE Outside Counsel shall either accept the offer, reject the offer or make a counteroffer.

(b) The national aggregate of all Liquidated Fees to be agreed to by the Original Participating Manufacturers in connection with the settlement of those actions indicated on Exhibits D, M and N to the Agreement shall not exceed one billion two hundred fifty million dollars ($1,250,000,000).

(c) If the Original Participating Manufacturers and STATE Outside Counsel agree in writing upon a Liquidated Fee:

(i) STATE Outside Counsel shall not be eligible for a Fee Award;

(ii) such Liquidated Fee shall not become a Payable Liquidated Fee until such time as (A) State-Specific Finality has occurred in the State of STATE; (B) each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority of the Litigating Political Subdivision] has granted the release described in subsection (b) of section 4 hereof; and (C) notice of the events described in subparagraphs (A) and (B) of this paragraph has been provided to the Original Participating Manufacturers.

(iii) payment of such Liquidated Fee pursuant to sections 8 and 9 hereof (together with payment of costs and expenses pursuant to section 19 hereof), shall be STATE Outside Counsel's total and sole compensation by the Original Participating Manufacturers in connection with the Action.

(d) If the Original Participating Manufacturers and STATE Outside Counsel do not agree in writing upon a Liquidated Fee, STATE Outside Counsel may submit an Application to the Panel for a Fee Award to be paid as provided in sections 16, 17 and 18 hereof.

SECTION 8. *Payment of Liquidated Fee.*

In the event that the Original Participating Manufacturers and STATE Outside Counsel agree in writing upon a Liquidated Fee, and until such time as the Designated Representative has received payments in full satisfaction of such Liquidated Fee —

(a) On February 1, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before January 15, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel as of January 15, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(b) On August 1, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee on or after January 15, 1999 and before July 15, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees on or after January 15, 1999 and before July 15, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(c) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee on or after July 15, 1999 and before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees on or after July 15, 1999 and before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(d) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, or (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that become Payable Liquidated Fees before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(e) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel or (ii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(f) On the last day of each calendar quarter, beginning with the first calendar quarter of 2000 and ending with the fourth calendar quarter of 2003, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee at least 15 Business Days prior to the last day of each such calendar quarter, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel or (ii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel as of the date 15 Business Days prior to the date of the payment in question exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

SECTION 9. *Limitations on Payments of Liquidated Fees.*

Notwithstanding any other provision hereof, all payments by the Original Participating Manufacturers with respect to Liquidated Fees shall be subject to the following:

(a) Under no circumstances shall the Original Participating Manufacturers be required to make any payment that would result in aggregate national payments of Liquidated Fees:

(i) during 1999, totaling more than $250 million;

(ii) with respect to any calendar quarter beginning with the first calendar quarter of 2000 and ending with the fourth calendar quarter of 2003, totaling more than $62.5 million, except to the extent that a payment with respect to any prior calendar quarter of any calendar year did not total $62.5 million; or

(iii) with respect to any calendar quarter after the fourth calendar quarter of 2003, totaling more than zero.

(b) The Original Participating Manufacturers' obligations with respect to the Liquidated Fee of STATE Outside Counsel, if any, shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, such Liquidated Fee shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

SECTION 10. *Fee Awards.*

(a) In the event that the Original Participating Manufacturers and STATE Outside Counsel do not agree in writing upon a Liquidated Fee as described in section 7 hereof, the Original Participating Manufacturers shall pay, pursuant to the terms hereof, the Fee Award awarded by the Panel to STATE Outside Counsel.

(b) The Original Participating Manufacturers' payment of any Fee Award pursuant to this STATE Fee Payment Agreement shall be subject to the payment schedule and the annual and quarterly aggregate national caps specified in sections 17 and 18 hereof, which shall apply to:

(i) all payments of Fee Awards in connection with an agreement to pay fees as part of the settlement of any Tobacco Case on terms that provide for payment by the Original Participating Manufacturers or other defendants acting in agreement with the Original Participating Manufacturers (collectively, "Participating Defendants") of fees with respect to any Private Counsel, subject to an annual cap on payment of all such fees; and

(ii) all payments of attorneys' fees (other than fees for attorneys of Participating Defendants) pursuant to Fee Awards for activities in connection with any Tobacco Case resolved by operation of Federal Legislation.

SECTION 11. *Composition of the Panel.*

(a) The first and the second members of the Panel shall both be permanent members of the Panel and, as such, will participate in the determination of all Fee Awards. The third Panel member shall not be a permanent Panel member, but instead shall be a state-specific member selected to determine Fee Awards on behalf of Private Counsel retained in connection with litigation within a single state. Accordingly, the third, state-specific member of the Panel for purposes of determining Fee Awards with respect to litigation in the State of STATE shall not participate in any determination as to any Fee Award with respect to litigation in any other state (unless selected to participate in such determinations by such persons as may be authorized to make such selections under other agreements).

(b) The members of the Panel shall be selected as follows:

(i) The first member shall be the natural person selected by Participating Defendants.

(ii) The second member shall be the person jointly selected by the agreement of Participating Defendants and a majority of the committee described in the fee payment agreements entered in connection with the settlements of the Tobacco Cases brought by the Previously Settled States. In the event that the person so selected is unable or unwilling to continue to serve, a replacement for such member shall be selected by agreement of the Original Participating Manufacturers and a majority of the members of a committee composed of the following members: Joseph F. Rice, Richard F. Scruggs, Steven W. Berman, Walter Umphrey, one additional representative, to be selected in the sole discretion of NAAG, and two representatives of Private Counsel in Tobacco Cases, to be selected at the sole discretion of the Original Participating Manufacturers.

(iii) The third, state-specific member for purposes of determining Fee Awards with respect to litigation in the State of STATE shall be a natural person selected by STATE Outside Counsel, who shall notify the Director and the Original Participating Manufacturers of the name of the person selected.

SECTION 12. *Application of STATE Outside Counsel.*

(a) STATE Outside Counsel shall make a collective Application for a single Fee Award, which shall be submitted to the Director. Within five Business Days after receipt of the Application by STATE Outside Counsel, the Director shall serve the Application upon the Original Participating Manufacturers and the STATE. The Original Participating Manufacturers shall submit all materials in response to the Application to the Director by the later of (i) 60 Business Days after service of the Application upon the Original Participating Manufacturers by the Director, (ii) five Business Days after the date of State-Specific Finality in the State of STATE or (iii) five Business Days after the date on which notice of the name of the third, state-specific panel member described in paragraph (b)(iii) of section 11 hereof has been provided to the Director and the Original Participating Manufacturers.

(b) The Original Participating Manufacturers may submit to the Director any materials that they wish and, notwithstanding any restrictions or representations made in any other agreements, the Original Participating Manufacturers shall be in no way constrained from contesting the amount of the Fee Award requested by STATE Outside Counsel. The Director, the Panel, the State of STATE, the Original Participating Manufacturers and STATE Outside Counsel shall preserve the confidentiality of any attorney work-product materials or other similar confidential information that may be submitted.

(c) The Director shall forward the Application of STATE Outside Counsel, as well as all written materials relating to such Application that have been submitted by the Original Participating Manufacturers pursuant to subsection (b) of this section, to the Panel within five Business Days after the later of (i) the expiration of the period for the Original Participating Manufacturers to submit such materials or (ii) the earlier of (A) the date on which the Panel issues a Fee Award with respect to any Application of other Private Counsel previously forwarded to the Panel by the Director or (B) 30 Business Days after the forwarding to the Panel of the Application of other Private Counsel most recently forwarded to the Panel by the Director. The Director shall notify the Parties upon forwarding the Application (and all written materials relating thereto) to the Panel.

(d) In the event that either Party seeks a hearing before the Panel, such Party may submit a request to the Director in writing within five Business Days after the forwarding of the Application of STATE Outside Counsel to the Panel by the Director, and the Director shall promptly forward the request to the Panel. If the Panel grants the request, it shall promptly set a date for hearing, such date to fall within 30 Business Days after the date of the Panel's receipt of the Application.

SECTION 13. *Panel Proceedings.*

The proceedings of the Panel shall be conducted subject to the terms of this Agreement and of the Protocol of Panel Procedures attached as an Appendix hereto.

SECTION 14. *Award of Fees to STATE Outside Counsel.*

The members of the Panel will consider all relevant information submitted to them in reaching a decision as to a Fee Award that fairly provides for full reasonable compensation of STATE Outside Counsel. In considering the amount of the Fee Award, the Panel shall not consider any Liquidated Fee agreed to by any other Outside Counsel, any offer of or negotiations relating to any proposed liquidated fee for STATE Outside Counsel or any Fee Award that already has been or yet may be awarded in connection with any other Tobacco Case. The Panel shall not be limited to an hourly-rate or lodestar analysis in determining the amount of the Fee Award of STATE Outside Counsel, but shall take into account the totality of the circumstances. The Panel's decisions as to the Fee Award of STATE Outside Counsel shall be in writing and shall report the amount of the fee awarded (with or without explanation or opinion, at the Panel's discretion). The Panel shall determine the amount of the Fee Award to be paid to STATE Outside Counsel within the later of 30 calendar days after receiving the Application (and all related materials) from the Director or 15 Business Days after the last date of any hearing held pursuant to subsection (d) of section 12 hereof. The Panel's decision as to the Fee Award of STATE Outside Counsel shall be final, binding and non-appealable.

SECTION 15. *Costs of Arbitration.*

All costs and expenses of the arbitration proceedings held by the Panel, including costs, expenses and compensation of the Director and of the Panel members (but not including any costs, expenses or compensation of counsel making applications to the Panel), shall be borne by the Original Participating Manufacturers in proportion to their Relative Market Shares.

SECTION 16. *Payment of Fee Award of STATE Outside Counsel.*

On or before the tenth Business Day after the last day of each calendar quarter beginning with the first calendar quarter of 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the Allocated Amount for STATE Outside Counsel for the calendar quarter with respect to which such quarterly payment is being made (the "Applicable Quarter").

SECTION 17. *Allocated Amounts of Fee Awards.*

The Allocated Amount for each Private Counsel with respect to any payment to be made for any particular Applicable Quarter shall be determined as follows:

(a) The Quarterly Fee Amount shall be allocated equally among each of the three months of the Applicable Quarter. The amount for each such month shall be allocated among those Private Counsel retained in connection with Tobacco Cases settled before or during such month (each such Private Counsel being an "Eligible Counsel" with respect to such monthly amount), each of which shall be allocated a portion of each such monthly amount up to (or, in the event that the sum of all Eligible Counsel's respective Unpaid Fees exceeds such monthly amount, in proportion to) the amount of such Eligible Counsel's Unpaid Fees. The monthly amount for each month of the calendar quarter shall be allocated among those Eligible Counsel having Unpaid Fees, without regard to whether there may be Eligible Counsel that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter. The allocation of subsequent Quarterly Fee Amounts for the calendar year, if any, shall be adjusted, as necessary, to account for any Eligible Counsel that are granted Fee Awards in a subsequent quarter of such calendar year, as provided in paragraph (b)(ii) of this section.

(b) In the event that the amount for a given month is less than the sum of the Unpaid Fees of all Eligible Counsel:

(i) in the case of the first quarterly allocation for any calendar year, such monthly amount shall be allocated among all Eligible Counsel for such month in proportion to the amounts of their respective Unpaid Fees.

(ii) in the case of a quarterly allocation after the first quarterly allocation, the Quarterly Fee Amount shall be allocated among only those Private Counsel, if any, that were Eligible Counsel with respect to any monthly amount for any prior quarter of the calendar year but were not allocated a proportionate share of such monthly amount (either because such Private Counsel's applications for Fee Awards were still under consideration as of the last day of the calendar quarter containing the month in question or for any other reason), until each such Eligible Counsel has been allocated a proportionate share of all such prior monthly payments for the calendar year (each such share of each such Eligible Counsel being a "Payable Proportionate Share"). In the event that the sum of all Payable Proportionate Shares exceeds the Quarterly Fee Amount, the Quarterly Fee Amount shall be allocated among such Eligible Counsel on a monthly basis in proportion to the amounts of their respective Unpaid Fees (without regard to whether there may be other Eligible Counsel with respect to such prior monthly amounts that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter). In the event that the sum of all Payable Proportionate Shares is less than the Quarterly Fee Amount, the amount by which the Quarterly Fee Amount exceeds the sum of all such Payable Proportionate Shares shall be allocated among each month of the calendar quarter, each such monthly amount to be allocated among those Eligible Counsel having Unpaid Fees in proportion to the amounts of their respective Unpaid Fees (without regard to whether there may be Eligible Counsel that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter).

(c) Adjustments pursuant to subsection (b)(ii) of this section 17 shall be made separately for each calendar year. No amounts paid in any calendar year shall be subject to refund, nor shall any payment in any given calendar year affect the allocation of payments to be made in any subsequent calendar year.

SECTION 18. *Credits to and Limitations on Payment of Fee Awards.*

Notwithstanding any other provision hereof, all payments by the Original Participating Manufacturers with respect to Fee Awards shall be subject to the following:

(a) Under no circumstances shall the Original Participating Manufacturers be required to make payments that would result in aggregate national payments and credits by Participating Defendants with respect to all Fee Awards of Private Counsel:

(i) during any year beginning with 1999, totaling more than the sum of the Quarterly Fee Amounts for each calendar quarter of the calendar year, excluding certain payments with respect to any Private Counsel for 1998 that are paid in 1999; and

(ii) during any calendar quarter beginning with the first calendar quarter of 1999, totaling more than the Quarterly Fee Amount for such quarter, excluding certain payments with respect to any Private Counsel for 1998 that are paid in 1999.

(b) The Original Participating Manufacturers' obligations with respect to the Fee Award of STATE Outside Counsel, if any, shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, such Fee Award shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

SECTION 19. *Reimbursement of Outside Counsel's Costs.*

(a) The Original Participating Manufacturers shall reimburse STATE Outside Counsel for reasonable costs and expenses incurred in connection with the Action, provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers ordinarily reimburse their own counsel or agents. Payment of any Approved Cost Statement pursuant to this STATE Fee Payment Agreement shall be subject to (i) the condition precedent of approval of the Agreement by the Court for the State of STATE and (ii) the payment schedule and the aggregate national caps specified in subsection (c) of this section, which shall apply to all payments made with respect to Cost Statements of all Outside Counsel.

(b) In the event that STATE Outside Counsel seek to be reimbursed for reasonable costs and expenses incurred in connection with the Action, the Designated Representative shall submit a Cost Statement to the Original Participating Manufacturers. Within 30 Business Days after receipt of any such Cost Statement, the Original Participating Manufacturers shall either accept the Cost Statement or dispute the Cost Statement, in which event the Cost Statement shall be subject to a full audit by examiners to be appointed by the Original Participating Manufacturers (in their sole discretion). Any such audit will be completed within 120 Business Days after the date the Cost Statement is received by the Original Participating Manufacturers. Upon completion of such audit, if the Original Participating Manufacturers and STATE Outside Counsel cannot agree as to the appropriate amount of STATE Outside Counsel's reasonable costs and expenses, the Cost Statement and the examiner's audit report shall be submitted to the Director for arbitration before the Panel or, in the event that STATE Outside Counsel and the Original Participating Manufacturers have agreed upon a Liquidated Fee pursuant to section 7 hereof, before a separate three-member panel of independent arbitrators, to be selected in a manner to be agreed to by STATE Outside Counsel and the Original Participating Manufacturers, which shall determine the amount of STATE Outside Counsel's reasonable costs and expenses for the Action. In determining such reasonable costs and expenses, the members of the arbitration panel shall be governed by the Protocol of Panel Procedures attached as an Appendix hereto. The amount of

STATE Outside Counsel's reasonable costs and expenses determined pursuant to arbitration as provided in the preceding sentence shall be final, binding and non-appealable.

(c) Any Approved Cost Statement of STATE Outside Counsel shall not become a Payable Cost Statement until approval of the Agreement by the Court for the State of STATE. Within five Business Days after receipt of notification thereof by the Designated Representative, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the Payable Cost Statement of STATE Outside Counsel, subject to the following:

(i) All Payable Cost Statements of Outside Counsel shall be paid in the order in which such Payable Cost Statements became Payable Cost Statements.

(ii) Under no circumstances shall the Original Participating Manufacturers be required to make payments that would result in aggregate national payments by Participating Defendants of all Payable Cost Statements of Private Counsel in connection with all of the actions identified in Exhibits D, M and N to the Agreement, totaling more than $75 million for any given year.

(iii) Any Payable Cost Statement of Outside Counsel not paid during the year in which it became a Payable Cost Statement as a result of paragraph (ii) of this subsection shall become payable in subsequent years, subject to paragraphs (i) and (ii), until paid in full.

(d) The Original Participating Manufacturers' obligations with respect to reasonable costs and expenses incurred by STATE Outside Counsel in connection with the Action shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, any Approved Cost Statement determined pursuant to subsection (b) of this section (including any Approved Cost Statement determined pursuant to arbitration before the Panel or the separate three-member panel of independent arbitrators described therein) shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other incumbrance.

SECTION 20. *Distribution of Payments among STATE Outside Counsel.*

(a) All payments made to the Designated Representative pursuant to this STATE Fee Payment Agreement shall be for the benefit of each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], each of which shall receive from the Designated Representative a percentage of each such payment in accordance with the fee sharing agreement, if any, among STATE Outside Counsel (or any written amendment thereto).

(b) The Original Participating Manufacturers shall have no obligation, responsibility or liability with respect to the allocation among those persons or entities identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], or with respect to any claim of misallocation, of any amounts paid to the Designated Representative pursuant to this STATE Fee Payment Agreement.

SECTION 21. *Calculations of Amounts.*

All calculations that may be required hereunder shall be performed by the Original Participating Manufacturers, with notice of the results thereof to be given promptly to the Designated Representative. Any disputes as to the correctness of calculations made by the Original Participating Manufacturers shall be resolved pursuant to the procedures described in Section XI(c) of the Agreement for resolving disputes as to calculations by the Independent Auditor.

SECTION 22. *Payment Responsibility.*

(a) Each Original Participating Manufacturer shall be severally liable for its share of all payments pursuant to this STATE Fee Payment Agreement. Under no circumstances shall any payment due hereunder or any portion thereof become the joint obligation of the Original Participating Manufacturers or the obligation of any person other than the Original Participating Manufacturer from which such payment is originally due, nor shall any Original Participating Manufacturer be required to pay a portion of any such payment greater than its Relative Market Share.

(b) Due to the particular corporate structures of R. J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("Brown & Williamson") with respect to their non-domestic tobacco operations, Reynolds and Brown & Williamson shall each be severally liable for its respective share of each payment due pursuant to this STATE Fee Payment Agreement up to (and its liability hereunder shall not exceed) the full extent of its assets used in, and earnings and revenues derived from, its manufacture and sale in the United States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of its other assets or earnings to satisfy such obligations.

SECTION 23. *Termination.*

In the event that the Agreement is terminated with respect to the State of STATE pursuant to Section XVIII(u) of the Agreement (or for any other reason) the Designated Representative and each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision] shall immediately refund to the Original Participating Manufacturers all amounts received under this STATE Fee Payment Agreement.

SECTION 24. *Intended Beneficiaries.*

No provision hereof creates any rights on the part of, or is enforceable by, any person or entity that is not a Party or a person covered by either of the releases described in section 4 hereof, except that sections 5 and 20 hereof create rights on the part of, and shall be enforceable by, the State of STATE. Nor shall any provision hereof bind any non-signatory or determine, limit or prejudice the rights of any such person or entity.

SECTION 25. *Representations of Parties.*

The Parties hereto hereby represent that this STATE Fee Payment Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of the Parties hereto.

SECTION 26. *No Admission.*

This STATE Fee Payment Agreement is not intended to be and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of any liability or wrongdoing whatsoever on the part of any signatory hereto or any person covered by either of the releases provided under section 4 hereof. The Original Participating Manufacturers specifically disclaim and deny any liability or wrongdoing whatsoever with respect to the claims released under section 4 hereof and enter into this STATE Fee Payment Agreement for the sole purposes of memorializing the Original Participating Manufacturers' rights and obligations with respect to payment of attorneys' fees pursuant to the Agreement and avoiding the further expense, inconvenience, burden and uncertainty of potential litigation.

SECTION 27. *Non-admissibility.*

This STATE Fee Payment Agreement having been undertaken by the Parties hereto in good faith and for settlement purposes only, neither this STATE Fee Payment Agreement nor any evidence of negotiations relating hereto shall be offered or received in evidence in any action or proceeding other than an action or proceeding arising under this STATE Fee Payment Agreement.

SECTION 28. *Amendment and Waiver.*

This STATE Fee Payment Agreement may be amended only by a written instrument executed by the Parties. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving Party. The waiver by any Party of any breach hereof shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this STATE Fee Payment Agreement.

SECTION 29. *Notices.*

All notices or other communications to any party hereto shall be in writing (including but not limited to telex, facsimile or similar writing) and shall be given to the notice parties listed on Schedule A hereto at the addresses therein indicated. Any Party hereto may change the name and address of the person designated to receive notice on behalf of such Party by notice given as provided in this section including an updated list conformed to Schedule A hereto.

SECTION 30. *Governing Law.*

This STATE Fee Payment Agreement shall be governed by the laws of the State of STATE without regard to the conflict of law rules of such State.

SECTION 31. *Construction.*

None of the Parties hereto shall be considered to be the drafter hereof or of any provision hereof for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter hereof.

SECTION 32. *Captions.*

The captions of the sections hereof are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 33. *Execution of STATE Fee Payment Agreement.*

This STATE Fee Payment Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered valid signatures as of the date hereof, although the original signature pages shall thereafter be appended to this STATE Fee Payment Agreement.

SECTION 34. *Entire Agreement of Parties.*

This STATE Fee Payment Agreement contains an entire, complete and integrated statement of each and every term and provision agreed to by and among the Parties with respect to payment of attorneys' fees by the Original Participating Manufacturers in connection with the Action and is not subject to any condition or covenant, express or implied, not provided for herein.

IN WITNESS WHEREOF, the Parties hereto, through their fully authorized representatives, have agreed to this STATE Fee Payment Agreement as of this __th day of ________, 1998.

[SIGNATURE BLOCK]

APPENDIX
to MODEL FEE PAYMENT AGREEMENT

PROTOCOL OF PANEL PROCEEDINGS

This Protocol of procedures has been agreed to between the respective parties to the STATE Fee Payment Agreement, and shall govern the arbitration proceedings provided for therein.

SECTION 1. *Definitions.*

All definitions contained in the STATE Fee Payment Agreement are incorporated by reference herein.

SECTION 2. *Chairman.*

The person selected to serve as the permanent, neutral member of the Panel as described in paragraph (b)(ii) of section 11 of the STATE Fee Payment Agreement shall serve as the Chairman of the Panel.

SECTION 3. *Arbitration Pursuant to Agreement.*

The members of the Panel shall determine those matters committed to the decision of the Panel under the STATE Fee Payment Agreement, which shall govern as to all matters discussed therein.

SECTION 4. *ABA Code of Ethics.*

Each of the members of the Panel shall be governed by the *Code of Ethics for Arbitrators in Commercial Disputes* prepared by the American Arbitration Association and the American Bar Association (the "*Code of Ethics*") in conducting the arbitration proceedings pursuant to the STATE Fee Payment Agreement, subject to the terms of the STATE Fee Payment Agreement and this Protocol. Each of the party-appointed members of the Panel shall be governed by Canon VII of the *Code of Ethics*. No person may engage in any *ex parte* communications with the permanent, neutral member of the Panel selected pursuant to paragraph (b)(ii) of section 11, in keeping with Canons I, II and III of the *Code of Ethics*.

SECTION 5. *Additional Rules and Procedures.*

The Panel may adopt such rules and procedures as it deems necessary and appropriate for the discharge of its duties under the STATE Fee Payment Agreement and this Protocol, subject to the terms of the STATE Fee Payment Agreement and this Protocol.

SECTION 6. *Majority Rule.*

In the event that the members of the Panel are not unanimous in their views as to any matter to be determined by them pursuant to the STATE Fee Payment Agreement or this Protocol, the determination shall be decided by a vote of a majority of the three members of the Panel.

SECTION 7. *Application for Fee Award and Other Materials.*

(a) The Application of STATE Outside Counsel and any materials submitted to the Director relating thereto (collectively, "submissions") shall be forwarded by the Director to each of the members of the Panel in the manner and on the dates specified in the STATE Fee Payment Agreement.

(b) All materials submitted to the Director by either Party (or any other person) shall be served upon all Parties. All submissions required to be served on any Party shall be deemed to have been served as of the date on which such materials have been sent by either (i) hand delivery or (ii) facsimile and overnight courier for priority next-day delivery.

(c) To the extent that the Panel believes that information not submitted to the Panel may be relevant for purposes of determining those matters committed to the decision of the Panel under the terms of the STATE Fee Payment Agreement, the Panel shall request such information from the Parties.

SECTION 8. *Hearing.*

Any hearing held pursuant to section 12 of the STATE Fee Payment Agreement shall not take place other than in the presence of all three members of the Panel upon notice and an opportunity for the respective representatives of the Parties to attend.

SECTION 9. *Miscellaneous.*

(a) Each member of the Panel shall be compensated for his services by the Original Participating Manufacturers on a basis to be agreed to between such member and the Original Participating Manufacturers.

(b) The members of the Panel shall refer all media inquiries regarding the arbitration proceeding to the respective Parties to the STATE Fee Payment Agreement and shall refrain from any comment as to the arbitration proceedings to be conducted pursuant to the STATE Fee Payment Agreement during the pendency of such arbitration proceedings, in keeping with Canon IV(B) of the *Code of Ethics*.

EXHIBIT P
NOTICES

[Intentionally Omitted]

EXHIBIT Q
1996 AND 1997 DATA

(1) 1996 Operating Income

Original Participating Manufacturer	Operating Income
Brown & Williamson Tobacco Corp.	$801,640,000
Lorillard Tobacco Co.	$719,100,000
Philip Morris Inc.	$4,206,600,000
R.J. Reynolds Tobacco Co.	$1,468,000,000
Total (Base Operating Income)	$7,195,340,000

(2) 1997 volume (as measured by shipments of Cigarettes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,911,000,000
Lorillard Tobacco Co.	42,288,000,000
Philip Morris Inc.	236,203,000,000
R.J. Reynolds Tobacco Co.	118,254,000,000
Total (Base Volume)	475,656,000,000

(3) 1997 volume (as measured by excise taxes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,758,000,000
Lorillard Tobacco Co.	42,315,000,000
Philip Morris Inc.	236,326,000,000
R.J. Reynolds Tobacco Co.	119,099,000,000

* The volume includes 2,847,595 pounds of "roll your own" tobacco converted into the number of Cigarettes using 0.0325 ounces per Cigarette conversion factor.

EXHIBIT R
EXCLUSION OF CERTAIN BRAND NAMES

Brown & Williamson Tobacco Corporation
GPC
State Express 555
Riviera

Philip Morris Incorporated
Players
B&H
Belmont
Mark Ten
Viscount
Accord
L&M
Lark
Rothman's
Best Buy
Bronson
F&L
Genco
GPA
Gridlock
Money
No Frills
Generals
Premium Buy
Shenandoah
Top Choice

Lorillard Tobacco Company
None

R.J. Reynolds Tobacco Company
Best Choice
Cardinal
Director's Choice
Jacks
Rainbow
Scotch Buy
Slim Price
Smoker Friendly
Valu Time
Worth

EXHIBIT S
DESIGNATION OF OUTSIDE COUNSEL

[Intentionally Omitted]

EXHIBIT T
MODEL STATUTE

Section __. Findings and Purpose.[1]

(a) Cigarette smoking presents serious public health concerns to the State and to the citizens of the State. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the State. Under certain health-care programs, the State may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the State pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

(d) It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts.

(e) On _______, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the State. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the State (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

(f) It would be contrary to the policy of the State if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the State will have an eventual source of recovery from them if they are proven to have acted culpably. It is thus in the interest of the State to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise.

Section __. Definitions.

(a) "Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

(b) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of ten percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(c) "Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

(d) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

(e) "Master Settlement Agreement" means the settlement agreement (and related documents) entered into on _______, 1998 by the State and leading United States tobacco product manufacturers.

(f) "Qualified escrow fund" means an escrow arrangement with a federally or State chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least $1,000,000,000 where such arrangement requires that such financial institution hold the escrowed funds' principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing or directing the use of the funds' principal except as consistent with section ___(b)-(c) of this Act.

(g) "Released claims" means Released Claims as that term is defined in the Master Settlement Agreement.

(h) "Releasing parties" means Releasing Parties as that term is defined in the Master Settlement Agreement.

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[1] [A State may elect to delete the "findings and purposes" section in its entirety. Other changes or substitutions with respect to the "findings and purposes" section (except for particularized state procedural or technical requirements) will mean that the statute will no longer conform to this model.]

(i) "Tobacco Product Manufacturer" means an entity that after the date of enactment of this Act directly (and not exclusively through any affiliate):

(1) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsections II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

(2) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(3) becomes a successor of an entity described in paragraph (1) or (2).

The term "Tobacco Product Manufacturer" shall not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within any of (1) - (3) above.

(j) "Units sold" means the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State. The [fill in name of responsible state agency] shall promulgate such regulations as are necessary to ascertain the amount of State excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

Section __. Requirements.

Any tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary or intermediaries) after the date of enactment of this Act shall do one of the following:

(a) become a participating manufacturer (as that term is defined in section II(jj) of the Master Settlement Agreement) and generally perform its financial obligations under the Master Settlement Agreement; or

(b) (1) place into a qualified escrow fund by April 15 of the year following the year in question the following amounts (as such amounts are adjusted for inflation) --

1999: $.0094241 per unit sold after the date of enactment of this Act;[2]

2000: $.0104712 per unit sold after the date of enactment of this Act;[3]

for each of 2001 and 2002: $.0136125 per unit sold after the date of enactment of this Act;

for each of 2003 through 2006: $.0167539 per unit sold after the date of enactment of this Act;

for each of 2007 and each year thereafter: $.0188482 per unit sold after the date of enactment of this Act.

(2) A tobacco product manufacturer that places funds into escrow pursuant to paragraph (1) shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances --

(A) to pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the State or any releasing party located or residing in the State. Funds shall be released from escrow under this subparagraph (i) in the order in which they were placed into escrow and (ii) only to the extent and at the time necessary to make payments required under such judgment or settlement;

(B) to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the State's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement (as determined pursuant to section IX(i)(2) of the Master Settlement Agreement, and before any of the adjustments or offsets described in section IX(i)(3) of that Agreement other than the Inflation Adjustment) had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or

(C) to the extent not released from escrow under subparagraphs (A) or (B), funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

(3) Each tobacco product manufacturer that elects to place funds into escrow pursuant to this subsection shall annually certify to the Attorney General [or other State official] that it is in compliance with this subsection. The Attorney General [or other State official] may bring a civil action on behalf of the State against any tobacco product

[2] [All per unit numbers subject to verification]

[3] [The phrase "after the date of enactment of this Act" would need to be included only in the calendar year in which the Act is enacted.]

manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall --

(A) be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 5 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100 percent of the original amount improperly withheld from escrow;

(B) in the case of a knowing violation, be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 15 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300 percent of the original amount improperly withheld from escrow; and

(C) in the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed 2 years.

Each failure to make an annual deposit required under this section shall constitute a separate violation.[4]

[4] [A State may elect to include a requirement that the violator also pay the State's costs and attorney's fees incurred during a successful prosecution under this paragraph (3).]

EXHIBIT U
STRATEGIC CONTRIBUTION FUND PROTOCOL

The payments made by the Participating Manufacturers pursuant to section IX(c)(2) of the Agreement ("Strategic Contribution Fund") shall be allocated among the Settling States pursuant to the process set forth in this Exhibit U.

Section 1

A panel committee of three former Attorneys General or former Article III judges ("Allocation Committee") shall be established to determine allocations of the Strategic Contribution Fund, using the process described herein. Two of the three members of the Allocation Committee shall be selected by the NAAG executive committee. Those two members shall choose the third Allocation Committee member. The Allocation Committee shall be geographically and politically diverse.

Section 2

Within 60 days after the MSA Execution Date, each Settling State will submit an itemized request for funds from the Strategic Contribution Fund, based on the criteria set forth in Section 4 of this Exhibit U.

Section 3

The Allocation Committee will determine the appropriate allocation for each Settling State based on the criteria set forth in Section 4 below. The Allocation Committee shall make its determination based upon written documentation.

Section 4

The criteria to be considered by the Allocation Committee in its allocation decision include each Settling State's contribution to the litigation or resolution of state tobacco litigation, including, but not limited to, litigation and/or settlement with tobacco product manufacturers, including Liggett and Myers and its affiliated entities.

Section 5

Within 45 days after receiving the itemized requests for funds from the Settling States, the Allocation Committee will prepare a preliminary decision allocating the Strategic Contribution Fund payments among the Settling States who submitted itemized requests for funds. All Allocation Committee decisions must be by majority vote. Each Settling State will have 30 days to submit comments on or objections to the draft decision. The Allocation Committee will issue a final decision allocating the Strategic Contribution Fund payments within 45 days.

Section 6

The decision of the Allocation Committee shall be final and non-appealable.

Section 7

The expenses of the Allocation Committee, in an amount not to exceed $100,000, will be paid from disbursements from the Subsection VIII(c) Account.

APPENDIX C

PROPOSED FORM OF OPINION OF BOND COUNSEL

PHONE (212) 820-9300
FAX (212) 514-8425

ONE CHASE MANHATTAN PLAZA
NEW YORK, NY 10005
WWW.HAWKINS.COM

NEW YORK
WASHINGTON
NEWARK
HARTFORD
LOS ANGELES
SACRAMENTO
SAN FRANCISCO

June 27, 2007

Tobacco Settlement Financing Corporation
Providence, Rhode Island

Ladies and Gentlemen:

We have examined the Constitution and laws of the State of Rhode Island and Providence Plantations (the "State") and a record of proceedings relating to the issuance of $197,005,742.20 aggregate principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2007 (the "Bonds"), of the Tobacco Settlement Financing Corporation (the "Corporation"), a public corporation of the State having a legal existence distinct from the State, created by and existing under the Tobacco Settlement Financing Corporation Act, Article 8 of Chapter 65 of the Public Laws of 2002, as amended by Chapter 66 of the Public Laws of 2002, codified at R.I.G.L. Section 42-133-1 *et seq.*, and Chapter 45 of the Public Laws of 2007 (the "Act").

In such examinations, we have assumed the genuineness of all signatures, the authenticity of all documents submitted to us as originals and the conformity with originals of all documents submitted to us as copies thereof.

The Bonds are authorized and issued pursuant to the Act and a resolution of the Corporation duly adopted by its Board on June 8, 2007, and are issued pursuant to the Indenture, and supplements thereto authorized by said resolution, by and between the Corporation and Wells Fargo Bank, N.A., as trustee (the "Trustee"), dated as of June 1, 2007 (the "Indenture"). Capitalized terms used herein and not defined herein are used as defined in the Indenture.

In rendering our opinion, we have relied, to the extent we deemed such reliance proper, on certain representations, certifications of fact, and statements of reasonable expectation made by the Corporation and the State in connection with the Bonds, and certain opinions provided to us, and we have assumed compliance by the Corporation and the State with certain ongoing covenants to comply with applicable requirements of the Internal Revenue Code of 1986, as amended (the "Code"), to assure the exclusion of interest on the Bonds from gross income under Section 103 of the Code. We have assumed the due authorization, execution and delivery of the Purchase and Sale Agreement by the State and of the Indenture by the Trustee. We have also assumed the enforceability of the Purchase and Sale Agreement against the State and the enforceability of the Indenture against the Trustee, each in accordance with its respective terms.

We undertake no responsibility for the accuracy, completeness or fairness of any Offering Circular or other offering material relating to the Bonds and we express no opinion with respect thereto.

Subject to the foregoing, we are of the opinion that:

1. Under the laws of the State, including the Constitution of the State, and under the Constitution of the United States, the Act is valid with respect to all provisions thereof material to the subject matters of this opinion letter.

2. The Corporation is duly created and established and validly existing under the Act as a public corporation of the State, having a legal existence distinct from the State and not constituting a department of the State government, with the good right and lawful authority and power to enter into the Indenture and the Purchase and Sale Agreement, to perform the duties and obligations of the Corporation under the Indenture and the Purchase and Sale Agreement, and to issue the Bonds.

3. Each of the Purchase and Sale Agreement and the Indenture has been duly and lawfully authorized, executed and delivered by the Corporation, is in full force and effect and is the legal, valid and binding agreement of the Corporation, enforceable in accordance with its terms.

4. The Indenture creates the valid pledge of, and first-priority security interest in, the Collateral (including, without limitation, the Residual Pledged TSRs) that it purports to create. Pursuant to the Act, the lien of such pledge and security interest is valid and binding as against all parties asserting or having claims of any kind in tort, contract or otherwise against the Corporation, irrespective of whether such parties have notice thereof.

5. The Bonds have been duly and validly authorized and issued by the Corporation in accordance with provisions of the Indenture and are valid and binding special revenue obligations of the Corporation, payable solely and only out of the Collateral pledged by the Corporation under the Indenture in Section 2.01 thereof.

6. The Bonds are not a debt, liability, or obligation of the State or of any political subdivision thereof other than the Corporation, or a pledge of the faith and credit of the State or any political subdivision, but shall be payable solely from the assets of the Corporation pledged therefor.

7. Under existing statutes and court decisions, interest on the Bonds (i) is excluded from the gross income of the owners for Federal income tax purposes pursuant to Section 103 of the Code, and (ii) is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

8. Under the Act, income on the Bonds, including any profit made on the sale thereof, is free from taxation by the State, except for inheritance, estate and gift taxes. Interest on the Bonds may be included in the measure of certain business and corporate taxes.

We express no opinion regarding any other tax consequences with respect to the Bonds. We render our opinion under existing statutes and court decisions as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any action hereafter taken or not taken, or any facts or circumstances that may hereafter come to our attention, or changes in law or in interpretations thereof that may hereafter occur, or for any other reason. Except to the extent of our concurrence therewith, we express no opinion on the effect of any action taken or not taken after the date of our opinion in reliance on an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of the interest on the Bonds or under State or local tax law.

Very truly yours,

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APPENDIX D

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

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THE INDENTURE

The following summary describes certain terms of the Indenture pursuant to which the Bonds will be issued. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee.

Directors and State Not Liable on Bonds

Neither the members, directors or officers of the Corporation nor any person executing Bonds or other obligations of the Corporation nor any official, employee or agent of the Corporation will be liable personally or be subject to any personal liability or accountability solely by reason of the issuance of the Indenture.

Bonds issued by the Corporation are payable solely and only out of the monies, assets, or revenues pledged by the Corporation, and are not a general obligation or indebtedness of the Corporation or an obligation or indebtedness of the State or any subdivision of the State. The Corporation has no power or authorization to pledge the credit or taxing power of the State or any political subdivision of the State, or create a debt or obligation of the State, or make its debts payable out of any monies except monies of the Corporation. (Section 1.03)

Security and Pledge

In trust upon the terms set forth in the Indenture, the Corporation pledges to the Trustee, and grants to the Trustee a first lien and security interest in, all of the Corporation's right, title and interest, whether now owned or thereafter acquired, in, to and under the "Collateral," consisting of: (a) the Revenues, (b) all rights to receive the Revenues and the proceeds of such rights, (c) all Accounts and assets of the Indenture, including money, contract rights, general intangibles or other personal property, held by the Trustee under the Indenture, (d) subject to the following sentence, all rights and interest of the Corporation under the Agreement, including the representations, warranties and covenants of the State in the Agreement and (e) any and all other property of every kind and nature from time to time thereafter, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture. Except as specifically provided under the Indenture, the Collateral does not include: (i) the rights of the Corporation to the receipt of the Pledged TSRs under the 2002 Indenture and the 2002 Agreement before the 2002 Bonds are deemed paid under the 2002 Indenture, (ii) the rights of the Corporation pursuant to provisions for consent or other action by the Corporation, notice to the Corporation, indemnity or the filing of documents with the Corporation, or otherwise for its benefit and not for that of the Beneficiaries, or (iii) any right or power reserved to the Corporation pursuant to the Act or other law; nor does Section 2.01 of the Indenture preclude the Corporation's enforcement of its rights under and pursuant to the Agreement for the benefit of the Beneficiaries as provided under the Indenture. Unless otherwise specified in the Series Supplement applicable thereto, the proceeds of any Bonds do not constitute any portion of the Residual Tobacco Assets, are not pledged to the holders of such Bonds and are not subject to the lien of the Indenture. The Corporation will implement, protect and defend this grant of a security interest and pledge by all appropriate legal action, the cost thereof to be an Operating Expense. The Collateral is pledged and a security interest is therein granted to secure the payment of Bonds, the Remainder Certificate and payments in respect of Swap Contracts and Ancillary Contracts, all with the respective priorities specified therein. The pledge and

assignment made by the Indenture and the covenants and agreements to be performed by or on behalf of the Corporation will be for the equal and ratable benefit, protection and security of the Holders of any and all of the Outstanding Bonds, all of which, regardless of the time or times of their issue or maturity, will be of equal rank without preference, priority or distinction of such Bonds over any other Bonds except as expressly provided therein or permitted under the Indenture. The lien of such pledge and the obligation to perform the contractual provisions under the Indenture made will have priority over any or all other obligations and liabilities of the Corporation secured by the Revenues. The Corporation will not incur any obligations, except as authorized under the Indenture, secured by a lien on the Revenue Account equal or prior to the lien thereof.

Defeasance

When (a) there is held by or for the account of the Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities as will provide sufficient funds to pay or redeem all or any portion of the Outstanding Bonds in accordance with their terms and all or any portion of the obligations to Beneficiaries (including parties to Swap Contracts and Ancillary Contracts (the holders of said Bonds and such Beneficiaries therein called the "Defeased Beneficiaries")) (to be verified by a nationally recognized firm of independent certified public accountants), (b) any required notice of redemption will have been duly given in accordance with the Indenture or irrevocable written instructions to give notice will have been given to the Trustee, and (c) all the rights under the Indenture of the Fiduciary have been provided for, then upon written notice from the Corporation to the Trustee, such Defeased Beneficiaries will cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien, the security interests created by the Indenture with respect to such Defeased Beneficiaries (except in such funds and investments) will terminate, and the Corporation and the Trustee will execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created under the Indenture and to make the Residual Pledged TSRs payable to the order of the holder of the Remainder Certificate. Upon such defeasance, the funds and investments required to pay or redeem the Bonds and other obligations to such Defeased Beneficiaries will be irrevocably set aside for that purpose, subject, however, to the provisions of the Indenture, and money held for defeasance will be invested only as provided in the provisions of the Indenture and applied by the Trustee and other Paying Agents, if any, to the retirement of the Bonds and such other obligations. Upon defeasance of all Outstanding Bonds and Beneficiaries, any funds or property held by the Trustee and not required for payment or redemption of the Bonds and such other obligations to Beneficiaries and Fiduciaries in full will be distributed to the order of the State. The requirements for defeasance of Turbo Term Bonds will be as set forth in the Series Supplement pursuant to which such Turbo Term Bonds were issued. (Section 2.02)

Bonds of the Corporation

By Series Supplement complying procedurally and in substance with the Indenture, the Corporation may authorize, issue, sell and deliver (1) the Series 2007 Bonds and (2) other Series of Bonds from time to time in such principal amounts as the Corporation will determine. (Section 3.01)

Accounts

The following Accounts have been established and will be held and maintained by the Trustee:

Revenue Account;

Operating Account;

Debt Service Account;

Debt Service Reserve Account;

Extraordinary Prepayment Account;

Lump Sum Prepayment Account; and

Turbo Redemption Account

Eligible investments may be made into the foregoing Accounts by the Trustee. (Section 4.01)

Redemption and Prepayment of the Bonds

The Corporation may redeem Bonds at its option in accordance with their terms and, will redeem Bonds in accordance with their terms pursuant to any mandatory redemption ("sinking fund") requirements established by Series Supplement. When Bonds are called for redemption, the Principal thereof will become due on the redemption date. To the extent not otherwise provided, the Corporation will deposit with the Trustee on or prior to the redemption date a sufficient sum to pay Principal or Accreted Value, redemption premium, if any, and accrued interest.

When a Bond is to be redeemed prior to its Maturity Date, the Trustee will give notice in the name of the Corporation, which notice will identify the Bonds to be redeemed, state the date fixed for redemption and state that such Bonds will be redeemed at the corporate trust office of the Trustee or a Paying Agent. The notice will further state that on such date there will become due and payable upon each Bond to be redeemed the redemption price thereof, and that money therefor having been deposited with the Trustee or Paying Agent on or prior to the redemption date, from and after such date, interest thereon will cease to accrue or accrete. The Trustee will give 15 days' notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions under the Indenture, to the registered owners of any Bonds which are to be redeemed, at their addresses shown on the registration books of the Corporation. Such notice may be waived by any Holder of Bonds to be redeemed. Failure by a particular Holder to receive notice, or any defect in the notice to such Holder, will not affect the redemption of any other Bond. Any notice of redemption given pursuant to the Indenture may be rescinded by written notice to the Trustee by the Corporation no later than 2 days prior to the date specified for redemption. The Trustee will give notice of such rescission as soon thereafter as practicable in the same manner and to the same persons, as notice of such redemption was given as described above. (Section 4.06)

Turbo Redemptions

The Bonds are subject to mandatory redemption prior to their stated maturity dates in Authorized Denominations, in whole or in part, from amounts on deposit in the Turbo Redemption Account on any Distribution Date for which notice can be given, at the redemption price of 100% of the Principal or Accreted Value and interest thereof, as applicable, without premium; provided, however, that any such redemption shall be in a minimum maturity value of Authorized Denominations. Amounts in the Turbo Redemption Account may not be applied to the purchase of Bonds on the open market. Any redemption of Bonds pursuant to this subsection (f) shall be made by Series in accordance with the Payment Priorities and Pro Rata within each Series. For purpose of defeasance, Bonds shall have the related assumed redemption requirements set forth in the Turbo Defeasance Schedule attached to the Series Supplement. (Section 4.06)

Investments

Pending its use under the Indenture, money in the Accounts may be invested by the Trustee in Eligible Investments maturing or redeemable at the option of the holder at or before the time when such money is expected to be needed and shall be so invested pursuant to written direction of the Corporation if there is not then an Event of Default actually known to an Authorized Officer of the Trustee. Eligible Investments shall mature or be redeemable at the option of the Corporation on or before the Business Day preceding each next succeeding Distribution Date, except to the extent that other Eligible Investments timely mature or are so redeemable in an amount sufficient to make payments under the Indenture on the next succeeding Distribution Date. Investments shall be held by the Trustee in the respective Accounts and shall be sold or redeemed to the extent necessary to make payments or transfers from each Account. The Trustee shall not be liable for any losses on investments made at the direction of the Corporation.

In computing the amount in any Account, the value of Eligible Investments shall be determined by the Trustee at least as frequently as each Distribution Date and shall be calculated as follows:

(i) As to investments the bid and asked prices of which are published on a regular basis in *The Wall Street Journal* (or, if not there, then in *The New York Times*): the average of the bid and asked prices for such investments so published on or most recently prior to such time of determination;

(ii) As to investments the bid and asked prices of which are not published on regular basis in *The Wall Street Journal* or *The New York Times*: the average bid price at such time of determination for such investments by any two nationally recognized government securities dealers (selected by the Trustee in its absolute discretion) at the time making a market in such investments or the bid price published by a nationally recognized pricing service;

(iii) As to certificates of deposit and bankers acceptances: the face amount thereof, plus accrued interest; and

(iv) As to any investment not specified above: the value thereof established by prior agreement between the Corporation and the Trustee.

The Trustee may hold undivided interests in Eligible Investments for more than one Account (for which they are eligible, but not including the Rebate Account) and may make interfund transfers in kind.

In respect of Defeasance Collateral held for Defeased Bonds, the provisions of the Indenture summarized under the caption "Investments" shall be effective only to the extent it is consistent with other applicable provisions of the Indenture or any separate escrow agreement. (Section 4.06)

Contract; Obligations to Beneficiaries.

In consideration of the purchase and acceptance of any or all of the Bonds and Swap Contracts and Ancillary Contracts by those who shall hold the same from time to time, the provisions of the Indenture shall be a part of the contract of the Corporation with the Beneficiaries. The pledge made in the Indenture and the covenants set forth under the Indenture to be performed by the Corporation will be for the equal benefit, protection and security of the Beneficiaries of the same priority. All of the Bonds or payments on Swap Contracts or Ancillary Contracts of the same priority, regardless of the time or times of their issuance or maturity, shall be of equal rank without preference, priority or distinction of any thereof over any other except as expressly provided in the Indenture.

The Corporation covenants to pay when due all sums payable on the Bonds, but only from the Revenues and money designated under the Indenture, subject only to (i) the Indenture, and (ii) to the extent permitted by the Indenture, (x) agreements with Holders of Bonds pledging particular collateral for the payment thereof and (y) the rights of Beneficiaries under Swap Contracts and Ancillary Contracts. The obligation of the Corporation to pay Principal, interest and redemption premium, if any, to the Holders of Bonds shall be absolute and unconditional, shall be binding and enforceable in all circumstances whatsoever, and shall not be subject to setoff, recoupment or counterclaim.

The Corporation represents that it is duly authorized pursuant to law, including the Act, to create and issue the Bonds, to enter into the Indenture and to pledge the Revenues and other Collateral purported to be pledged in the manner and to the extent provided under the Indenture. The Revenues and other Collateral so pledged are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Indenture, and all corporate action on the part of the Corporation to that end has been duly and validly taken. The Bonds and the provisions under the Indenture are and will be the valid and binding obligations of the Corporation in accordance with their terms.

At any and all times the Corporation shall, so far as it may be authorized or permitted by law, pass, make, do, execute, acknowledge and deliver, all and every such further resolutions, acts, deeds, conveyances, assignments, transfers and assurances as may be necessary or desirable for the better assuring, conveying, granting, assigning, confirming and affecting the rights, the Revenues and other Collateral pledged or assigned under the Indenture, or intended so to be, or which the Corporation may become bound to pledge or assign. (Section 5.01)

Tax Covenants

The Corporation shall at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Corporation on Tax-Exempt Bonds shall be excludable from gross income for federal income tax purposes pursuant to § 103(a) of the Code; and no funds of the Corporation shall at any time be used directly or indirectly to acquire securities, obligations or other investment property the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code. If and to the extent required by the Code, the Corporation shall periodically, at such times as may be required to comply with the Code, pay as an Operating Expense the amount, if any, required by the Code to be rebated or paid as a related penalty. Notwithstanding any other provisions provided under the Indenture, the requirements provided under the Section titled "Tax Covenants" shall survive the defeasance or other payment of the Tax-Exempt Bonds. (Section 5.03)

Accounts and Reports

The Corporation will (1) cause to be kept books of account in which complete and accurate entries shall be made of its transactions relating to all funds and accounts under the Indenture, which books shall, at all reasonable times and at the expense of the Corporation, be subject to the inspection of the Trustee and the Holders of an aggregate of not less than 25% in Principal amount of Bonds then Outstanding or their representatives duly authorized in writing; and (2) annually, within ten months after the close of the Fiscal Year ending June 30, 2007 and on or before each May 1 thereafter, deliver to the Trustee and each Rating Agency, a copy of its financial statements for such Fiscal Year, as audited by an independent certified public accountant or accountants. (Section 5.04)

Ratings

The Corporation shall pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect ratings on all the Senior Bonds from at least one nationally recognized statistical rating organizations. (Section 5.06)

Affirmative Covenants

The Corporation will make the following covenants under the Indenture:

Punctual Payment. The Corporation shall duly and punctually pay the Principal of and premium, if any, and interest on the Bonds in accordance with the terms of the Bonds and the Indenture.

Maintenance of Existence. The Corporation shall keep in full effect its existence, rights and franchises as a special purpose, independent instrumentality of the State under the laws of the State.

Protection of Collateral. The Corporation shall from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (i) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (ii) perfect, publish notice of or protect the validity of any grant made or to be made by the Indenture; (iii) preserve and defend title to the Revenues and other Collateral pledged under the Indenture and the rights of the Trustee and the Bondholders in the Collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of

the Consent Decree, the Indenture, the Act, the Agreement, the 2002 Residual Certificate or the 2002 Agreement or the performance by any party thereunder; (iv) enforce the Agreement, the 2002 Residual Certificate and the 2002 Agreement; (v) pay any and all taxes levied or assessed upon all or any part of the Collateral; or (vi) carry out more effectively the purposes of the Indenture; provided, however, that nothing contained under the Indenture shall prevent the Corporation from granting a subordinate interest in the Revenues pursuant to a separate indenture.

Performance of Obligations. The Corporation (i) shall diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the Collateral and (ii) shall not take any action and will use its best efforts not to permit any action to be taken by others that would release any person from any of such person's covenants or obligations under any such instrument or agreement or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, any such instrument or agreement, except, in each case, as expressly provided in the Indenture, the Agreement or the Consent Decree.

Notice of Events of Default. The Corporation shall give the Trustee and Rating Agencies prompt written notice of each Event of Default under the Indenture.

Additional Obligations Under a Senior Indenture. The Corporation will only issue Additional Obligations only upon receipt by the Trustee under the Indenture of (i) a Rating Confirmation from each Rating Agency then rating the Outstanding Bonds under the Indenture and (ii) a certificate of the Corporation that as a result of the issuance of such Additional Obligations, the weighted average life of each Bond then outstanding under the Indenture, projected in years from its date of issuance, will not exceed the sum of (i) the weighted average life of each such Outstanding Bond issued under the Indenture as projected at the time such Bond was issued and set forth in the Series Supplement relating thereto (with respect to the Series 2007 Bonds, such expected weighted average lives are as set forth in the Turbo Defeasance Schedule attached to the Series 2007 Supplement) and (ii) one. In calculating the weighted average life of each of the Outstanding Bonds under the Indenture for the purpose of the certificate required by clause (ii) of the preceding sentence, the Corporation shall take into consideration (1) the amount of Turbo Redemptions of such Bonds that have been paid prior to and including to the date of issuance of the Additional Obligations and (2) the amount of Turbo Redemptions projected by the Corporation to be paid on each Distribution Date subsequent to the issuance of such Additional Obligations based upon the amount of Pledged TSRs then expected to be received by the Corporation and available for payment of Turbo Redemptions of each outstanding bond under the Senior Indenture. In determining compliance with clause (ii) of this paragraph, the Corporation may rely conclusively on a certification of a financial advisor or an underwriting firm, who may rely on a report of a nationally recognized firm of econometric experts on matters related to projected or forecasted cigarette consumption. (Section 5.07)

Negative Covenants

The Corporation will make the following covenants under the Indenture:

Sale of Assets. Except as expressly permitted by the Indenture, the Corporation shall not sell, transfer, exchange or otherwise dispose of any of its properties or assets that are pledged under the Indenture.

No Setoff. The Corporation shall not claim any credit on, or make any deduction from the Principal or premium, if any, or interest due in respect of, the Bonds or assert any claim against any present or former Bondholder by reason of the payment of taxes levied or assessed upon any part of the Collateral.

Liquidation. The Corporation shall not terminate its existence or dissolve or liquidate in whole or in part.

Limitation of Liens. The Corporation shall not (i) permit the validity of effectiveness of the Indenture, the Agreement, the 2002 Indenture, the 2002 Residual Certificate or the 2002 Agreement to be impaired, or permit the lien of the Indenture to be amended, hypothecated, subordinated, terminated or discharged, or permit any person to be released from any covenants or obligations with respect to the Bonds under the Indenture except as may be expressly permitted under the Indenture, (ii) permit any lien, charge, excise, claim, security interest, mortgage or other encumbrance (other than the lien of the Indenture) to be created on or extend to or otherwise arise upon or burden the Collateral or any part thereof or any interest therein or the proceeds thereof or (iii) permit the lien of the Indenture not to constitute a valid first priority security interest in the Collateral.

Limitations on Consolidation, Merger, Sale of Assets, etc. Except as otherwise provided in the Indenture, the Corporation shall not consolidate or merge with or into any other person, or convey or transfer all or substantially all of its properties or assets, unless:

(i) the person surviving such consolidation or merger (if other than the Corporation or the transferee) is organized and existing under the laws of the United States or any state and expressly assumes the due and punctual payment of the Principal of and premium, if any, and interest on all Bonds and the performance or observance of every agreement and covenant of the Corporation in the Indenture;

(ii) immediately after giving effect to such transaction, no Default has occurred and is continuing under the Indenture;

(iii) the Corporation has received Rating Confirmation;

(iv) the Corporation has received an opinion of Counsel to the effect that such transaction will not have material adverse tax consequence to the Corporation and will not adversely affect the exclusion of interest on any Tax Exempt Bond from gross income for federal income tax purposes;

(v) any action as is necessary to maintain the lien and security interest created by the Indenture has been taken; and

(vi) the Corporation has delivered to the Trustee an Officer's Certificate and an opinion of Counsel to the effect that such transaction complies with the Indenture and that all conditions precedent to such transaction have been complied with.

No Other Business. The Corporation shall not engage in any business other than financing, purchasing, owning and managing the Collateral in the manner contemplated by the Indenture and activities incidental thereto.

No Borrowing. Except for the 2002 Bonds, Permitted Indebtedness and indebtedness permitted under the Indenture, the Corporation shall not issue, incur, assume, guarantee or otherwise become liable, directly or indirectly, for any indebtedness. Swap Contracts and Ancillary Contracts are not indebtedness within the meaning of this covenant.

Guarantees, Loan, Advances and Other Liabilities. Except as otherwise contemplated by the Indenture and the Agreement, the Corporation shall not make any loan or advance of credit to, or guarantee (directly or indirectly or by an instrument having the effect or assuring another's payment or performance on any obligation or capability of so doing or otherwise), endorse or otherwise become contingently liable, directly or indirectly, in connection with the obligations, stock or dividends of, or own, purchase, repurchase or acquire (or agree contingently to do so) any stock, obligations, assets or securities of, or any other interest in, or make any capital contribution to, any other person.

Restricted Payments. The Corporation shall not, directly or indirectly, make payments to or distributions from the Revenue Account except in accordance with the Indenture and the Remainder Certificate. (Section 5.08)

Trustee's Organization, Authorization, Capacity and Responsibility

The Trustee represents and warrants that it is duly organized and validly existing as a national banking association under the laws of the United States of America, including the capacity to exercise the powers and duties of the Trustee under the Indenture, and that by proper corporate action it has duly authorized the execution and delivery of the Indenture.

The duties and responsibilities of the Trustee shall be as provided solely as set forth under the Indenture. Notwithstanding the foregoing, no provision of the Indenture shall require the Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties under the Indenture, or in the exercise of any of its rights or powers, unless it receives indemnity satisfactory to it against any loss, liability or expense. Whether or not therein expressly so provided, every provision of the Indenture relating to the conduct or affecting the liability of or affording protection to the Trustee shall be subject to the provisions of this Article.

As Trustee under the Indenture:

(i) the Trustee may conclusively rely and shall be fully protected in acting or refraining from acting upon any Officer's Certificate, opinion of Counsel (or both), resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document believed by it to be genuine and to have been signed or presented by the proper person or persons. The Trustee need not investigate any fact or matter stated in any document, but the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit;

(ii) before the Trustee acts or refrains from acting, it may require an Officers' Certificate and/or an opinion of Counsel. The Trustee shall not be liable for any action it takes or omits to take in accordance with any direction of the Corporation or Holders. Whenever in the administration of the trusts of the Indenture the Trustee shall deem it necessary or desirable that a matter be proved or established prior to taking or suffering or omitting to take any action under the Indenture, such matter (unless other evidence in respect thereof be under the Indenture specifically prescribed) may, in the absence of negligence or willful misconduct on the part of the Trustee, be deemed to be conclusively proved and established by an Officers' Certificate delivered to the Trustee, and such certificate, in the absence of negligence or willful misconduct on the part of the Trustee, shall be full warrant to the Trustee for any action taken, suffered or omitted to be taken by it under the provisions of the Indenture upon the faith thereof;

(iii) any request, direction, order or demand of the Corporation mentioned under the Indenture shall be sufficiently evidenced by an Officers' Certificate (unless other evidence in respect thereof be specifically prescribed); and any Corporation resolution may be evidenced to the Trustee by a copy thereof certified by the secretary or an assistant secretary of the Corporation; and

(iv) prior to the occurrence of an Event of Default under the Indenture and after the curing or waiving of all Events of Default, the Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, Officers' Certificate, opinion of Counsel, Corporation resolution, statement, instrument, opinion, report, notice, request, consent, order, approval, appraisal, bond, debenture, note, coupon, security, or other paper or document unless requested in writing so to do by a Majority in Interest of the Senior Bonds affected and then Outstanding; and, that, if the payment within a reasonable time to the Trustee of the costs, expenses or liabilities likely to be incurred by it in the making of such investigation is, in the opinion of the Trustee, not reasonably assured to the Trustee by the security afforded to it by the terms of the Indenture, the Trustee may require indemnity satisfactory to it against such expenses or liabilities as a condition to proceeding. (Section 7.01)

Rights and Duties of the Fiduciaries

All money and investments received by the Fiduciaries under the Indenture shall be held in trust, in a segregated trust account in the trust department of such Fiduciary, not commingled with any other funds, and applied solely pursuant to the provisions under the Indenture.

The Fiduciaries will keep proper accounts of their transactions under the Indenture (separate from its other accounts), which shall be open to inspection on reasonable notice by the Corporation and its representatives duly authorized in writing.

The Fiduciaries will not be required to monitor the financial condition of the Corporation and, unless otherwise expressly provided, shall not have any responsibility with respect to reports, notices, certificates or other documents filed with them under the Indenture, except to make them available for inspection by Beneficiaries.

Each Fiduciary shall be entitled to the advice of counsel (who may be counsel for any party) and shall not be liable for any action taken or omitted in good faith in reliance on such

advice. Each Fiduciary may rely conclusively on any notice, certificate or other document furnished to it under the Indenture and reasonably believed by it to be genuine. A Fiduciary shall not be liable for any action taken or omitted to be taken by it in good faith and reasonably believed by it to be within the discretion or power conferred upon it, or taken by it pursuant to any direction or instruction by which it is governed under the Indenture or omitted to be taken by it by reason of the lack of direction or instruction required for such action, or be responsible for the consequences of any error of judgment reasonably made by it. When any payment or consent or other action by a Fiduciary is called for by the Indenture, the Fiduciary may defer such action pending receipt of such evidence, if any, as it may reasonably require in support thereof. A permissive right or power to act shall not be construed as a requirement to act.

The Fiduciaries shall in no event be liable for the application or misapplication of funds, or for other acts or failures to act, by any person, firm or corporation except by their respective directors, officers, agents, and employees. No recourse shall be had for any claim based on the Indenture, the Bonds, the 2002 Indenture, the 2002 Residual Certificate, the Remainder Certificate or any Swap Contracts or Ancillary Contracts against any director, officer, agent or employee of any Fiduciary unless such claim is based upon the bad faith, fraud or deceit of such person.

Nothing in the Indenture shall obligate any Fiduciary to pay any debt or meet any financial obligations to any person in relation to the Bonds, the Remainder Certificate, Swap Contracts or Ancillary Contracts except from money received for such purposes under the provisions hereof or from the exercise of the Trustee's rights under the Indenture.

The Fiduciaries may be or become the owner of or trade in the Bonds or enter into Swap Contracts or Ancillary Contracts with the same rights as if they were not the Fiduciaries.

Unless otherwise specified by Series Supplement, the Fiduciaries shall not be required to furnish any bond or surety.

The Corporation covenants and agrees to pay, as and only as an Operating Expense, to the Fiduciaries from time to time, and the Fiduciaries shall be entitled to, the fees and expenses agreed in writing in a separate fee agreement, and will further pay or reimburse the Fiduciaries upon its request for all reasonable expenses, disbursements and advances incurred or made by the Fiduciaries in accordance with any of the provisions hereof or any other documents executed in connection herewith (including the reasonable compensation and the reasonable expenses and disbursements of their counsel and of all persons not regularly in their employ). The obligations of the Indenture to compensate the Fiduciaries and to pay or reimburse the Fiduciaries for reasonable expenses, disbursements and advances shall survive the satisfaction and discharge of the Indenture or the earlier resignation or removal of the Fiduciaries.

The Corporation shall, as and only as an Operating Expense, indemnify and save each Fiduciary and its officers, directors, employees or agents harmless against any and all expenses claims, obligations, losses, damages, injuries (to person, property, or natural resources), penalties, stamp or other similar taxes, actions, suits, judgments, reasonable costs and liabilities (including reasonable legal fees and expenses) of whatever kind or nature regardless of their merit, demanded, asserted or claimed against it directly or indirectly that it may incur in the exercise of its duties under the Indenture and that are not due to its negligence or bad faith. The

provisions set forth in Section 7.02 of the Indenture shall survive the termination of the Indenture or the earlier resignation or removal of any Fiduciary.

The Fiduciaries may execute any of the trusts or powers under the Indenture or perform any duties under the Indenture either directly or by or through agents, attorneys, custodians and nominees appointed with due care, and shall not be responsible for any negligence (other than gross negligence), willful misconduct or bad faith on the part of any agent, attorney, custodian or nominee so appointed.

Any fees, expenses, reimbursements or other charges which any Fiduciary may be entitled to receive from the Corporation under the Indenture, if not otherwise paid, shall be a first lien upon (but only upon) any funds held under the Indenture by the Trustee for payment of Operating Expenses.

Nothing under the Indenture shall relieve any Fiduciary of responsibility for its negligence or willful misconduct. (Section 7.02)

Resignation or Removal of the Trustee

The Trustee may resign at any time on not less than 30 days' written notice to the Corporation, the Holders and each of the Rating Agencies. The Trustee will promptly certify to the Corporation that it has sent written notice to all Holders and such certificate will be conclusive evidence that such notice was mailed as required under the Indenture. Upon receiving such notice of resignation, the Corporation shall promptly appoint a successor and, upon the acceptance by the successor of such appointment, release the resigning Trustee from its obligations under the Indenture by written instrument, a copy of which instrument shall be delivered to each of the Holders, the resigning Trustee and the successor Trustee. The Trustee may be removed by the Corporation or by a Majority in Interest of Outstanding Senior Bonds, upon written notice to the Trustee. The Trustee may also be removed by written notice from the Corporation if no Default is then continuing or from a Majority in Interest of the Holders of the Outstanding Senior Bonds to the Trustee and the Corporation. No such resignation or removal shall take effect until a successor has been appointed and has accepted the duties of Trustee. (Section 7.04)

Successor Fiduciaries

Any corporation or association which succeeds to the municipal corporate trust business of a Fiduciary as a whole or substantially as a whole, whether by sale, merger, consolidation or otherwise, shall become vested with all the property, rights, powers and duties thereof under the Indenture, without any further act or conveyance or without the execution or filing of any paper with any party under the Indenture except where an instrument of transfer or assignment is required by law to effect such succession, anything under the Indenture to the contrary notwithstanding.

In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary shall with due care terminate its activities under the Indenture and a successor may, or in the case of the Trustee shall, be appointed by the Corporation. The

Corporation shall notify the Holders and the Rating Agencies of the appointment of a successor Trustee in writing within 20 days from the appointment. The Corporation will promptly certify to the successor Trustee that it has given such notice to all Holders and such certificate will be conclusive evidence that such notice was given as required under the Indenture. If no appointment of a successor Trustee is made within 45 days after the giving of written notice in accordance with Section 7.04 or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Trustee or any Holder may apply to any court of competent jurisdiction for the appointment of such a successor, and such court may thereupon, after such notice, if any, as such court may deem proper, appoint such successor. Any successor Trustee appointed under Section 7.05 of the Indenture shall be a trust company, or a bank having the powers of a trust company, having a capital and surplus of not less than $50,000,000. Any such successor Trustee shall notify the Corporation of its acceptance of the appointment and, upon giving such notice, shall become Trustee, vested with all the property, rights, powers and duties of the Trustee under the Indenture, without any further act or conveyance. Such successor Trustee shall execute, deliver, record and file such instruments as are required to confirm or perfect its succession under the Indenture and any predecessor Trustee shall from time to time execute, deliver, record and file such instruments as the incumbent Trustee may reasonably require to confirm or perfect any succession under the Indenture. (Section 7.05)

Nonpetition Covenant

Prior to the date which is one year and one day after which the Corporation no longer has any Bonds Outstanding, the Corporation shall not file a voluntary petition under the Federal Bankruptcy Code as it may, from time to time, be in effect, and neither any public official nor any organization, entity or other person shall authorize the Corporation to be or to become a debtor under the Federal Bankruptcy Code during such period.

Action by Holders

Any request, authorization, direction, notice, consent, waiver or other action provided by the Indenture to be given or taken by Holders of Bonds may be contained in and evidenced by one or more writings of substantially the same tenor signed by the requisite number of Holders or their attorneys duly appointed in writing. Proof of the execution of any such instrument, or of an instrument appointing any such attorney, shall be sufficient for any purpose of the Indenture (except as otherwise expressly provided in the Indenture) if made in the following manner, but the Corporation or the Trustee may nevertheless in its discretion require further or other proof in cases where it deems the same desirable. The fact and date of the execution by any Bondholder or his attorney of such instrument may be proved by the certificate or signature guarantee, which need not be acknowledged or verified, of an officer of a bank, trust company or securities dealer satisfactory to the Corporation or to the Trustee; or of any notary public or other officer authorized to take acknowledgments of deeds to be recorded in the state in which he purports to act, that the person signing such request or other instrument acknowledged to him the execution thereof; or by an affidavit of a witness of such execution, duly sworn to before such notary public or other officer. The authority of the person or persons executing any such instrument on behalf of a corporate Holder may be established without further proof if such instrument is signed by a person purporting to be the president or a vice president of such corporation with a corporate seal affixed and attested by a person purporting to be its clerk or secretary or an assistant clerk or secretary. Any action of the owner of any Bond shall be irrevocable and bind all future record and beneficial owners thereof. (Section 8.01)

Registered Owners

The enumeration of certain provisions of the Indenture applicable to DTC as Holder of immobilized Bonds shall not be construed in limitation of the rights of the Corporation and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in the Indenture. Notwithstanding any other provisions under the Indenture, any payment to the registered owner of a Bond shall satisfy the Corporation's obligations thereon to the extent of such payment. (Section 8.02)

Events of Default

"Event of Default" in the Indenture means any one of the following:

(a) Principal of or interest on any Senior Bond has not been paid, when due;

(b) the Corporation fails to observe or perform any other provision of the Indenture, which failure is not remedied within 30 days after written notice thereof is given to the Corporation by the Trustee or to the Corporation and the Trustee by the Holders of at least 25% in Principal amount of the Senior Bonds then Outstanding;

(c) bankruptcy, reorganization, arrangement or insolvency proceedings, or other proceedings for relief under any bankruptcy or similar law or laws for the relief of debtors, are instituted by or against the Corporation and, if instituted against the Corporation, are not dismissed within 60 days after such institution;

(d) the State fails to observe or perform a covenant included in the Indenture for the benefit of the Holders, which failure is not remedied within 30 days after written notice thereof is given to the Corporation and the State by the Trustee or to the Corporation and the Trustee by the Holders of at least 25% in Principal amount of the Senior Bonds then Outstanding; or

(e) the State fails to pay promptly to the Corporation or the Trustee any Residual Pledged TSRs received by it; or

(f) the State consents to or acquiesces in an amendment or modification of the MSA, or the Consent Decree is amended or modified, in each case, so as materially to reduce the amount of TSRs payable to the State under the MSA or to materially delay any date of payment of a material amount thereof. (Section 9.01)

Remedies

(a) The beneficial owners of the Bonds and the Trustee waive all rights and remedies prior to the date on which there are no bonds outstanding under the 2002 Indenture, and no rights or remedies shall be available under the Indenture, under any other provision of the Bonds or the Indenture or applicable law until the lien of the 2002 Indenture is fully defeased;

(b) if an Event of Default occurs and is continuing the Trustee may, and upon written request of the Holders of 25% in Principal amount of the Senior Bonds Outstanding shall, in its own name by action or proceeding in accordance with State law:

(i) enforce all rights of the Holders and require the Corporation or, to the extent permitted by law, the State to carry out their respective agreements with the Holders and to perform their respective duties under the Agreement;

(ii) sue upon such Bonds;

(iii) require the Corporation to account as if it were the trustee of an express trust for the Holders of such Bonds; and

(iv) enjoin any acts or things which may be unlawful or in violation of the rights of the Holders of such Bonds.

(c) The Trustee shall, in addition to the other provisions under the Indenture, have and possess all of the powers necessary or appropriate for the exercise of any functions incident to the general representation of Holders in the enforcement and protection of their rights.

(d) Upon a Default of the Corporation under Section 9.01(a)(1) of the Indenture or a failure actually known to an Authorized Officer of the Trustee to make any other payment required by the Indenture within seven days after the same becomes due and payable, the Trustee shall give written notice thereof to the Corporation. The Trustee shall give Default notices under paragraphs (b), (d), (e) and (f) of Section 9.01 of the Indenture when instructed to do so by the written direction of another Fiduciary or the owners of at least 25% in Principal amount of the Outstanding Senior Bonds. The Trustee shall proceed under Section 9.02 of the Indenture for the benefit of the Holders in accordance with the written direction of a Majority in Interest of the Outstanding Senior Bonds. The Trustee shall not be required to take any remedial action (other than the giving of notice) unless indemnity satisfactory to it is furnished for any expense or liability to be incurred therein. Upon receipt of written notice, direction and indemnity, and after making such investigation, if any, as it deems appropriate to verify the occurrence of any event of which it is notified as aforesaid, the Trustee shall promptly pursue the remedies provided by the Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Holders, and shall act for the protection of the Holders with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs. (Section 9.02)

Supplements and Amendments to the Indenture

(a) The Indenture may be:

(i) supplemented by delivery to the Trustee of an instrument certified by an Authorized Officer of the Corporation to (A) provide for earlier or greater deposits into the Revenue Account, (B) subject any property to the lien under the Indenture, (C) add to the covenants and agreements of the Corporation or surrender or limit any right or power of the Corporation, (D) identify particular Bonds for purposes not inconsistent with the Indenture, including credit or liquidity support, remarketing, serialization and defeasance, (E) cure any ambiguity or defect, (F) protect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes, or the exemption from registration of the Bonds under the Securities Act of 1933, as amended, or of the Indenture under the Trust Indenture Act of 1939, as amended, or (G) authorize Bonds of a Series and in connection therewith determine the matters referred to in the Indenture, including Sections 3.01 and 7.06, and any other things relative to such Bonds that are not materially adverse to the Holders of Outstanding Bonds, or to modify or rescind any such

authorization or determination at any time prior to the first authentication and delivery of such Series of Bonds; or

(ii) amended in any other respect by the Corporation and the Trustee, with the consent of the holder of the Remainder Certificate, (A) to add provisions that are not materially adverse to the Holders, or (B) to adopt amendments that do not take effect unless and until (1) no Bonds Outstanding prior to the adoption of such amendment remain Outstanding or (2) such amendment is consented to by the Holders of such Bonds in accordance with the further provisions under the Indenture; or

(iii) amended only with written notice to the Rating Agencies and the written consent of a Majority in Interest of the Outstanding Subordinate Bonds and Senior Bonds (acting as separate classes) affected thereby; **provided, however**, the Indenture shall not be amended so as to (A) extend the Maturity Date of any Bond, (B) reduce the Principal amount, applicable premium or interest rate of any Bond, (C) make any Bond redeemable other than in accordance with its terms, (D) create a preference or priority of any Bond over any other Bond of the same class or (E) reduce the percentage of the Bonds required to be represented by the Holders giving their consent to any amendment unless the Holders of the Bonds affected thereby have consented thereto in writing

(b) Any amendment of the Indenture shall be accompanied by a Counsel's opinion addressed to the Trustee to the effect that the amendment is permitted by law and does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes.

(c) When the Corporation determines that the requisite number of consents have been obtained for an amendment to the Indenture or to the Agreement which requires consents, it shall, file a certificate to that effect in its records and give written notice to the Trustee and the Holders. The Trustee will promptly certify to the Corporation that it has given such notice to all Holders and such certificate will be conclusive evidence that such notice was given in the manner required by the Indenture. (Section 10.01)

Definitions

In addition to terms defined elsewhere herein, the following terms have the following meanings in this summary, unless the context otherwise requires:

"Accounts" means the Revenue Account, all other Accounts established under the Indenture and any accounts established by Series Supplement; all of which shall be segregated trust accounts established and held by the Trustee.

"Act" means, collectively, the Tobacco Settlement Financing Corporation Act, Article 8 of Chapter 65 of the Public Laws of 2002, as amended by Chapter 66 of the Public Laws of 2002, codified at R.I.G.L. Section 42-133-1 et seq., and Article 41 of Chapter ___ of the Public Laws of 2007.

"Authorized Officer" means: (i) in the case of the Corporation, the Chairperson, the Secretary, and any other person authorized to act by the Board under the Indenture by appropriate Written Notice to the Trustee, and (ii) in the case of the Trustee, any officer assigned to the Corporate Trust Office, including any managing director, vice president, assistant vice

president, assistant treasurer, assistant secretary or any other officer of the Trustee customarily performing functions similar to those performed by any of the above designated officers and having direct responsibility for the administration of the Indenture, and also, with respect to a particular matter, any other officer, to whom such matter is referred because of such officer's knowledge of and familiarity with the particular subject.

"Beneficiaries" means Bondholders and, to the extent specified in the Indenture, the parties to Swap Contracts and Ancillary Contracts.

"Bondholders", **"Holders"** and similar terms mean the registered owners of the Bonds from time to time as shown on the books of the Corporation.

"Bonds" means all obligations issued pursuant to the Indenture.

"Code" or **"Tax Code"** means the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

"Consent Decree" means the Consent Decree and Final Judgment of the Superior Court of the State of Rhode Island, Providence County, dated December 17, 1998, as the same has been and may be corrected, amended or modified, in the class action styled State of Rhode Island v. American Tobacco, Inc., et al. (Docket No. 97-3058).

"Corporate Trust Office" means the office of the Trustee at which the corporate trust business of the Trustee related to the Indenture shall, at any particular time, be principally administered, which office is, on the date of the Indenture, located at 213 Court Street, Middletown, Connecticut 06457.

"Counsel" means nationally recognized bond counsel or such other counsel as may be selected by the Corporation for a specific purpose under the Indenture.

"Defeasance Collateral" means money and any of the following:

(a) non-callable obligations of, or obligations guaranteed as to principal and interest by, the United States or any agency or instrumentality thereof, when such obligations are backed by the full faith and credit of the United States, including, but not limited to, all direct or fully guaranteed U.S. Treasury Services Administration Participation certificates, U.S. Maritime Administration Guaranteed Title XI financing, Small Business Administration – Guaranteed participation certificates and Guaranteed pool certificates, Government National Mortgage Association ("GNMA") – GNMA guaranteed mortgage-backed securities and GNMA guaranteed participation certificates, U.S. Department of Housing and Urban Development Local authority bonds; (ii) non-callable obligations of government-sponsored agencies that are not backed by the full faith and credit of the U.S. Government, including, but not limited to, Federal Home Loan Mortgage Corp. (FHLMC) Debt Obligations, Farm Credit System (formerly Federal Land Banks, Intermediate Credit Banks, and Banks for Cooperatives) Consolidated Systemwide bonds and notes, Federal Home Loan Banks (FHL Banks) Consolidated debt obligations, Federal National Mortgage Association (FNMA) Debt Obligations, and Resolution Funding Corp. (REFCORP) Debt obligations; and (iii) certain stripped securities where the principal-only and interest-only strips are derived from non-callable obligations issued by the U.S. Treasury and REFCORP securities

stripped by the Federal Reserve Bank of New York, excluding custodial receipts, i.e. CATs, TIGERS, unit investment trust and mutual funds, etc;

(b) obligations timely maturing and bearing interest (but only to the extent that the full faith and credit of the United States of America are pledged to the timely payment thereof);

(c) certificates evidencing ownership of the right to the payment of the principal of and interest on obligations described in clause (ii), provided, that such obligations are held in the custody of a bank or trust company satisfactory to the Trustee in a segregated trust account in the trust department separate from the general assets of such custodian;

(d) bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state (a) which are not callable at the option of the obligor or otherwise prior to maturity or as to which irrevocable notice has been given by the obligor to call such bonds or obligations on the date specified in the notice and (b) timely payment of which is fully secured by a fund consisting only of cash or obligations of the character described in clause (i), (ii) or (iii) which fund may be applied only to the payment when due of such bonds or other obligations; and

(e) investment arrangements that are rated, or with providers whose senior unsecured debt obligations are rated, in the highest long term and short term rating category by each Rating Agency.

"Defeased Bonds" means Bonds that remain in the hands of their Holders, but are deemed no longer Outstanding.

"Eligible Investments" means any of the following:

(i) Defeasance Collateral;

(ii) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank or trust company, savings and loan association or savings bank, payable on demand or on a specified date no more than 270 days after the date of issuance thereof, if such deposits or instruments are rated "F-1" by Fitch (if rated by Fitch), "A-1" by S&P and "P-1" by Moody's;

(iii) municipal obligations of any state of the United States or any political subdivision thereof rated at least "Aal" by Moody's and receiving one of the two highest long-term unsecured debt ratings available for such securities by S&P and Fitch (if rated by Fitch);

(iv) commercial or finance company paper (including both non-interest-bearing discount obligations and interest bearing obligations payable on demand or on a specified date not more than 270 days after the date of issuance thereof) that is rated "F-1" by Fitch (if rated by Fitch), "A-1" by S&P and "P-1" by Moody's;

(v) repurchase agreements collateralized by securities described in clause (i), (ii), (iv), or (v) with any registered broker/dealer, domestic commercial bank or insurance company whose long-term debt obligations are rated "investment grade" by each Rating Agency, provided that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (3) the agreement has a term of thirty days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored with five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is equal to at least 102%;

(vi) securities bearing interest or sold at a discount (payable on demand or on a specified date no more than 270 days after the date of issuance thereof) that are issued by any corporation incorporated under the laws of the United States of America, or any state, municipality or any political subdivision thereof and rated "F-1" by Fitch (if rated by Fitch), "P-1" by Moody's and "A-1" by S&P at the time of such investment or contractual commitment providing for such investment;

(vii) units of taxable money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated at least "Aa1" by Moody's, in one of the two highest categories by Fitch (if rated by Fitch) and at least "Aam" or "AAm-G" by S&P, including if so rated any such fund which the Trustee or an affiliate of the Trustee serves as an investment advisor, administrator, shareholder, servicing agent and/or custodian or sub-custodian, notwithstanding that (a) the Trustee or an affiliate of the Trustee charges and collects fees and expenses (not exceeding current income) from such funds for services rendered, (b) the Trustee charges and collects fees and expenses for services rendered pursuant to the Indenture, and (c) services performed for such funds and pursuant to the Indenture may converge at any time (the Corporation specifically authorizes the Trustee or an affiliate of the Trustee to charge and collect all fees and expenses from such funds for services rendered to such funds, in addition to any fees and expenses the Trustee may charge and collect for services rendered pursuant to the Indenture);

(viii) investment agreements, forward delivery agreements or guaranteed investment contracts which are uncollateralized and are rated, or with any financial institution or corporation whose senior long-term debt obligations are rated, or guaranteed by a financial institution whose senior long-term debt obligations are rated, at the time such agreement or contract is entered into, in one of the three highest long-term rating categories by at least two National Recognized Rating Service Organizations "NRSOs" (S&P, Moody's and Fitch) if the Corporation has an option to terminate such agreement in the event that any such rating is either withdrawn or downgraded below the rating on the Senior Bonds, or if not so rated, then collateralized by securities described

in clause (i), (ii), (iv), (v) or (vii) above with any registered broker/dealer, domestic commercial bank or insurance company whose long-term debt obligations are rated "investment grade" by each Rating Agency, provided that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (3) the agreement has a term of thirty days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored with seven Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is equal to at least 102%; and

(ix) other obligations, securities agreements or contracts that are non-callable and that are acceptable to each Rating Agency; provided, however, that no Eligible Investment may (a) except for Defeasance Collateral, evidence the right to receive only interest with respect to the obligations underlying such instrument or (b) be purchased at a price greater than par if such instrument may be prepaid or called at a price less than its purchase price prior to its stated maturity.

"Fiduciary" means the Trustee, any representative of the Holders of Bonds appointed by Series Supplement, and each Paying Agent.

"Fiscal Year" means the twelve (12) month period commencing July 1 of each year and ending on June 30 of the succeeding year.

"Officer's Certificate" means a certificate signed by an Authorized Officer of the Corporation.

"Operating Expenses" means all expenses incurred by the Corporation, including but not limited to arbitrage rebate and penalties, salaries, administrative expenses, insurance premiums, advisory, auditing and legal expenses, fees and expenses incurred for professional consultants and fiduciaries, and all Operating Expenses so identified in the Indenture.

"Outstanding" when used as to Bonds, means Bonds issued under the Indenture, excluding: (i) Bonds that have been exchanged or replaced, or delivered to the Trustee for credit against a Principal payment; (ii) Bonds that have been paid; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Bonds for which (A) there has been irrevocably set aside sufficient Defeasance Collateral timely maturing and bearing interest, to pay or redeem them and (B) any required notice of redemption shall have been duly given in accordance with the Indenture or irrevocable instructions to give notice shall have been given to the Trustee; (v) Bonds the payment of which shall have been provided for pursuant to the Indenture; and (vi) for purposes of any consent or other action to be taken by the Holders of a Majority in Interest or specified percentage of Bonds under the Indenture, Bonds held by or for the account of the Corporation, the State or any person controlling, controlled by or under common control with either of them. For the purposes of this definition, "control," when used

with respect to any specified person, means the power to direct the management and policies of such person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise, and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"Paying Agent" means each Paying Agent designated from time to time pursuant to the Indenture.

"Principal" means, except as otherwise set forth in a Series Supplement authorizing the issuance of a Series of Bonds under the Indenture, the amount of the principal or Accreted Value due on the Maturity Date for any Bonds, provided, however, that for purposes of (i) receiving payment of the redemption price of a Capital Appreciation Bond if any such Bond is redeemed prior to maturity, (ii) receiving payment pursuant to the Indenture of a Capital Appreciation Bond following the occurrence of an Event of Default or (iii) computing the Principal amount of Bonds held by the Holder of a Capital Appreciation Bond in giving to the Corporation or Trustee any notice, consent, request or demand pursuant to the Indenture for any purpose whatsoever, the then current Accreted Value of such Bond shall be deemed to be its Principal amount.

"Revenues" means the Residual Pledged TSRs and all future aid, rents, fees, charges, payments, investment earnings and other income and receipts (including Bond proceeds but only to the extent deposited in an Account) paid or payable on or after the Closing Date for the Series 2007 Bonds to the owner of the 2002 Residual Certificate or the Trustee for the account of the owner of the 2002 Residual Certificate or the Beneficiaries.

"Supplemental Indenture" means a Series Supplement or supplement adopted and becoming effective in accordance with the terms under the Indenture. Any provision that may be included in a Series Supplement or Supplemental Indenture is also eligible for inclusion in the other subject to the provisions under the Indenture.

"Written Notice", **"written notice"** or **"notice in writing''** means notice in writing which may be delivered by hand or first class mail and also means facsimile transmission.

THE PURCHASE AND SALE AGREEMENT

The following summary describes certain terms of the Purchase and Sale Agreement. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to the provisions of the Purchase and Sale Agreement. Copies of the Purchase and Sale Agreement may be obtained upon written request to the Corporation.

Conveyance of Residual Tobacco Assets and Purchase Consideration

On the Closing Date, and simultaneously with the Corporation's delivery of the Purchase Consideration in accordance with the Purchase and Sale Agreement, the State shall by appropriate instrument or instruments sell, transfer, assign, set over and otherwise convey to the Corporation, without recourse (but subject to certain continuing obligations described in the Purchase and Sale Agreement) the Residual Tobacco Assets. The State acknowledges and consents to any pledge, assignment and grant of a security interest by the Corporation to the Trustee pursuant to the Indenture for the benefit of the Bondholders of any or all right, title and interest of the Corporation in, to and under the Residual Tobacco Assets or the assignment of any or all of the Corporation's rights and obligations under the Purchase and Sale Agreement to the

Trustee for the benefit of the Bondholders. From and after the Closing Date, all payments required by the 2002 Residual Certificate to be made to the State shall be made to the Corporation, or to the extent provided in the Indenture, to the Trustee. In the event the State shall receive any payments or other funds constituting Residual Tobacco Assets after the Closing Date, the State will promptly disburse the same to the Corporation or the Trustee, as directed. (Section 2.01)

On the Closing Date, and simultaneously with the State's conveyance of the Residual Tobacco Assets in accordance with the Purchase and Sale Agreement, the Corporation shall deliver, or cause to be delivered to the State, the Purchase Consideration consisting of the Net Proceeds (as defined below) and the 2007 Remainder Certificate; and the State shall apply the proceeds of sale of the Series 2007 Bonds remaining after deducting therefrom all Financing Costs paid or to be paid therefrom (including costs and expenses of the State and the Corporation which under the terms of the Purchase and Sale Agreement or of the Indenture are permitted to be paid or reimbursed from the proceeds of the Series 2007 Bonds) (the "Net Proceeds") in accordance with the Constitution and statutes of the State, as detailed in a certificate of a Responsible Officer of the State delivered on the Closing Date. (Section 2.02)

Representations of the State

The State, as seller, makes the following representations on which the Corporation is deemed to have relied in acquiring the Residual Tobacco Assets. The representations speak as of the Closing Date, and shall survive the sale of the Residual Tobacco Assets to the Corporation and the pledge thereof to the Trustee pursuant to the Indenture.

Power and Authority. The State has full power and authority to execute and deliver the Purchase and Sale Agreement and to carry out its terms; the State has full power, authority and legal right to sell and assign the Residual Tobacco Assets to the Corporation and the State has duly authorized such sale and assignment to the Corporation by all necessary action; and the execution, delivery and performance of the Purchase and Sale Agreement has been duly authorized by the State by all necessary action. Pursuant to the Act, the State has full power and authority to determine the terms and conditions of the Purchase and Sale Agreement and the related documents and agreements and to execute and deliver the same.

Binding Obligation. The Purchase and Sale Agreement has been duly executed and delivered by a Responsible Officer on behalf of and in the name of the State and, assuming the due authorization, execution and delivery of the Purchase and Sale Agreement by the Corporation and the State, constitutes a legal, valid and binding obligation of the State enforceable in accordance with its terms.

No Consents. No consent, approval, authorization, order, registration or qualification of or with any court or governmental agency or body is, to the State's knowledge, required for the consummation of the transactions contemplated by the Purchase and Sale Agreement, except for those which have been obtained and are in full force and effect.

No Violation. The consummation of the transactions contemplated by the Transaction Documents and the fulfillment of the terms thereof do not, to the State's knowledge, in any

material way conflict with, result in any material breach by the State of any of the material terms and provisions of, nor constitute (with or without notice or lapse of time) a material default by the State under any indenture, agreement or other instrument to which the State is a party or by which it shall be bound; nor violate any law or, to the State's knowledge, any order, rule or regulation applicable to the State of any court or of any federal or state regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the State or its property.

No Proceedings. To the State's knowledge, except as disclosed in this Offering Circular, there are no material proceedings or investigations pending against the State, before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the State: (i) asserting the invalidity of any of the Transaction Documents, the Series 2007 Bonds, the 2002 Indenture, the 2002 Residual Certificate or the 2002 Agreement, (ii) seeking to prevent the issuance of the Tobacco Settlement Residual Bonds or the consummation of any of the transactions contemplated by any of the Transaction Documents, or (iii) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of any of the Transaction Documents, the Series 2007 Bonds, the 2002 Indenture, the 2002 Residual Certificate or the 2002 Agreement.

Title to Residual Tobacco Assets. Except as otherwise provided in the 2007 Remainder Certificate, from and after the conveyance of the Residual Tobacco Assets by the State to the Corporation on the Closing Date the State shall have no interest in the Residual Tobacco Assets.

Absence of State Liens on Residual Tobacco Assets. The State has not sold, transferred, assigned, set over or otherwise conveyed any right, title or interest of any kind whatsoever in all or any portion of the Residual Tobacco Assets, nor has the State created, or to its knowledge permitted the creation of, any State Lien thereon. The State warrants that, to its knowledge, the Residual Tobacco Assets are free and clear of State Liens.

Assignment to Bondholders. The State acknowledges that the Corporation will assign to the Trustee for the benefit of the Bondholders all of its rights and remedies with respect to the breach of any representations and warranties of the State under the Purchase and Sale Agreement. Upon discovery by the State or the Corporation of a breach of any of the foregoing representations and warranties that materially and adversely affects the value of the Residual Tobacco Assets, the party discovering such breach shall give prompt written notice to the other parties, to the Trustee and to the Rating Agencies. (Section 3.01)

Limitation on Liability

The State and any officer or employee or agent of the State may rely in good faith on the advice of counsel or on any document of any kind, prima facie properly executed and submitted by any Indemnified Party respecting any matters arising under the provisions of the Purchase and Sale Agreement. Neither the State nor any of the officers or employees or agents of the State shall be under any liability to the State or the Corporation, except as provided under the Purchase Sale Agreement, for any action taken or for refraining from the taking of any action pursuant to the Purchase and Sale Agreement or for errors in judgment; but this sentence shall not protect the State or any such person against any liability that would otherwise be imposed by reason of

willful misfeasance, bad faith or gross negligence in the performance of duties or by reason of reckless disregard of obligations and duties under the Purchase and Sale Agreement. (Section 3.02)

Protection of Title; Non-Impairment Covenant

Pursuant to the Act, the State covenants and agrees with the Corporation, and the Corporation is authorized to include such covenant and agreement in the Indenture for the benefit of the Bondholders or other parties receiving the express benefit of the security for the Bonds ("benefited parties"), that the State will (i) enforce the Corporation's rights to receive the Residual Tobacco Assets to the full extent permitted by the MSA, (ii) not amend the MSA in any manner that would materially impair the rights of the Bondholders or benefited parties, (iii) not limit or alter the rights of the Corporation to fulfill the terms of its agreements with the Bondholders and benefited parties, (iv) not in any way impair the rights and remedies of the Bondholders or benefited parties or the security for the Tobacco Settlement Residual Bonds until the Tobacco Settlement Residual Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of the Bondholders, are fully paid and discharged, (v) not fail to enforce the Qualifying Statute, and (vi) not amend, supersede or repeal the Qualifying Statute in any way that would materially adversely affect the amount of any payment to, or materially impair the rights of, the Corporation, such owners of the Tobacco Settlement Residual Bonds or such benefited parties.

The State covenants and agrees with the Corporation, and the Corporation is authorized to include such covenant and agreement in the Indenture for the benefit of the Bondholders and other benefited parties, that (i) the State shall take all actions as may be required by law and the MSA fully to preserve, maintain, defend, protect and confirm the interest of the Corporation in the Residual Tobacco Assets and in the proceeds thereof in all material respects, and the State will not take any material action that will adversely affect the Corporation's legal right to receive the Residual Tobacco Assets; (ii) the State will promptly pay to the Trustee any Residual Tobacco Assets received by the State; and (iii) without the prior written consent of the Corporation and the Trustee, the State will not take any action and will use its best reasonable efforts not to permit any action to be taken by others that (x) would release any person from any of such person's covenants or obligations under the MSA or (y) would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the MSA or waive timely performance or observance under such document, in each case if the effect thereof would be materially adverse to the Bondholders or benefited parties; provided, however, that if a Rating Confirmation is received relating to such proposed action then such proposed action will be deemed not to be materially adverse to the Bondholders or benefited parties. The State shall deliver to the Corporation and to the Trustee written notice of any action described in clause (iii)(x) or (iii)(y) of the preceding sentence which it intends to take. The State shall deliver such written notice a reasonable period of time before taking any such action.

In accordance with the Act, prior to the date which is one year and one day after which the Corporation no longer has any Tobacco Settlement Residual Bonds Outstanding, the Corporation is prohibited from filing and shall have no authority to file a voluntary petition under the Federal Bankruptcy Code as it may, from time to time, be in effect, and neither any public official nor any organization, entity or other person shall authorize the Corporation to be

or to become a debtor under the Federal Bankruptcy Code during such period. In accordance with the Act, this contractual obligation shall not subsequently be modified by State law during the period of this contractual obligation, and the State covenants with the Corporation, and the Corporation is authorized to include such covenant and agreement in the Indenture for the benefit of the Bondholders, that the State shall not limit or alter the denial of authority under this subsection during the period referred to in the preceding sentence.

Pursuant to Section 42-133-17 of the Act, the State pledges to and agrees with the holders of any Tobacco Settlement Residual Bonds that the State will not modify or limit, the responsibility of the Attorney General to administer, protect and discharge all duties, rights and obligations of the State under the Master Settlement Agreement and the Qualifying Statute. Pursuant to Section 42-133-5(14) of the Act, the Corporation agrees to direct the Attorney General of the State to enforce, in the name of the State and, if permissible, to enforce directly through the Corporation's own attorneys in the name of the State, with notice to the Attorney General, the MSA; provided, that the Corporation may not give any approval to any amendment to the MSA or the Qualifying Statute without notice to the Attorney General and the approval of the General Assembly of the State. As provided in said Section of the Act, this power and obligation constitutes a part of the contractual obligation owed to the Bondholders.

There is incorporated by reference for the benefit of the Corporation and the Trustee on behalf of the Bondholders, the covenants and agreements of the State set forth in the 2002 Agreement. (Section 3.03)

Further Actions

Upon request of the State or the Trustee, the Corporation will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of the Purchase and Sale Agreement. The Corporation shall, as soon as practicable, pay to the State any amounts due to the State that are received by the Corporation in error. (Section 4.01)

State Tax Covenants

Pursuant to section 42-133-7(e) of the Act, the State shall at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Corporation on the Tax-Exempt Bonds shall be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code;

The State will not directly or indirectly use or permit the use of any of the proceeds of the Bonds that would cause the Tax-Exempt Bonds to be "private activity bonds" within the meaning of Section 141(a) of the Tax Code or would cause interest on the Tax-Exempt Bonds to not be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code; and

The State agrees that no gross proceeds (as such term is defined in Section 1.148-1 of the Treasury Regulations promulgated under Section 148 of the Tax Code, as such Treasury Regulations and the Tax Code may be amended from time to time) of the Tax-Exempt Bonds shall at any time be used directly or indirectly to acquire securities or obligations the acquisition

or holding of which would cause any Tax-Exempt Bond to be an “arbitrage bond” as defined in the Tax Code and any applicable Treasury Regulations promulgated under the Purchase and Sale Agreement. (Section 3.06)

Amendment

After issuance of the Bonds, the Purchase and Sale Agreement may be amended by agreement of the State, and the Corporation with the consent of the Trustee but without the consent of any of the Bondholders: (i) to cure any ambiguity; (ii) to correct or supplement any provisions in the Purchase and Sale Agreement; (iii) to correct or amplify the description of the Residual Tobacco Assets; (iv) to add additional covenants for the benefit of the Corporation; or (v) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Purchase and Sale Agreement that shall not, as evidenced by a Rating Confirmation delivered to the Trustee, adversely affect in any material respect the Senior Bonds.

Except as otherwise provided in the preceding paragraph, the Purchase and Sale Agreement may also be amended from time to time by the State and the Corporation with (x) the consent of the Trustee and (y) a Rating Confirmation for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Purchase and Sale Agreement or of modifying in any manner the rights of the Senior Bondholders. (Section 5.01)

Assignment

Except pursuant to the Indenture, the Purchase and Sale Agreement may not be assigned by the Corporation and any purported assignment shall be of no effect. The Purchase and Sale Agreement may not be assigned by the Corporation except as explicitly set forth therein. (Section 5.03)

Definitions

In addition of terms defined elsewhere herein, the following terms have the following meanings in this summary, unless the context otherwise requires:

“Financing Costs” means (i) all costs, fees, expenses incurred by the Corporation in connection with the issuance of the Tobacco Settlement Residual Bonds; (ii) capitalized operating expenses; (iii) capitalized interest on the Tobacco Settlement Residual Bonds; (iv) all proceeds of the Tobacco Settlement Residual Bonds deposited in any debt service reserve fund to secure the Tobacco Settlement Residual Bonds; and (v) the cost of any credit or liquidity enhancement for the Tobacco Settlement Residual Bonds.

“Opinion of Counsel” means one or more written opinions of counsel acceptable to the Trustee, which counsel may be the Attorney General of the State or the General Counsel to the Corporation.

“Rating Confirmation” means written confirmation from each Rating Agency, to the effect that the then-current ratings assigned by such Rating Agency to the Tobacco Settlement Residual Bonds, without regard to any bond insurance or any other form of credit enhancement, will not be adversely affected by the proposed action for which a Rating Confirmation is sought.

If no rating is in effect with respect to any Series of Tobacco Settlement Residual Bonds, references to "Rating Confirmation" herein shall be considered deleted and none shall be required with respect to such Series.

"Responsible Officer" means, with respect to the State, the State Treasurer, the Attorney General or any other official of the State customarily performing functions similar to those performed by any of the above designated officials, and also with respect to a particular matter, any other official to whom such matter is referred because of such official's knowledge of and familiarity with the particular subject.

"State Lien" means a security interest, lien, charge, pledge, equity or encumbrance of any kind, attaching to the interests of the State in and to the Residual Tobacco Assets, whether or not as a result of any act or omission by the State.

"Transaction Documents" means the Purchase and Sale Agreement, the Indenture and the Underwriting Agreement. (Section 1.01)

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APPENDIX E

SUMMARY OF 2002 INDENTURE

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APPENDIX E

SUMMARY OF 2002 INDENTURE

The following summary describes certain terms of the 2002. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the 2002 Indenture. Copies of the 2002 Indenture may be obtained upon written request to the Trustee. All references to the "Bonds" and the "Indenture" refer to the 2002 Bonds and the 2002 Indenture and certain other terms are defined at the end of this Appendix E.

Directors and State Not Liable on Bonds

Neither the directors or officers of the Corporation nor any person executing Bonds or other obligations of the Corporation will be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance thereof.

The Bonds issued by the Corporation are payable solely and only out of the monies, assets, or revenues pledged by the Corporation, and are not a general obligation or indebtedness of the Corporation or an obligation or indebtedness of the State or any subdivision of the State. The Corporation has no power or authorization to pledge the credit or taxing power of the State or any political subdivision of the State, or create a debt or obligation of the State, or make its debts payable out of any monies except monies of the Corporation. (Section 103)

Security Interest and Pledge

Pursuant to the Indenture, in order to secure payment of the Bonds, the Corporation will pledge and grant to the Indenture Trustee a first lien and security interest in, all of the Corporation's right, title and interest, whether now owned or hereafter acquired, in, to and under the Collateral, consisting of: (a) the Purchase and Sale Agreement, the Pledged TSRs and the right to receive them in accordance with the terms of the Purchase and Sale Agreement; (b) the Accounts (other than the Rebate Account), all money, instruments, investment property, or other property credited to or on deposit in the Accounts (other than the Rebate Account), and all investment earnings on amounts on deposit in or credited to the Accounts (which, together with the Pledged TSRs constitute Revenues); (c) all present and future claims, demands, causes and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments and other property which at any time constitute all or part of or are included in the proceeds of any of the foregoing and (d) all proceeds of the foregoing. Except as specifically provided herein, the Collateral does not include (i) the rights of the Corporation pursuant to provisions contained in the Purchase and Sale Agreement for consent or other action by the Corporation, notice to the Corporation, indemnity or the filing of documents with the Corporation, or otherwise for its benefit and not for that of the Beneficiaries (including all reserved rights contained in the Purchase and Sale Agreement) or (ii) the Rebate Account, and all money, instruments, investment property or other property credited to or on deposit in the Rebate Account. The Corporation will implement, protect and defend this grant of a security interest and pledge by all appropriate legal action, the cost thereof to be an Operating Expense. (Section 201)

Defeasance

When (a) there is held by or for the account of the Indenture Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities as will provide sufficient funds to pay or redeem all obligations to Beneficiaries in full (to be verified by a nationally recognized firm of

defeasance escrow verification agents), (b) any required notice of redemption will have been duly given in accordance with the Indenture or irrevocable instructions to give notice will have been given to the Indenture Trustee, and (c) all the rights under the Indenture of the Fiduciary have been provided for, then upon written notice from the Corporation to the Indenture Trustee, such Beneficiaries will cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien, the security interests created by the Indenture (except in such funds and investments) will terminate, and the Corporation and the Indenture Trustee will execute and deliver such instruments as may be necessary to discharge the Indenture Trustee's lien and security interests created in the Indenture and to make the Pledged TSRs payable to the order of the Corporation. Upon such defeasance, the funds and investments required to pay or redeem or prepay the Bonds and other obligations to such Beneficiaries will be irrevocably set aside for that purpose, subject, however, to the provisions of the Indenture, and money held for defeasance will be invested only as provided in the provisions of the Indenture summarized above under the caption "Security and Pledge" and applied by the Indenture Trustee and other Paying Agents, if any, to the retirement of the Bonds and such other obligations. Any funds or property held by the Indenture Trustee and not required for payment in full or redemption of the Bonds and such other obligations to Beneficiaries and Fiduciaries will be distributed to the order of the Corporation upon such indemnification, if any, as the Indenture Trustee may reasonably require. Unless otherwise required by federal tax law and subject to the Corporation's right to redeem Bonds at its option, when Bonds are to be defeased, the Corporation shall provide during the period of defeasance ending with the date of maturity or, in the Corporation's discretion in establishing such defeasance escrow, the date of optional redemption established by the Corporation for redemption of the Principal of such Bonds, based on the assumption that the Outstanding principal balance on certain Distribution Dates (taking such redemptions into account) for such Bonds shall equal the Term Bond redemption payments therefor as shown in Table 5 in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION–Schedule of Projected Turbo-Term Bond Redemption Payments by Bond Maturity Under DRI•WEFA Base Case Consumption Forecast" in the Offering Circular for the Bonds. If on the date of defeasance the principal amount of such Bonds Outstanding is greater than the scheduled principal balance from Table 5 (constituting an "Excess"), such excess balance must be redeemed within not more than 30 days of the date of defeasance. If on the date of defeasance the principal amount of such Bonds Outstanding is less than the scheduled principal balance from Table 5 (constituting a "Deficiency"), no principal payment of such Bonds shall occur until the Distribution Date on which the scheduled principal outstanding is attained, and after such date the redemptions shall occur in the amounts and on the dates shown in said Table 5. (Section 202)

Bonds of the Corporation

No series of bonds other than the Bonds shall be issued under the Indenture. See "THE BONDS." (Section 301)

Establishment of Accounts

Accounts held by the Indenture Trustee. The Indenture Trustee will establish and maintain the following segregated trust accounts in the Corporation's name:

(1) the Collection Account;

(2) the Operating Account;

(3) the Debt Service Account;

(4) the Debt Service Reserve Account;

(5) the Extraordinary Prepayment Account;

(6) the Contingency Account;

(7) the Turbo Redemption Account;

(8) the Lump Sum Prepayment Account; and

(9) the Capitalized Interest Account. (Section 401)

Redemption and Prepayment of the Bonds

The Corporation may redeem or prepay Bonds at its option in accordance with their terms and will redeem or prepay Bonds in accordance with their terms pursuant to any mandatory redemption requirements established in the Indenture or by Series Supplement. When Bonds are called for redemption or prepayment, the accrued interest thereon will become due on the redemption or prepayment date. To the extent not otherwise provided, the Corporation will deposit with the Indenture Trustee on or prior to the redemption or prepayment date a sufficient sum to pay Principal of, redemption or prepayment premium, if any, and accrued interest on, the Bonds to be redeemed on such redemption or prepayment date.

When a Bond is to be redeemed or prepaid prior to its stated maturity date, the Indenture Trustee shall give notice in the name of the Corporation, which notice shall identify the Bonds to be redeemed or prepaid, state the date fixed for redemption or prepayment and state that such Bonds will be redeemed or prepaid at the Corporate Trust Office of the Indenture Trustee or a Paying Agent. The notice shall further state that on such date there shall become due and payable upon each Bond to be redeemed or prepaid the redemption or prepayment price thereof, together with interest accrued to the redemption or prepayment date, and that money therefor having been deposited with the Indenture Trustee or Paying Agent, from and after such date, interest thereon shall cease to accrue. The Indenture Trustee shall give 30 days' notice by mail, or otherwise transmit the redemption or prepayment notice in accordance with any appropriate provisions of the Indenture, to the registered owners of any Bonds which are to be redeemed or prepaid, at their addresses shown on the registration books of the Corporation. Such notice may be waived by any Bondholders holding Bonds to be redeemed or prepaid. Failure by a particular Bondholder to receive notice, or any defect in the notice to such Bondholder, shall not affect the redemption or prepayment of any other Bond. The Indenture Trustee shall not send notice to Bondholders of any optional redemption of Bonds unless the Indenture Trustee has on deposit a sum sufficient to pay the redemption price of and accrued interest on, the Bonds to be redeemed on such redemption date. Any notice of redemption or prepayment given pursuant to the Indenture may be rescinded by written notice to the Indenture Trustee by the Corporation no later than 15 days prior to the date specified for redemption or prepayment. The Indenture Trustee shall give notice of such rescission as soon as thereafter as practicable in the same manner and to the same persons, as notice of such redemption or prepayment was given as described above. (Section 404)

Turbo Redemptions

The Bonds shall be redeemed in whole or in part prior to their stated maturity from amounts on deposit in the Turbo Redemption Account on any Distribution Date at the redemption price of 100% of the principal amount thereof, together with interest accrued thereon to the date fixed for redemption, without premium, provided, however, that any such redemption shall be in a minimum aggregate amount of $50,000. Any redemption of Term Bonds shall redeem Term Bonds in order of maturity. In addition, the Term Bonds are subject to redemption upon and after defeasance of the Term Bonds, in accordance with the Indenture. (Section 404)

Investments

Pending its use under the Indenture, money in the Accounts may be invested by the Indenture Trustee in Eligible Investments and shall be so invested pursuant to written direction of the Corporation if there is not

then an Event of Default actually known to an Authorized Officer of the Indenture Trustee. The proceeds of the Series 2002A Bonds to be used by the Corporation to purchase the Tobacco Assets from the State under the Purchase and Sale Agreement continue to be proceeds of the Series 2002A Bonds in the hands of the State and the State has agreed in the Purchase and Sale Agreement to invest such proceeds subject to the restrictions of the Corporation Tax Certificate to the extent that such proceeds are subject to the investment limitation requirements of the Corporation Tax Certificate. Eligible Investments shall mature or be redeemable at the option of the Corporation on or before the Business Day preceding each next succeeding Distribution Date, except to the extent that other Eligible Investments timely mature or are so redeemable in an amount sufficient to make payments under the Indenture on each such next succeeding Distribution Date. Investments shall be held by the Indenture Trustee in the respective Accounts and shall be sold or redeemed to the extent necessary to make payments or transfers from each Account. The Indenture Trustee shall not be liable for any losses on investments made at the direction of the Corporation.

In computing the amount in any Account, the value of Eligible Investments will be determined by the Indenture Trustee at least as of each Deposit Date and will be calculated as follows:

(i) As to investments the bid and asked prices of which are published on a regular basis in The Wall Street Journal (or, if not there, then in The New York Times): the average of the bid and asked prices for such investments so published on or most recently prior to such time of determination;

(ii) As to investments the bid and asked prices of which are not published on a regular basis in The Wall Street Journal or The New York Times: the average bid price at such time of determination for such investments by any two nationally recognized government securities dealers (selected by the Indenture Trustee in its absolute discretion) at the time making a market in such investments or the bid price published by a nationally recognized pricing service;

(iii) As to certificates of deposit and bankers acceptances: the face amount thereof, plus accrued interest; and

(iv) As to any investment not specified above: the value thereof established by prior agreement between the Corporation and the Indenture Trustee.

The Indenture Trustee may hold undivided interests in Eligible Investments for more than one Account (for which they are eligible, but not including the Rebate Account) and may make interfund transfers in kind.

In respect of Defeasance Collateral held for Defeased Bonds, the provisions of the Indenture summarized under the caption “Investments” shall be effective only to the extent it is consistent with other applicable provisions of the Indenture or any separate escrow agreement. (Section 405)

Contract; Obligations to Beneficiaries

In consideration of the purchase and acceptance of any or all of the Bonds by those who will hold the same from time to time, the provisions of the Indenture will be a part of the contract of the Corporation with the Beneficiaries. The pledge and grant of a security interest made in the Indenture and the covenants set forth under the Indenture to be performed by the Corporation will be for the equal benefit, protection and security of the Beneficiaries. All of the Bonds will be of equal rank without preference, priority or distinction of any thereof over any other except as expressly provided in the Indenture.

The Corporation covenants to pay when due all sums payable on the Bonds, but only from the Revenues and money designated under the Indenture. The obligation of the Corporation to pay Principal,

interest and premium, if any, to the Beneficiaries will be absolute and unconditional, will be binding and enforceable in all circumstances whatsoever, and will not be subject to setoff, recoupment or counterclaim.

The Corporation represents that it is duly authorized pursuant to law to create and issue the Bonds, to enter into the Indenture and to pledge and grant a security interest in the Revenues and other Collateral as summarized under the caption "Security Interest and Pledge." The Revenues and other Collateral are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge and security interest created by the Indenture, and all action on the part of the Corporation to that end has been duly and validly taken. The Bonds and the provisions under the Indenture are and will be the valid and binding obligations of the Corporation in accordance with their terms, subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles and to the exercise of judicial discretion in appropriate cases.

Pursuant to the Act, the State pledges to and agrees with the Bondholders of any Bonds issued under the Indenture that the State will not limit or alter the rights vested in the Corporation to fulfill the terms of any agreements made with the Bondholders, or otherwise take any action that materially and adversely affects the rights of the Bondholders, until the Bonds, together with the interest thereon, with interest on any unpaid installments of interest, and all costs and expenses in connection with any action or proceeding by or on behalf of Bondholders, are fully met and discharged.

Pursuant to the Purchase and Sale Agreement, the State covenants and agrees with the Corporation, and the Corporation is authorized to include such covenant and agreement in the Indenture for the benefit of the Bondholders, that (i) the State shall take all actions as may be required by law and the MSA fully to preserve, maintain, defend, protect and confirm the interest of the Corporation in the Pledged TSRs and in the proceeds thereof in all material respects, and the State will not take any material action that will adversely affect the Corporation's legal right to receive the Pledged TSRs; (ii) the State will promptly pay to the Indenture Trustee any Pledged TSRs received by the State; and (iii) without the prior written consent of the Corporation and the Indenture Trustee, the State will not take any action and will use its best reasonable efforts not to permit any action to be taken by others that (x) would release any person from any of such person's covenants or obligations under the MSA or (y) would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the MSA or waive timely performance or observance under such document, in each case if the effect thereof would be materially adverse to the Bondholders or benefited parties; provided, however, that if a Rating Confirmation is received relating to such proposed action then such proposed action will be deemed not to be materially adverse to the Bondholders or benefited parties. The State shall deliver to the Corporation and to the Indenture Trustee written notice of any action described in clause (iii)(x) or (iii)(y) of the preceding sentence which it intends to take. The State shall deliver such written notice a reasonable period of time before taking any such action. (Section 501)

The State has provided through the MSA, the Consent Decree and the Purchase and Sale Agreement for the (i) Corporation's ownership and receipt of the Pledged TSRs, (ii) receipt or other application of the net proceeds of the Bonds and (iii) the resulting benefits to the people of the State. The Corporation acknowledges that the MSA, the Consent Decree and the Purchase and Sale Agreement constitute important security provisions of the Bonds and waives any right to assert any claim to the contrary and agrees that it shall neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the State or any other person of, any such claim to the contrary. By acknowledging that the MSA, the Consent Decree and the Purchase and Sale Agreement constitute important security provisions of the Bonds, the Corporation also acknowledges that, in the event of any failure or refusal by the State to comply with its agreements included in the MSA, the Consent Decree and the Purchase and Sale Agreement, the Holders of the Bonds may have suffered monetary damages, the extent of the remedy for which may be, to the fullest extent permitted by applicable federal and State law, determined, in addition to any other remedy available at law or in equity, in the course of any action taken pursuant to the Indenture; and the Corporation waives any right to assert any claim to the contrary and agrees that it shall neither in any manner directly or indirectly assert, nor in

any manner directly or indirectly support the assertion by the State or any other person of, any claim to the effect that no such monetary damages have been suffered.

Tax Covenants

The Corporation will covenant under the Indenture that:

(a) the Corporation will at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Corporation on Tax-Exempt Bonds will be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code; and

(b) no funds of the Corporation will at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code and any applicable Regulations issued thereunder. (Section 503)

Accounts and Reports

The Corporation will (1) cause to be kept books of account in which complete and accurate entries will be made of its transactions relating to all funds and accounts under the Indenture, which books will at all reasonable times be subject to the inspection of the Indenture Trustee and the Holders of an aggregate of not less than 25% in principal amount of Bonds then Outstanding or their representatives duly authorized in writing; and (2) annually, within 210 days after the close of each Fiscal Year, deliver to the Indenture Trustee and each Rating Agency, a copy of its financial statements for such Fiscal Year, as audited by an independent certified public accountant or accountants. (Section 505)

Ratings

The Corporation will pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect ratings on all the Bonds from at least two nationally recognized statistical rating organizations. (Section 507)

Affirmative Covenants

The Corporation will make the following affirmative covenants under the Indenture:

Maintenance of Existence. The Corporation will keep in full effect its existence, rights and franchises as a public entity under the laws of the State.

Protection of Collateral. The Corporation will from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (i) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (ii) perfect or protect the validity of any grant made or to be made by the Indenture; (iii) preserve and defend title to the Revenues and other Collateral pledged under the Indenture and the rights of the Indenture Trustee, on behalf of the Beneficiaries, in such Collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of the MSA, the Indenture, the Purchase and Sale Agreement, the Corporation Tax Certificate or the performance by any party thereunder; (iv) enforce the Purchase and Sale Agreement; (v) pay any and all taxes levied or assessed upon all or any part of the Collateral; or (vi) carry out more effectively the purposes of the Indenture.

Performance of Obligations. The Corporation (i) will diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the collateral and (ii) will not take any action and will

use its best efforts not to permit any action to be taken by others that would release any person from any of such person's covenants or obligations under any such instrument or agreement or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, any such instrument or agreement, except, in each case, as expressly provided in the Indenture, the Purchase and Sale Agreement, or the Corporation Tax Certificate, and (iii) with respect to Pledged TSRs, the Corporation shall direct the Attorney General to enforce, in the name of the State and, if permissible, to enforce directly through the Corporation's own attorneys in the name of the State, with notice to the Attorney General, the MSA, provided that the Board may not give any approval to any amendment to the MSA or the Qualifying Statute without notice to the Attorney General and the approval of the general assembly, this power constitutes a part of the contractual obligation owed to the holders of any Bonds.

Notice of Events of Default. The Corporation will give the Indenture Trustee and Rating Agencies prompt written notice of each Event of Default under the Indenture, as set forth under the caption, "Event of Default." (Section 607)

Other. The Corporation shall:

(i) conduct its own business in its own name and not in the name of any other Person and correct any known misunderstandings regarding its separate identity;

(ii) maintain or contract for a sufficient number of employees and compensate all employees, consultants and agents directly, from the Corporation's bank accounts, for services provided to the Corporation by such employees, consultants and agents and, to the extent any employee, consultant or agent of the Corporation is also an employee, consultant or agent of another Person, allocate the compensation of such employee, consultant or agent between the Corporation and such Person on a basis that reflects the services rendered to the Corporation and such Person;

(iii) have a separate telephone number, which will be answered only in its name and separate stationery, invoices and checks in its own name;

(iv) conduct all transactions with any other Person strictly on an arm's-length basis, allocate all overhead expenses (including, without limitation, telephone and other utility charges) for items shared between the Corporation and such Person on the basis of actual use to the extent practicable and, to the extent such allocation is not practicable, on a basis reasonably related to actual use;

(v) observe all formalities as a distinct entity, and ensure that all actions relating to (1) the dissolution or liquidation of the Corporation or (2) the initiation of, participation in, acquiescence in or consent to any bankruptcy, insolvency, reorganization or similar proceeding involving the Corporation, are duly authorized by unanimous vote of its Members;

(vi) maintain its books and records separate from those of any other Person and maintain its assets readily identifiable as its own assets rather than assets of any other Person and not commingle its assets with those of any other Person;

(vii) prepare its financial statements separately from those of any other Person and not prepare any financial statements that are consolidated with those of any other Person;

(viii) only maintain bank accounts or other depository accounts to which the Corporation alone is the account party, and from which only the Corporation has the power to make withdrawals;

(ix) pay all of the Corporation's operating expenses from the Corporation's own assets (except for expenses incurred prior to the date of issuance of the Bonds);

(x) operate its business and activities such that: it does not engage in any business or activity of any kind, or enter into any transaction or indenture, mortgage, instrument, agreement, contract, lease or other undertaking, other than the transactions contemplated and authorized by its organizational documents; and does not create, incur, guarantee, assume or suffer to exist any indebtedness or other liabilities, whether direct or contingent, other than (1) as a result of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business, (2) the incurrence of obligations under the Basic Documents, (3) the incurrence of operating expenses in the ordinary course of business of the type otherwise contemplated by the Basic Documents, and (4) the incurrence of obligations payable solely from specified assets of the Corporation not subject to the lien of the Indenture and the holders of which expressly have no recourse to any other assets of the Corporation in the event of non-payment;

(xi) maintain its organization in conformity with the Indenture. (Section 508)

Negative Covenants

The Corporation will make the following negative covenants under the Indenture:

Sale of Assets. Except as expressly permitted by the Indenture, the Corporation shall not sell, transfer, exchange or otherwise dispose of any of its properties or assets that are pledged under the Indenture.

No Setoff. The Corporation shall not claim any credit on, or make any deduction from the Principal or premium, if any, or interest on, the Bonds or assert any claim against any present or former Bondholder by reason of payment of taxes levied or assessed upon any part of the Collateral.

Liquidation. The Corporation will not terminate its existence or dissolve or liquidate in whole or in part.

Limitation of Liens. The Corporation will not (i) permit the validity of effectiveness of the Indenture to be impaired, or permit the lien of the Indenture to be amended, hypothecated, subordinated, terminated or discharged, or permit any Person to be released from any covenants or obligations with respect to the Bonds under the Indenture except as may be expressly permitted hereby, (ii) permit any lien, charge, excise, claim, security interest, mortgage or other encumbrance (other than the lien of the Indenture) to be created on or extend to or otherwise arise upon or burden the collateral or any part thereof or any interest therein or the proceeds thereof or (iii) permit the lien of the Indenture not to constitute a valid first priority security interest in the Collateral.

Limitations on Consolidation, Merger, Sale of Assets, etc. The Corporation shall not consolidate or merge with or into any other Person, or convey or transfer all or substantially all of its properties or assets.

Restricted Payments. The Corporation shall not, directly or indirectly, make distributions from the Collection Account except in accordance with the Indenture. (Section 509)

Indenture Trustee's Organization, Authorization, Capacity and Responsibility

The Indenture Trustee represents and warrants in the Indenture that it is duly organized and validly existing under the laws of the jurisdiction of its organization, having the authority to engage in the trust business within the State, including the capacity to exercise the powers and duties of the Indenture Trustee

under the Indenture, and that by proper corporate action it has duly authorized the execution and delivery of the Indenture.

The duties and responsibilities of the Indenture Trustee will be as provided by law and as set forth under the Indenture. Notwithstanding the foregoing, no provision of the Indenture shall require the Indenture Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties under the Indenture, or in the exercise of any of its rights or powers, unless it receives indemnity satisfactory to it against any loss, liability or expense; provided, that the Indenture Trustee shall make the payments and distributions required by the Indenture without requiring that any indemnity be provided to it. Whether or not therein expressly so provided, every provision of the Indenture relating to the conduct or affecting the liability of or affording protection to the Indenture Trustee will be subject to the provisions of the Indenture.

Resignation or Removal of the Indenture Trustee.

The Indenture Trustee may resign on not less than 30 days' written notice to the Corporation, the Beneficiaries and each Rating Agency. The Indenture Trustee will promptly certify to the Corporation that it has given written notice to all Beneficiaries and such certificate will be conclusive evidence that such notice was given as required under the Indenture. The Indenture Trustee will be removed if rated below investment grade by each Rating Agency and each successor Indenture Trustee will have an investment grade rating from each Rating Agency. The Indenture Trustee may be removed by written notice from the Corporation (if not in Default) or a majority of the Principal amount of the Outstanding Bonds to the Indenture Trustee and the Corporation. Such resignation or removal will not take effect until a successor has been appointed and has accepted the duties of Indenture Trustee. (Section 704)

Successor Fiduciaries.

Any corporation or association into which the Indenture Trustee may be merged or converted or with which it may be consolidated, or any corporation or association resulting from any merger, conversion or consolidation to which the Indenture Trustee shall be a party, or any corporation or association succeeding to all or substantially all of the corporate trust business of the Indenture Trustee, shall be the successor of the Indenture Trustee under the Indenture, without the execution or filing of any paper or any further act on the part of any of the parties under the Indenture.

In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary will with due care terminate its activities under the Indenture and a successor may, or in the case of the Indenture Trustee will, be appointed by the Corporation. The Corporation will notify the Beneficiaries and each Rating Agency of the appointment of a successor Indenture Trustee in writing within 20 days from the appointment. The Corporation will promptly certify to the successor Indenture Trustee that it has given such notice to all Beneficiaries and such certificate will be conclusive evidence that such notice was given as required hereby. If no appointment of a successor Indenture Trustee is made within 45 days after the giving of written notice in accordance with the provisions relating to the resignation or removal of the Indenture Trustee under the Indenture or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Indenture Trustee or any Beneficiary may apply to any court of competent jurisdiction for the appointment of such a successor, and such court may thereupon, after such notice, if any, as such court may deem proper, appoint such successor. Any successor Indenture Trustee appointed under this section shall be a trust company or a bank having the powers of a trust company, having (together with its corporate parent, if applicable) a capital and surplus of not less than $50,000,000. Any such successor Indenture Trustee will notify the Corporation of its acceptance of the appointment and, upon giving such notice, shall become the Indenture Trustee, vested with all the property, rights, powers and duties of the Indenture Trustee under the Indenture, without any further act or conveyance. Such successor Indenture Trustee will execute, deliver, record and file

such instruments as are required to confirm or perfect its succession under the Indenture and any predecessor Indenture Trustee will from time to time execute, deliver, record and file such instruments as the incumbent Indenture Trustee may reasonably require to confirm or perfect any succession under the Indenture. (Section 705)

Nonpetition Covenant

Prior to the date which is one (1) year and one (1) day after the date on which the Corporation no longer has any Bonds outstanding, the Corporation has no authority to file a voluntary petition under Chapter 9 of the United States Bankruptcy Code or such corresponding law as may, from time to time, be in effect, and neither any public official nor any other organization, entity, or other person shall authorize the Corporation to be or become a debtor under the United States Bankruptcy Code or any corresponding law during such periods. Pursuant to the Act, the State agrees that it will not modify or delete these provisions during the periods described in this paragraph. (Section 707)

Action by Bondholders

Any request, authorization, direction, notice, consent, waiver or other action provided by the Indenture to be given or taken by Bondholders may be contained in and evidenced by one or more writings of substantially the same tenor signed by the requisite number of Bondholders or their attorneys duly appointed in writing. Proof of the execution of any such instrument, or of an instrument appointing any such attorney, shall be sufficient for any purpose of the Indenture (except as otherwise expressly provided in the Indenture) if made in the following manner, but the Corporation or the Indenture Trustee may nevertheless in its discretion require further or other proof in cases where it deems the same desirable. The fact and date of the execution by any Bondholder or its attorney of such instrument may be proved by the certificate or signature guarantee by a guarantor institution participating in a guarantee program acceptable to the Indenture Trustee; or of any notary public or other officer authorized to take acknowledgments of deeds to be recorded in the jurisdiction in which such notary public or other officer purports to act, that the person signing such request or other instrument acknowledged to such notary public or other officer the execution thereof; or by an affidavit of a witness of such execution, duly sworn to before such notary public or other officer. The authority of the person or persons executing any such instrument on behalf of a corporate Bondholder may be established without further proof if such instrument is signed by a person purporting to be the chairperson or an executive officer of such corporation with a corporate seal affixed and attested by a person purporting to be its clerk or secretary or an assistant clerk or secretary. Any action of the Bondholder shall be irrevocable and bind all future record and beneficial owners hereof. (Section 801)

Registered Owners

The enumeration of certain provisions of the Indenture applicable to DTC as Holder of immobilized Bonds will not be construed in limitation of the rights of the Corporation and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in the Indenture. Notwithstanding any other provisions under the Indenture, any payment to the registered owner of a Bond will satisfy the Corporation's obligations thereon to the extent of such payment. (Section 802)

Events of Default

"**Event of Default**" in the Indenture means any one of the events set forth below:

(a) failure to pay when due interest on any interest payment date or Principal on the applicable Maturity Date or failure to pay when due interest on and Principal of any Bonds in accordance with any notice of redemption or prepayment;

(b) failure of the Corporation to observe or perform any other provision of the Indenture which is not remedied within 60 days after written notice thereof is given to the Corporation by the Indenture Trustee or to the Corporation and the Indenture Trustee by the Holders of at least 25% in principal amount of the Bonds then Outstanding; or

(c) a material breach by the State of its covenants contained in Section 501(d), (e), (f) or Section 504 of the Indenture, which breach is not remedied within 60 days after written notice, specifying such default and requiring the same to be remedied, shall have been given to the Corporation and the State by the Indenture Trustee or by the Holders of at least 25% in principal amount of the Bonds then Outstanding. In the case of a default specified in this subsection, if the default be such that it cannot be corrected within the said 60-day period, it shall not constitute an Event of Default if corrective action is instituted by the State within said 60-day period and diligently pursued until the default is corrected. (Section 901)

Remedies

(a) *Remedies of the Indenture Trustee.* If an Event of Default occurs and is continuing:

(1) The Indenture Trustee may, and upon written request of the Holders of at least 25% in principal amount of the Bonds Outstanding shall, in its own name by action or proceeding in accordance with law:

(a) enforce all rights of the Bondholders and require the Corporation to carry out its agreements with the Bondholders;

(b) sue upon such Bonds;

(c) require the Corporation to account as if it were the trustee of an express trust for such Bondholders; and

(d) enjoin any acts or things which may be unlawful or in violation of the rights of such Bondholders.

(2) The Indenture Trustee shall, in addition to the other provisions of this Section, have and possess all of the powers necessary or appropriate for the exercise of any functions incident to the general representation of Bondholders in the enforcement and protection of their rights under the Indenture.

(3) Upon a Default of the Corporation under (a) under the definition of "**Events of Default**" above, or a failure actually known to an Authorized Officer of the Indenture Trustee to make any other payment required hereby within 7 days after the same becomes due and payable, the Indenture Trustee will give written notice thereof to the Corporation. The Indenture Trustee will give Default notices under (b) under the definition of "Events of Default" above when instructed to do so by the written direction of another Fiduciary or the Holders of at least 25% in principal amount of the Outstanding Bonds. The Indenture Trustee will proceed under the provisions of the Indenture for the benefit of the Bondholders in accordance with the written direction of at least 25% in Principal amount of the Outstanding Bonds. The Indenture Trustee will not be required to take any remedial action (other than the giving of notice) unless reasonable indemnity is furnished for any expense or liability to be incurred therein. Upon receipt of written notice, direction and indemnity, and after making such investigation, if any, as it deems appropriate to verify the occurrence of any event of which it is notified as aforesaid, the Indenture Trustee will promptly pursue the remedies provided by the Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Bondholders, and will act for the protection of the

Bondholders with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

(b) *Extraordinary Prepayment.* If an Event of Default has occurred and is continuing, amounts on deposit in the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account will be applied on each Distribution Date in the following order: *first*, to pay interest on overdue interest on the Bonds (to the extent legally permissible) pro rata without regard to their order of Maturity; *second*, to pay overdue interest on the Bonds then due pro rata without regard to their order of maturity; *third*, to pay interest on the Bonds then due pro rata without regard to their order of maturity; and *fourth*, to prepay the Bonds pro rata without regard to their order of maturity, at the principal amount thereof without premium.

(c) *Individual Remedies.* No one or more Bondholders shall by its or their action affect, disturb or prejudice the pledge created by the Indenture, or enforce any right under the Indenture, except in the manner provided under the Indenture; and all proceedings at law or in equity to enforce any provision of the Indenture shall be instituted, had and maintained in the manner provided herein and for the equal benefit of all Bondholders of the same class; but nothing in the Indenture will affect or impair the right of any Bondholder to enforce payment of the Principal of, premium, if any, or interest thereon at and after the same comes due pursuant to the Indenture, or the obligation of the Corporation to pay such Principal, premium, if any, and interest on each of the Bonds to the respective Bondholders thereof at the time, place, from the source and in the manner expressed under the Indenture and in the Bonds.

(d) *Venue.* The venue of every action, suit or special proceeding against the Corporation shall be laid in the federal or state courts located in Providence County, Rhode Island.

(e) *Waiver.* If the Indenture Trustee determines that a Default has been cured before becoming an Event of Default and before the entry of any final judgment or decree with respect to it, the Indenture Trustee may waive the Default and its consequences, by written notice to the Corporation, and shall do so upon written instruction of the Holders of at least 25% in Principal amount of the Outstanding Bonds. (Section 902)

Supplements and Amendments to the Indenture

(a) The Indenture may be:

(1) supplemented in writing by the Corporation and the Indenture Trustee to (a) provide for earlier or greater deposits into the Debt Service Account, (b) subject any additional property to the lien under the Indenture, (c) add to the covenants and agreements of the Corporation or surrender or limit any right or power of the Corporation, (d) identify particular Bonds for purposes not inconsistent with the Indenture, including remarketing, serialization and defeasance, (e) cure any ambiguity or defect, (f) protect the exclusion of interest on the Series 2002A Bonds from gross income for federal income tax purposes, or the exemption from registration of the Bonds under the Securities Act of 1933, as amended, or of the Indenture under the Trust Indenture Act of 1939, as amended, and any other things relative to such Bonds that are not materially adverse to the Holders of Outstanding Bonds; or

(2) amended in writing by the Corporation and the Indenture Trustee, (a) to add provisions that are not materially adverse to the Bondholders, (b) to adopt amendments that do not take effect unless and until (i) no Bonds Outstanding prior to the adoption of such amendment remain Outstanding or (ii) such amendment is consented to by such Bondholders in accordance with the further provisions under the Indenture, or (c) pursuant to the following paragraph (b).

(b) Except as provided in the foregoing paragraph (a), the Indenture may be amended in writing by the Corporation and the Indenture Trustee:

(1) only with written notice to the Rating Agencies and the written consent of a majority of the principal amount of the Bonds to be Outstanding at the effective date thereof and affected thereby; but

(2) only with the unanimous written consent of the affected Bondholders for any of the following purposes: (a) to extend the stated maturity date of any Bond, (b) to reduce the principal amount, applicable premium or interest rate of any Bond, (c) to make any Bond redeemable or prepayable other than in accordance with its terms, or (d) to reduce the percentage of the Bonds required to be represented by the Bondholders giving their consent to any amendment.

Any amendment of the Indenture will be accompanied by an opinion of Counsel to the effect that the amendment is permitted by law and does not, in and of itself, result in the inclusion of interest on the Series 2002A Bonds in gross income for federal income tax purposes.

When the Corporation determines that the requisite number of consents have been obtained for an amendment hereto or to the agreement which requires consents, it shall file a certificate to that effect in its records and give notice to the Indenture Trustee and the Bondholders. The Indenture Trustee will promptly certify to the Corporation that it has given such notice to all Bondholders and such certificate will be conclusive evidence that such notice was given in the manner required under the Indenture. It will not be necessary for the consent of Bondholders pursuant to this Section to approve the particular form of any proposed amendment, but it will be sufficient if such consent will approve the substance thereof. (Section 1001)

Definitions

In addition to terms defined elsewhere herein, the following terms have the following meanings in this summary, unless the context otherwise requires:

"**Authorized Officer**" means: (i) in the case of the Corporation, the Chairperson, the Vice Chairperson and the Secretary, and any other person authorized to act by the Board under the Indenture by appropriate Written Notice to the Indenture Trustee, and (ii) in the case of the Indenture Trustee, any officer assigned to the Corporate Trust Office, including any managing director, vice president, assistant vice president, assistant treasurer, assistant secretary or any other officer of the Indenture Trustee customarily performing functions similar to those performed by any of the above designated officers and having direct responsibility for the administration of the Indenture, and also, with respect to a particular matter, any other officer, to whom such matter is referred because of such officer's knowledge of and familiarity with the particular subject.

"**Basic Documents**" means the Indenture, the Purchase and Sale Agreement, and the Corporation Tax Certificate.

"**Beneficiaries**" means Bondholders.

"**Bonds**" means the Series 2002A Bonds and the Series 2002B Bonds.

"**Code**" means the Internal Revenue Code of 1986, as amended.

"**Corporate Trust Office**" means the office of the Indenture Trustee at which the corporate trust business of the Indenture Trustee related hereto shall, at any particular time, be principally administered, which office is, at the date of the Indenture, located at 213 Court Street, Middletown, Connecticut 06457.

“**Corporation Tax Certificate**” means the Corporation Tax Certificate executed by the Corporation at the time of the issuance of the Bonds, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

“**Counsel**” means nationally recognized bond counsel or such other counsel as may be selected by the Corporation for a specific purpose under the Indenture.

“**Defeasance Collateral**” means money; and

(i) non-callable direct obligations of the United States of America, non-callable and non-prepayable direct federal agency obligations the timely payment of principal of and interest on which are fully and unconditionally guaranteed by the United States of America, non-callable direct obligations of the United States of America which have been stripped by the United States Treasury itself or by any Federal Reserve Bank (not including “CATS,” “TIGRS” and “TRS” unless the Corporation obtains Rating Confirmation with respect thereto) and the interest components of REFCORP bonds for which the underlying bond is non-callable (or non-callable before the due date of such interest component) for which separation of principal and interest is made by request to the Federal Reserve Bank of New York in book-entry form, and shall exclude investments in mutual funds and unit investment trusts;

(ii) obligations timely maturing and bearing interest (but only to the extent that the full faith and credit of the United States of America are pledged to the timely payment thereof);

(iii) certificates evidencing ownership of the right to the payment of the principal of and interest on obligations described in clause (ii), provided, that such obligations are held in the custody of a bank or trust company satisfactory to the Indenture Trustee in a segregated trust account in the trust department separate from the general assets of such custodian; and

(iv) bonds or other obligations of any state of the United States of America or any agency, instrumentality or local governmental unit of any such state (y) which are not callable at the option of the obligor or otherwise prior to maturity or as to which irrevocable notice has been given by the obligor to call such bonds or obligations on the date specified in the notice, and (z) timely payment of which is fully secured by a fund consisting only of cash or obligations of the character described in clause (i), (ii) or (iii) which fund may be applied only to the payment when due of such bonds or other obligations;

provided, that Defeasance Collateral shall not include obligations of the State.

“**Defeased Bonds**” means Bonds that remain in the hands of their Holders but are no longer deemed Outstanding.

“**Eligible Investments**” means:

(i) Defeasance Collateral;

(ii) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, any Federal Home Loan Bank, the Export-Import Bank of the United States, the Federal Financing Bank, the Government National Mortgage Association, the Farmers’ Home Administration, the Federal Home Loan Mortgage Company, the Federal Housing Administration, the Private Export Funding Corporation, the Federal Farm Credit Bank, the Resolution Trust Company, the Student Loan Marketing Association, or the Federal Farm Credit System;

(iii) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank or trust company, savings and loan association or savings bank, payable on demand or on a specified date no more than three months after the date of issuance thereof, if such deposits or instruments are rated at least A-1 by S&P, P-1 by Moody's and Fl by Fitch (if then rated by Fitch);

(iv) certificates, notes, warrants, bonds, obligations or other evidences of indebtedness of a state or a political subdivision thereof receiving one of the two highest long term unsecured debt ratings (without regard to rating subcategories) by S&P and Fitch (if then rated by Fitch);

(v) commercial or finance company paper (including both non-interest-bearing discount obligations and interest bearing obligations payable on demand or on a specified date not more than three months after the date of issuance thereof) that is rated A-1. by S&P, P-1 by Moody's and F1 by Fitch (if then rated by Fitch);

(vi) repurchase obligations with respect to any security described in clause (i) or (ii) above entered into with a primary dealer, depository institution or trust company (acting as principal) rated at least A-1 by S&P, P-1 by Moody's and F1 by Fitch (if then rated by Fitch) (if payable on demand or on a specified date no more than three months after the date of issuance thereof), or rated at least A3 by Moody's and in one of the three highest long-term rating categories by S&P and Fitch (if then rated by Fitch), or collateralized by securities described in clause (i) or (ii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "investment grade" by each Rating Agency; provided, that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Indenture Trustee or an independent third party acting solely as agent for the Indenture Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Indenture Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Indenture Trustee, (3) the agreement has a term of thirty days or less, or the Indenture Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is equal to at least 102%;

(vii) securities bearing interest or sold at a discount (payable on demand or on a specified date no more than three months after the date of issuance thereof) that are issued by any corporation incorporated under the laws of the United States of America or any state thereof and rated at least P-1 by Moody's, A-1 by S&P and F1 by Fitch (if then rated by Fitch) at the time of such investment or contractual commitment providing for such investment; provided, that securities issued by any such corporation will not be Eligible Investments to the extent that investment therein would cause the then outstanding principal amount of securities issued by such corporation that are then held to exceed 20% of the aggregate principal amount of all Eligible Investments then held;

(viii) units of taxable money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated at least Aa 1 by Moody's and at least AAm or AAm-G by S&P and at least AA by Fitch (if then rated by Fitch), including if so rated any such fund which the Indenture Trustee or an affiliate of the Indenture Trustee serves as an investment advisor, administrator, shareholder, servicing agent and/or custodian or sub-custodian, notwithstanding that (x) the Indenture Trustee or an affiliate of the Indenture Trustee charges and collects fees and expenses (not exceeding current income) from such funds for services rendered, (y) the Indenture Trustee charges and collects fees and expenses for services rendered pursuant to the Indenture, and (z) services performed for such funds and pursuant to the Indenture may converge at any time (the Corporation specifically authorizes the Indenture Trustee or an affiliate of

the Indenture Trustee to charge and collect all fees and expenses from such funds for services rendered to such funds, in addition to any fees and expenses the Indenture Trustee may charge and collect for services rendered pursuant to the Indenture);

(ix) investment agreements or guaranteed investment contracts rated, or with any financial institution or corporation whose senior long-term debt obligations are rated, or guaranteed by a financial institution whose senior long-term debt obligations are rated, at the time such agreement or contract is entered into, at least A3/P1 by Moody's and in one of the three highest long-term rating categories by S&P and Fitch (if then rated by Fitch) if the Corporation has an option to terminate such agreement in the event that either such rating is downgraded below the rating on the Bonds, or if not so rated, then collateralized by securities described in clause (i) or (ii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "investment grade" by each Rating Agency; provided, that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Indenture Trustee or an independent third party acting solely as agent for the Indenture Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Indenture Trustee shall have received. written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Indenture Trustee, (3) the agreement has a term of thirty days or less, or the Indenture Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is equal to at least 102%; and

(x) other obligations or securities that are non-callable and that are acceptable to each Rating Agency;

provided, that no Eligible Investment may (a) except for Defeasance Collateral, evidence the right to receive only interest with respect to the obligations underlying such instrument or (b) be purchased at a price greater than par if such instrument may be prepaid or called at a price less than its purchase price prior to its stated maturity, and provided further, that Eligible Investments will not include any obligations of the State.

"**Fiduciary**" means the Indenture Trustee and each Paying Agent, if any.

"**Fiscal Year**" means each 12-month period ending each June 30.

"**Officer's Certificate**" means a certificate signed by an Authorized Officer of the Corporation.

"**Operating Expenses**" means operating and administrative expenses of the Corporation (including, without limitation, the cost of preparation of accounting and other reports, costs of maintenance of the ratings on the Bonds, arbitrage payments and rebate penalties, insurance premiums, costs and expenses of indemnification pursuant to the Indenture and costs of annual meetings or other required activities of the Corporation), fees and expenses incurred for the Indenture Trustee, any Paying Agents, professional consultants and fiduciaries, termination payments on investment contracts or investment agreements for Accounts or on forward purchase contracts for investments in Accounts, enforcement related costs with federal and state agencies incurred, as determined by the State, in order to preserve the tax-exempt status of any Bonds, and the costs related to enforcement of the Corporation's or the Indenture Trustee's enforcement rights with respect to the Indenture, the Purchase and Sale Agreement, the Corporation Tax Certificate or the Bonds, and all other expenses so identified as Operating Expenses in the Indenture.

"**Outstanding**," when used as to Bonds, or a Series thereof, as the context requires, means Bonds issued under the Indenture, excluding: (i) Bonds that have been exchanged or replaced, or delivered to the Indenture Trustee for credit against a Principal payment; (ii) Bonds that have been paid in full; (iii) Bonds that

have become due and for the payment of which money has been duly provided to the Indenture Trustee for deposit in the Debt Service Account; (iv) Bonds the payment of which shall have been provided for pursuant to the Indenture; and (v) for purposes of any consent or other action to be taken by a specified percentage of Bondholders under the Indenture, Bonds held by or for the account of the Corporation, or any Person controlling, controlled by or under common control with the Corporation. For the purposes of this definition, "control," when used with respect to any specified Person, means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise, and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"**Paying Agent**" means each Paying Agent designated from time to time pursuant to the Indenture.

"**Person**" means any individual, corporation, estate, partnership, joint venture, association, joint stock company, limited liability company, trust, unincorporated organization, government or any agency or political subdivision thereof, or any other entity of any type.

"**Principal**" means the principal of any Bond payable on the Maturity Date thereof.

"**Revenues**" means the Pledged TSRs and all fees, charges, payments, proceeds, collections, investment earnings and other income and receipts (including Bond proceeds but only to the extent deposited in an Account) paid or payable to the Corporation or the Indenture Trustee for the account of the Corporation or the Beneficiaries.

"**Supplemental Indenture**" means a Series Supplement or supplement to the Indenture executed and delivered in accordance with the terms under the Indenture. Any provision that may be included in a Series Supplement or Supplemental Indenture is also eligible for inclusion in the other subject to the provisions under the Indenture.

"**Tobacco Assets**" means one hundred percent (100%) of the "state's tobacco receipts," as defined in the Act, and sold pursuant to the Purchase and Sale Agreement, consisting of and limited to (1) all Annual Payments and Strategic Contribution Payments, and subsequent adjustments thereto, scheduled to be received by the State under the MSA on and after January 1, 2004, (2) all amounts to be received by the State under the MSA on and after January 1, 2004 consisting of adjustments to initial payments and annual payments made to the State under the MSA prior to January 1, 2004, and (3) the total of all Partial Lump Sum Payments and Final Lump Sum Payments (as such terms are defined in the Indenture) received prior to January 1, 2004 (less the positive difference between (i) $53,410,000 and (ii) the amount of the initial payment due on January 10, 2003 and the annual payment due on April 15, 2003, if and to the extent either or both of such payments were actually made).

"**Written Notice**", "**written notice**" or "**notice in writing**" means notice in writing which may be delivered by hand or first class mail and also means facsimile transmission.

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APPENDIX F

BOOK-ENTRY ONLY SYSTEM

The information in this Appendix F concerning The Depository Trust Company ("DTC"), New York, New York, and DTC's Book-Entry system has been obtained from DTC and the State, the Corporation and the Underwriters take no responsibility for the completeness or accuracy thereof. The State, the Corporation and the Underwriters cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of principal of and interest on the Series 2007 Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Series 2007 Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2007 Bonds, or that they will do so on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix F. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.

DTC will act as securities depository for the Series 2007 Bonds. The Series 2007 Bonds will be issued as fully registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered security certificate will be issued for each series of the Series 2007 Bonds, in the aggregate initial principal amount of such series, and will be deposited with DTC.

DTC, the world's largest depository, is a limited purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of the Series 2007 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2007 Bonds on DTC's records. The ownership interest of each actual purchaser of each Security ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2007 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2007 Bonds, except in the event that use of the book-entry system for the series 2007 Bonds is discontinued. To facilitate subsequent transfers, all Series 2007 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2007 Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2007 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2007 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2007 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2007 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the security documents. For example, Beneficial Owners of the Series 2007 Bonds may wish to ascertain that the nominee holding the Series 2007 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Series 2007 Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in the Series 2007 Bonds to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2007 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Corporation as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2007 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of and interest evidenced by the Series 2007 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Corporation or the Trustee on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Trustee, or the Corporation, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal of and interest evidenced by the Series 2007 Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Corporation or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

NONE OF THE STATE, THE CORPORATION, THE UNDERWRITERS OR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF BONDS FOR PREPAYMENT.

DTC may discontinue providing its services as Securities depository with respect to the Series 2007 Bonds at any time by giving reasonable notice to the Corporation or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, bond certificates are required to be printed and delivered. The Corporation may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered to DTC. In the event that the Book-Entry system is discontinued as described above, the requirements of the Indenture will apply.

The information this Section concerning DTC and DTC's book-entry system has been obtained from Sources that the Corporation believes to be reliable, but the Corporation takes no responsibility for the accuracy thereof.

APPENDIX G

TABLE OF ACCRETED VALUES

$176,974,412.70 Series 2007A Bonds

Date	Amount	Date	Amount
6/27/2007	$351.10	6/1/2030	$1,361.85
12/1/2007	360.10	12/1/2030	1,402.70
6/1/2008	370.90	6/1/2031	1,444.75
12/1/2008	382.05	12/1/2031	1,488.10
6/1/2009	393.50	6/1/2032	1,532.75
12/1/2009	405.30	12/1/2032	1,578.75
6/1/2010	417.45	6/1/2033	1,626.10
12/1/2010	430.00	12/1/2033	1,674.90
6/1/2011	442.90	6/1/2034	1,725.15
12/1/2011	456.15	12/1/2034	1,776.90
6/1/2012	469.85	6/1/2035	1,830.20
12/1/2012	483.95	12/1/2035	1,885.10
6/1/2013	498.50	6/1/2036	1,941.65
12/1/2013	513.45	12/1/2036	1,999.90
6/1/2014	528.85	6/1/2037	2,059.90
12/1/2014	544.70	12/1/2037	2,121.70
6/1/2015	561.05	6/1/2038	2,185.35
12/1/2015	577.85	12/1/2038	2,250.90
6/1/2016	595.20	6/1/2039	2,318.45
12/1/2016	613.05	12/1/2039	2,388.00
6/1/2017	631.45	6/1/2040	2,459.65
12/1/2017	650.40	12/1/2040	2,533.45
6/1/2018	669.90	6/1/2041	2,609.45
12/1/2018	690.00	12/1/2041	2,687.70
6/1/2019	710.70	6/1/2042	2,768.35
12/1/2019	732.05	12/1/2042	2,851.40
6/1/2020	754.00	6/1/2043	2,936.95
12/1/2020	776.60	12/1/2043	3,025.05
6/1/2021	799.90	6/1/2044	3,115.80
12/1/2021	823.90	12/1/2044	3,209.30
6/1/2022	848.65	6/1/2045	3,305.55
12/1/2022	874.10	12/1/2045	3,404.75
6/1/2023	900.30	6/1/2046	3,506.85
12/1/2023	927.35	12/1/2046	3,612.10
6/1/2024	955.15	6/1/2047	3,720.45
12/1/2024	983.80	12/1/2047	3,832.05
6/1/2025	1,013.35	6/1/2048	3,947.00
12/1/2025	1,043.75	12/1/2048	4,065.45
6/1/2026	1,075.05	6/1/2049	4,187.40
12/1/2026	1,107.30	12/1/2049	4,313.00
6/1/2027	1,140.50	6/1/2050	4,442.40
12/1/2027	1,174.75	12/1/2050	4,575.70
6/1/2028	1,209.95	6/1/2051	4,712.95
12/1/2028	1,246.25	12/1/2051	4,854.35
6/1/2029	1,283.65	6/1/2052	5,000.00
12/1/2029	1,322.15		

$17,336,217.50 Series 2007B Bonds

Date	Amount	Date	Amount
6/27/2007	$332.50	6/1/2030	$1,325.95
12/1/2007	341.20	12/1/2030	1,366.55
6/1/2008	351.65	6/1/2031	1,408.45
12/1/2008	362.40	12/1/2031	1,451.55
6/1/2009	373.50	6/1/2032	1,496.00
12/1/2009	384.95	12/1/2032	1,541.85
6/1/2010	396.70	6/1/2033	1,589.05
12/1/2010	408.85	12/1/2033	1,637.70
6/1/2011	421.40	6/1/2034	1,687.85
12/1/2011	434.30	12/1/2034	1,739.55
6/1/2012	447.60	6/1/2035	1,792.85
12/1/2012	461.30	12/1/2035	1,847.75
6/1/2013	475.45	6/1/2036	1,904.35
12/1/2013	490.00	12/1/2036	1,962.65
6/1/2014	505.00	6/1/2037	2,022.75
12/1/2014	520.45	12/1/2037	2,084.70
6/1/2015	536.40	6/1/2038	2,148.55
12/1/2015	552.85	12/1/2038	2,214.35
6/1/2016	569.75	6/1/2039	2,282.15
12/1/2016	587.20	12/1/2039	2,352.05
6/1/2017	605.20	6/1/2040	2,424.10
12/1/2017	623.75	12/1/2040	2,498.35
6/1/2018	642.85	6/1/2041	2,574.85
12/1/2018	662.55	12/1/2041	2,653.70
6/1/2019	682.85	6/1/2042	2,734.95
12/1/2019	703.75	12/1/2042	2,818.75
6/1/2020	725.30	6/1/2043	2,905.05
12/1/2020	747.50	12/1/2043	2,994.00
6/1/2021	770.40	6/1/2044	3,085.70
12/1/2021	794.00	12/1/2044	3,180.20
6/1/2022	818.30	6/1/2045	3,277.60
12/1/2022	843.35	12/1/2045	3,378.00
6/1/2023	869.20	6/1/2046	3,481.45
12/1/2023	895.80	12/1/2046	3,588.05
6/1/2024	923.25	6/1/2047	3,697.95
12/1/2024	951.55	12/1/2047	3,811.20
6/1/2025	980.65	6/1/2048	3,927.90
12/1/2025	1,010.70	12/1/2048	4,048.20
6/1/2026	1,041.65	6/1/2049	4,172.20
12/1/2026	1,073.55	12/1/2049	4,299.95
6/1/2027	1,106.45	6/1/2050	4,431.65
12/1/2027	1,140.30	12/1/2050	4,567.35
6/1/2028	1,175.25	6/1/2051	4,707.25
12/1/2028	1,211.25	12/1/2051	4,851.40
6/1/2029	1,248.35	6/1/2052	5,000.00
12/1/2029	1,286.55		

$2,695,112.00 Series 2007C Bonds

Date	Amount	Date	Amount
6/27/2007	$5,066.00	6/1/2030	$23,212.00
12/1/2007	5,212.00	12/1/2030	23,995.00
6/1/2008	5,388.00	6/1/2031	24,805.00
12/1/2008	5,569.00	12/1/2031	25,642.00
6/1/2009	5,757.00	6/1/2032	26,508.00
12/1/2009	5,952.00	12/1/2032	27,402.00
6/1/2010	6,153.00	6/1/2033	28,327.00
12/1/2010	6,360.00	12/1/2033	29,283.00
6/1/2011	6,575.00	6/1/2034	30,272.00
12/1/2011	6,797.00	12/1/2034	31,293.00
6/1/2012	7,026.00	6/1/2035	32,349.00
12/1/2012	7,263.00	12/1/2035	33,441.00
6/1/2013	7,509.00	6/1/2036	34,570.00
12/1/2013	7,762.00	12/1/2036	35,737.00
6/1/2014	8,024.00	6/1/2037	36,943.00
12/1/2014	8,295.00	12/1/2037	38,190.00
6/1/2015	8,575.00	6/1/2038	39,478.00
12/1/2015	8,864.00	12/1/2038	40,811.00
6/1/2016	9,163.00	6/1/2039	42,188.00
12/1/2016	9,473.00	12/1/2039	43,612.00
6/1/2017	9,792.00	6/1/2040	45,084.00
12/1/2017	10,123.00	12/1/2040	46,606.00
6/1/2018	10,465.00	6/1/2041	48,179.00
12/1/2018	10,818.00	12/1/2041	49,805.00
6/1/2019	11,183.00	6/1/2042	51,486.00
12/1/2019	11,560.00	12/1/2042	53,223.00
6/1/2020	11,951.00	6/1/2043	55,020.00
12/1/2020	12,354.00	12/1/2043	56,876.00
6/1/2021	12,771.00	6/1/2044	58,796.00
12/1/2021	13,202.00	12/1/2044	60,780.00
6/1/2022	13,647.00	6/1/2045	62,832.00
12/1/2022	14,108.00	12/1/2045	64,952.00
6/1/2023	14,584.00	6/1/2046	67,145.00
12/1/2023	15,077.00	12/1/2046	69,411.00
6/1/2024	15,585.00	6/1/2047	71,753.00
12/1/2024	16,111.00	12/1/2047	74,175.00
6/1/2025	16,655.00	6/1/2048	76,678.00
12/1/2025	17,217.00	12/1/2048	79,266.00
6/1/2026	17,798.00	6/1/2049	81,942.00
12/1/2026	18,399.00	12/1/2049	84,707.00
6/1/2027	19,020.00	6/1/2050	87,566.00
12/1/2027	19,662.00	12/1/2050	90,521.00
6/1/2028	20,326.00	6/1/2051	93,576.00
12/1/2028	21,012.00	12/1/2051	96,735.00
6/1/2029	21,721.00	6/1/2052	100,000.00
12/1/2029	22,454.00		

APPENDIX H

DEFEASANCE TURBO SCHEDULES

Date (June 1)	Series 2007A Expected Amortization of Accreted Value
2023	$ 5,228,942
2024	65,412,493
2025	66,260,930
2026	67,118,597
2027	67,997,751
2028	68,890,923
2029	69,806,171
2030	70,734,489
2031	71,676,937
2032	45,144,086

Date (June 1)	Series 2007B Expected Amortization of Accreted Value
2032	$27,453,096
2033	53,690,821

Date (June 1)	Series 2007C Expected Amortization of Accreted Value
2033	$15,069,964

APPENDIX I

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