NEW ISSUE **BOOK-ENTRY ONLY**

*In the opinions of Hawkins, Delafield & Wood and Preston Gates & Ellis LLP, as Co-Bond Counsel, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (1) interest on the Series 2002 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 "**Tax Code**"), and (2) interest on the Series 2002 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Tax 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. See "TAX MATTERS."*

TSA

$517,905,000
Tobacco Settlement Authority
Tobacco Settlement Asset-Backed Bonds, Series 2002

Dated: Date of Delivery **Maturity Dates: June 1, as set forth on the inside cover**

The Tobacco Settlement Authority (the "**Authority**") is issuing $517,905,000 aggregate principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2002 (the "**Series 2002 Bonds**"). The Authority is a public instrumentality and agency of the State of Washington (the "**State**"), separate and distinct from the State, exercising public and essential governmental functions.

The Series 2002 Bonds are to be issued by the Authority pursuant to an Indenture between the Authority and U.S. Bank, N.A., Seattle, Washington, as trustee (the "**Indenture Trustee**") and the Series 2002 Supplement between the Authority and the Indenture Trustee, each dated as of October 1, 2002 (collectively, the "**Indenture**"). The Series 2002 Bonds are being issued to finance the Authority's purchase of the "**Pledged TSRs**," which consist of the sum of (1) the first $30,000,000 of payments received by the State under the Master Settlement Agreement (the "**MSA**") on and after the Closing Date and before July 1, 2003 and (2) 29.2% of (a) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto), (b) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003 and (c) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003. The MSA was entered into by participating cigarette manufacturers (the "**PMs**"), 46 states (including the State) and six other U.S. jurisdictions in November 1998 to settle certain smoking-related litigation. The right of the Authority to receive the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, as Pledged TSRs, is prior to the claim of the State to all other payments received by the State under the MSA on and after the Closing Date and before July 1, 2003. The right of the Authority to receive the other Pledged TSRs on and after July 1, 2003, is valid and enforceable and on a parity with the claim of the State to the Unpledged TSRs.

The Series 2002 Bonds are limited obligations of the Authority. The Authority is pledging the Pledged TSRs as security and in trust for the benefit of the Holders of the Bonds. Payment of the Series 2002 Bonds depends on receipt by the Indenture Trustee, as assignee of the Authority, of the Pledged TSRs. The amount of Pledged TSRs actually collected depends on many factors, including cigarette consumption and the financial capability of the PMs. With the exception of Series 2002 Bond proceeds deposited into the Liquidity Reserve Account and the Capitalized Interest Subaccount of the Debt Service Account, the Holders of the Series 2002 Bonds have no pledge or lien on the proceeds of the Series 2002 Bonds. See "RISK FACTORS" for a discussion of certain factors that should be considered in connection with an investment in the Series 2002 Bonds.

Interest on the Series 2002 Bonds will be payable on each June 1 and December 1, commencing June 1, 2003. The Series 2002 Bonds consist of Serial Bonds and Turbo Term Bonds maturing on June 1, as set forth on the inside cover (each such date, a "**Maturity Date**"). The Turbo Term Bonds are subject to redemption in accordance with the schedule of Sinking Fund Installments and, in addition, are subject to mandatory redemption to the extent of available Collections ("**Turbo Redemptions**"), as set forth herein. Turbo Redemptions, if any, will be credited against both Sinking Fund Installments and Turbo Term Bond Maturities in chronological order. As a consequence, it is expected that payment of principal on the Turbo Term Bonds will be substantially earlier than the scheduled Sinking Fund Installments and Maturity Dates.

Failure to pay interest, Serial Maturities or Turbo Term Bond Maturities when due will constitute an Event of Default under the Indenture. Failure to pay Turbo Redemptions or Sinking Fund Installments will not constitute an Event of Default under the Indenture. **The ratings of the Series 2002 Bonds address only the payment of interest on the Series 2002 Bonds when due and the payment of Serial Maturities and Turbo Term Bond Maturities when due**. See "RATINGS."

The Series 2002 Bonds are also subject to optional and mandatory redemption as described herein.

See the inside cover for Maturity Schedule, Interest Rates, Prices, Yields, Projected Final Turbo Redemption Dates and Projected Average Lives.

This cover contains information for reference only. Potential investors must read the entire Offering Circular to obtain information essential to making an informed investment decision.

THE SERIES 2002 BONDS SHALL NOT BE OBLIGATIONS OF THE STATE AND SHALL BE OBLIGATIONS ONLY OF THE AUTHORITY, PAYABLE SOLELY FROM THE SPECIAL FUND OR FUNDS CREATED BY THE AUTHORITY FOR THEIR PAYMENT. PAYMENT OF THE PRINCIPAL OF, INTEREST ON, AND REDEMPTION PREMIUM, IF ANY, ON THE SERIES 2002 BONDS SHALL BE A VALID CLAIM ONLY AS AGAINST THE SPECIAL FUND OR FUNDS RELATING THERETO. NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OR ANY MUNICIPAL CORPORATION, SUBDIVISION OR AGENCY OF THE STATE, OTHER THAN THE AUTHORITY AS SET FORTH IN THE ACT, IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, INTEREST ON, AND PREMIUM, IF ANY, ON THE SERIES 2002 BONDS.

The Series 2002 Bonds are offered when, as and if issued by the Authority and accepted by the Underwriters, subject to the approval of legality by Hawkins, Delafield & Wood, New York, New York, and Preston Gates & Ellis LLP, Seattle, Washington, Co-Bond Counsel. Certain legal matters will be passed upon for the Authority by Preston Gates & Ellis LLP, Seattle, Washington, general counsel to the Authority; for the State by the Attorney General of the State; and for the Underwriters by Orrick, Herrington & Sutcliffe LLP, Seattle, Washington, counsel to the Underwriters. It is expected that the Series 2002 Bonds will be available for delivery on or about November 5, 2002, in book-entry form through The Depository Trust Company, New York, New York.

Bear, Stearns & Co. Inc. **Goldman, Sachs & Co.**

Merrill Lynch & Co. **RBC Dain Rauscher** **UBS PaineWebber Inc.** **U.S. Bancorp Piper Jaffray**

Dated: October 25, 2002

MATURITY SCHEDULES

$517,905,000

Tobacco Settlement Authority

Tobacco Settlement Asset-Backed Bonds, Series 2002

Dated: Date of Delivery

$58,625,000 Serial Bonds Maturing June 1

Year	Principal Amount	Interest Rate	Price or Yield	CUSIP No.
2005	$ 550,000	3.400%	100%	88880MAA9
2006	110,000	3.800	100%	88880MAB7
2008	10,675,000	5.000	100%	88880MAC5
2009	10,060,000	5.250	100%	88880MAD3
2010	9,620,000	5.250	5.500%	88880MAE1
2011	13,285,000	6.250	5.750%	88880MAF8
2012	14,325,000	5.500	5.875%	88880MAG6

$279,775,000

6.500% Turbo Term Bonds due June 1, 2026; Yield: 6.650%

Projected Final Turbo Redemption Date: June 1, 2016*

Projected Average Life: 9.1 years*

CUSIP No. 88880MAH4

$179,505,000

6.625% Turbo Term Bonds due June 1, 2032; Yield: 6.875%

Projected Final Turbo Redemption Date: June 1, 2019*

Projected Average Life: 14.7 years*

CUSIP No. 88880MAJ0

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* Assumes Turbo Redemptions in accordance with the assumptions described herein. No assurance is given that these assumptions will be realized. Payments of Turbo Redemptions have not been rated by the Rating Agencies. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION."

CERTAIN PERSONS 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 AUTHORITY, 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 IS CURRENTLY A LIMITED SECONDARY MARKET FOR SECURITIES SUCH AS THE SERIES 2002 BONDS PAYABLE FROM TOBACCO SETTLEMENT PAYMENTS MADE UNDER THE MSA. THERE CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES 2002 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 2002 BONDS.

This Offering Circular has been prepared by the Authority and contains information furnished by DRI•WEFA and other sources, all of which the Authority believes to be reliable. The information concerning the tobacco industry and participants therein has been obtained from certain publicly available information provided by certain participants and certain other sources. See "TOBACCO INDUSTRY." The participants in the tobacco industry have not provided any information to the Authority for use in connection with this offering. In certain cases, tobacco industry information set forth herein (such as market share data) may be derived from inconsistent sources. The Authority has no independent knowledge of any facts indicating that the information under the caption "Tobacco Industry" is inaccurate in any material respect, but has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. The information contained under the captions "DRI•WEFA Report" and in the DRI•WEFA Report attached as Appendix A to this Offering Circular has been included in reliance upon DRI•WEFA as an expert in econometric forecasting, and has not been independently verified for accuracy or for appropriateness of assumptions, although the Authority has no independent knowledge that the information is inaccurate.

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 Authority or the matters covered by the DRI•WEFA Report attached as Appendix A to this Offering Circular since the date hereof, or that the information contained herein is correct as of any date subsequent to the date hereof. Such information and expressions of opinion are included herein 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.

This Offering Circular contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the important factors that may materially affect the amount of Pledged TSRs (see "RISK FACTORS" and "SUMMARY OF THE MSA"), the inclusion in this Offering Circular of such forecasts, projections and estimates should not be regarded as a representation by the Authority, the State, DRI•WEFA or the Underwriters that 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" and "assumes" and analogous expressions are intended to identify forward-looking statements. Any such forward-looking 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, all of which are beyond the control of the Authority. These forward-looking statements speak only as of the date of this Offering Circular. The Authority disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any changes in the Authority's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

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 PROPOSED SECURITIES TRANSACTIONS DESCRIBED HEREIN WILL BE MADE ON THE BASIS OF EXEMPTIONS FROM REGISTRATION PRVIDED IN THE SECURITIES ACT OF 1933, AS AMENDED.

THE SERIES 2002 BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION OR ANY OTHER REGULATORY AUTHORITY, 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.

Table of Contents

	Page
SUMMARY STATEMENT	S-1
INTRODUCTORY STATEMENT	1
RISK FACTORS	2
Decline in Cigarette Consumption Materially Beyond Forecasted Levels May Adversely Affect Payments	2
Other Potential Payment Decreases Under the Terms of the MSA	3
Risks Related to Enforceability or Modification of the MSA and Constitutionality of the Model Statute	5
Tobacco Industry Litigation	8
Uncertainty as to Timing of Amortization	13
Bankruptcy of a PM May Delay or Reduce Payments	13
Bonds Secured Solely by the Collateral	14
Limited Remedies	14
Limited Liquidity of the Series 2002 Bonds	14
Limited Nature of Ratings; Reduction, Suspension or Withdrawal of a Rating	14
IRS Audits	15
SUMMARY OF THE MSA	15
General	15
Parties to the MSA	15
Scope of Release	16
Overview of Payments by the Participating Manufacturers	17
Initial Payments	18
Annual Payments	19
Strategic Contribution Payments	20
Adjustments to Payments	20
Subsequent Participating Manufacturers	23
Payments Made to Date	24
“Most Favored Nation” Provisions	25
State-Specific Finality and Final Approval	25
Disbursement of Funds from Escrow	25
Advertising and Marketing Restrictions; Educational Programs	26
Termination of MSA	26
Severability	27
Amendments and Waivers	27
MSA Provisions Relating to Model/Qualifying Statutes	27
WASHINGTON CONSENT DECREE	30
TOBACCO INDUSTRY	30
Industry Overview	31
Shipment Trends	33
Consumption Trends	34
Tax Collections	34
Distribution, Competition and Raw Materials	34
Gray Market	35
Regulatory Issues	35
Civil Litigation	39
DRI•WEFA REPORT	51
General	51
Comparison with Prior Forecasts	54
Historical Cigarette Consumption	54
Survey of the Economic Literature on Smoking	55
Factors Affecting Cigarette Consumption	57
SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION	61
Introduction	61
Cash Flow Assumptions	61
Bond Structuring Methodology	65
Debt Service Coverage	69
Allocation of Principal Payments	71
Effect of Changes in Cigarette Consumption Levels on Turbo Redemptions	71
USE OF PROCEEDS	75
THE AUTHORITY	76
SECURITY	77
Sale of Pledged TSRs; Pledge of Collateral	77
Payment by MSA Escrow Agent to Indenture Trustee	78
Application of Revenues	78
Additional Bonds	80
THE SERIES 2002 BONDS	81
Payments of Interest	81
Payments of Principal	81
Open Market Purchase of Turbo Term Bonds	83
Sinking Fund Installments	83
Optional Redemption	83
Turbo Redemptions	84
Mandatory Clean-up Call	85
Notice of Redemption	85
Reports by Indenture Trustee	85
Book-Entry Only System	86
THE SALES AGREEMENT	88
Authority	88
Conveyance of Tobacco Assets	88

Table of Contents
(Continued)

	Page
Purchase Consideration	89
Representations of State	89
Limitation on Liability	90
Pledges; Protection of Title; Non-Impairment Covenant	90
Further Actions	91
Tax Covenants	92
Residual Certificate and Unsold TSRs	92
Bonds Not Debt of State	92
Amendment	93
Definitions	93
THE INDENTURE	94
No Liability on Bonds	94
Security Interest and Pledge	94
Defeasance	95
Establishment of Accounts	97
Investments	97
Contract; Obligations to Bondholders	98
Operating Expenses	100
Tax Covenants	100
Non-Petition Covenant	101
Accounts and Reports	101
Ratings	101
Affirmative Covenants	101
Negative Covenants	103
Prior Notice	104
Indenture Trustee's Organization, Authorization, Capacity, and Responsibility	104
Rights and Duties of the Fiduciaries	106
Paying Agents	107
Resignation or Removal of the Indenture Trustee	108
Successor Fiduciaries	108
Action by Bondholders	108
Registered Holders	109
Events of Default	109
Remedies	110
Supplements and Amendments to the Indenture	111
Supplements and Amendments to the Sales Agreement	112
Definitions	112
LEGAL CONSIDERATIONS	118
Bankruptcy of a PM May Delay or Reduce Payments	118
MSA Enforceability	119
Qualifying Statute Constitutionality	120
Limitations on Certain Opinions; No Assurance as to Outcome of Litigation	121
Enforcement of Rights to Pledged TSRs	122
CONTINUING DISCLOSURE UNDERTAKING	122
TAX MATTERS	124
Opinions of Co-Bond Counsel	124
Certain Ongoing Federal Tax Requirements and Covenants	125
Certain Collateral Federal Tax Consequences	125
Original Issue Discount	125
Bond Premium	126
Possible Government Action	126
IRS Audits	126
RATINGS	127
UNDERWRITING	127
LEGAL MATTERS	127
OTHER PARTIES	128
DRI•WEFA	128
Financial Advisors	128
INDEX OF DEFINED TERMS	129

Appendix A DRI•WEFA Report
Appendix B Master Settlement Agreement
Appendix C Proposed Form of Opinions of Co-Bond Counsel

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 2002 Bonds to potential investors is made only by means of the entire Offering Circular. For locations of definitions of certain terms used herein, see "INDEX OF DEFINED TERMS."

Overview...

The Tobacco Settlement Authority (the "**Authority**") is issuing $517,905,000 aggregate principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2002 (the "**Series 2002 Bonds**").

The Series 2002 Bonds are to be issued pursuant to an Indenture between the Authority and U.S. Bank, N.A., Seattle, Washington, as trustee (the "**Indenture Trustee**") and the Series 2002 Supplement between the Authority and the Indenture Trustee, each dated as of October 1, 2002 (collectively, the "**Indenture**").

The Authority will apply the proceeds of the Series 2002 Bonds to (1) purchase the Pledged TSRs from the State of Washington (the "**State**"); (2) fund a Liquidity Reserve Account; (3) capitalize a portion of the interest due on the Series 2002 Bonds through June 1, 2003; (4) capitalize certain Operating Expenses; and (5) pay the costs of issuance of the Series 2002 Bonds. The State expects to use the proceeds of the sale of the Pledged TSRs to refinance and defease certain outstanding obligations of the State, to pay for certain capital projects and for working capital purposes. Funds received by the State as payment for the Pledged TSRs are not pledged to or accessible to Bondholders. The Authority will also issue a Residual Certificate to the State to evidence all of the Authority's right, title and interest in and to the Pledged TSRs following final payment of the Bonds and other obligations of the Authority under the Indenture.

"**Pledged TSRs**" means the sum of (1) the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, and (2) 29.2% of:

(a) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto);

(b) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003; and

(c) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003.

The MSA was entered into by participating cigarette manufacturers, 46 states (including the State) and six other U.S. jurisdictions in November 1998 to settle certain smoking-related litigation.

"**Unpledged TSRs**" means the sum of (1) the payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, other than the first $30,000,000 of such payments, (2) all Litigation Expense Reimbursements received by the State under the

MSA on and after July 1, 2003, and (3) 70.8% of:

(a) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto);

(b) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003; and

(c) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003.

The right of the Authority to receive the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, as Pledged TSRs, is prior to the claim of the State to all other payments received by the State under the MSA on and after the Closing Date and before July 1, 2003. The right of the Authority to receive the other Pledged TSRs on and after July 1, 2003, is valid and enforceable and on a parity with the claim of the State to the Unpledged TSRs.

"**Litigation Expense Reimbursements**" means the reimbursements and payments made or to be made to the State or any department or agency of the State pursuant to Section XVII(a) and (b) of the MSA.

The Series 2002 Bonds shall not be obligations of the State and shall be obligations only of the Authority, payable solely from the special fund or funds created by the Authority for their payment. Payment of the principal of, interest on, and redemption premium, if any, on the Series 2002 Bonds shall be a valid claim only as against the special fund or funds relating thereto. Neither the faith and credit nor the taxing power of the State or any municipal corporation, subdivision, or agency of the State, other than the Authority as set forth in the Act, is pledged to the payment of the principal of, interest on, and premium, if any, on the Series 2002 Bonds.

Collateral.. The Bonds are secured by and payable from the "**Collateral**," consisting of all of the Authority's right, title and interest in, to and under: (1) the Pledged TSRs and all fees, charges, payments, proceeds, collections, investment earnings and other income and receipts paid or payable to the Authority or the Indenture Trustee for the account of the Bondholders (including, without limitation, amounts paid to the Indenture Trustee for the account of the Authority under any Swap Contract) (the "**Collections**"); (2) all rights to receive the Collections and the proceeds of such rights; (3) the accounts established and maintained by the Indenture Trustee under the Indenture (the "**Accounts**") (except for the Rebate Account) and assets thereof, including money, contract rights, general intangibles or other personal property, held by the Indenture Trustee under the Indenture; (4) subject to certain rights reserved under the Indenture, all rights and interest of the Authority under the Sales Agreement, including the representations, warranties and covenants of the State in the Sales Agreement; (5) any payment received by the Indenture Trustee pursuant to a Swap Contract; (6) 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; (7) all proceeds of the foregoing; and (8) any and all other property of every kind and nature from time to time after the date of the Indenture, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture.

Master Settlement Agreement................ The MSA was entered into on November 23, 1998, among the attorneys general of 46 states (including Washington), the District of Columbia, the Commonwealth of 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**") (collectively, the "**Original Participating Manufacturers**" or "**OPMs**"). The MSA resolved cigarette smoking-related litigation among the Settling States and the OPMs, released the OPMs from past and present smoking-related claims by the Settling States 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). The MSA also provides for the imposition of certain tobacco advertising and marketing restrictions, among other things. The Authority is not a party to the MSA.

The MSA is an industry-wide settlement of litigation between the Settling States and the Participating Manufacturers (as defined below). The MSA provides for tobacco companies other than the OPMs to become parties to the MSA. Tobacco companies that 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 do not become parties to the MSA are referred to herein as "**Non-Participating Manufacturers**" or "**NPMs**." See "SUMMARY OF THE MSA."

MSA Payments .... Under the MSA, the State is entitled to 2.0532582% of the Initial Payments and Annual Payments and 5.7647432% of the Strategic Contribution Payments.

Under the MSA, the OPMs are required to pay to the Settling States (1) five initial payments, four of which have been paid, and the fifth of which is required to be paid by January 10, 2003 (the "**Initial Payments**"), (2) annual payments required to be made on each April 15, commencing April 15, 2000 and continuing in perpetuity (of which the April 15, 2000, April 15, 2001 and April 15, 2002 annual payments have already been paid) (the "**Annual Payments**") 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	Thereafter	9,000,000,000
2009	8,139,000,000		

and (3) ten annual payments of $861 million each (subject to adjustment as described herein) required to be made on each April 15, commencing April 15, 2008 and continuing through April 15, 2017 (the "**Strategic Contribution Payments**"). The Initial Payments, Annual Payments and Strategic Contribution Payments are referred to collectively herein as the "**Tobacco Settlement Revenues**" or "**TSRs**."

The TSRs due under the MSA are subject to numerous adjustments, some of which are material. Such adjustments include, among others, reductions for decreased domestic cigarette shipments, reductions for amounts paid by OPMs to four states which had previously settled their claims against the PMs independently of the MSA, and, in the case of the Annual Payments and Strategic Contribution Payments, increases related to inflation of not less than 3% per annum. See "RISK FACTORS—Other Potential Payment Decreases Under the Terms of the MSA—*Disputed or Recalculated Payments*" and "SUMMARY OF THE MSA."

"**Final Approval**" of the MSA occurred on November 12, 1999, when 80% of the Settling States by number and dollar volume achieved State-Specific Finality. The MSA Escrow Agent distributed the upfront Initial Payment upon Final Approval, and subsequently distributed the Initial Payments and the Annual Payments due to date to the Settling States that have achieved State-Specific Finality. The State has received its share of distributions made to date, none of which is available to pay or to secure the Series 2002 Bonds.

Under the MSA, each OPM is required to pay an allocable portion of each remaining Initial Payment, Annual Payment and Strategic Contribution Payment based on its relative market share of the United States cigarette market during the preceding calendar year, subject to certain adjustments as described herein. Each SPM that signed the MSA before February 22, 1999 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. Each SPM that signed the MSA after February 22, 1999 has Annual Payment and Strategic Contribution Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share, and its 1997 or

1998 market share, as applicable, is deemed to be zero. See "SUMMARY OF THE MSA—Subsequent Participating Manufacturers." The SPMs have no payment obligation with respect to the Initial Payments. The payment obligations under the MSA follow tobacco product brands if they are transferred by any of the PMs. Payments by the PMs are required to be made to the MSA Escrow Agent, which is required, in turn (pursuant to instruction to the MSA Escrow Agent by the State) to remit the Pledged TSRs directly to the Indenture Trustee. Such direction is irrevocable until the Bonds have been repaid. Since the Authority is not a party to the MSA, neither the Authority nor the Bondholders have any right to enforce the provisions of the MSA.

See "SUMMARY OF THE MSA" and "THE INDENTURE."

Washington Consent Decree.................. On November 23, 1998, the Consent Decree and Final Judgment (the "**Consent Decree**"), which governs the State's action against the tobacco companies, was entered in the Superior Court of Washington for King County. The Consent Decree is final and not subject to further appeal. As a result, the State has achieved State-Specific Finality.

Sale of Tobacco Settlement Revenues .... Pursuant to a Purchase and Sale Agreement, dated as of October 1, 2002 (the "**Sales Agreement**"), between the State and the Authority, the State will sell to the Authority, on the Closing Date, the Pledged TSRs. The Authority will assign and pledge the purchased Pledged TSRs to the Indenture Trustee. The MSA Escrow Agent has been directed by the State to pay the Pledged TSRs directly to the Indenture Trustee. See "THE SALES AGREEMENT."

Industry Overview .... The four OPMs—Philip Morris, Reynolds Tobacco, B&W and Lorillard—are the largest manufacturers of cigarettes in the United States (based on 2001 market share). According to Loews Corporation ("**Loews**"), the OPMs accounted for approximately 94%* of the United States domestic cigarette market in 2001 based on shipments. The market for cigarettes is highly competitive and is characterized by brand recognition and loyalty. See "TOBACCO INDUSTRY."

Cigarette Consumption .... As described in the DRI•WEFA Report (as defined below), domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980s and 1990s, reaching an estimated level of 419 billion cigarettes in 2001. See "DRI•WEFA REPORT."

DRI•WEFA Report .... DRI•WEFA, Inc. ("**DRI•WEFA**"), an international econometric and consulting firm, has been retained on behalf of the Authority to forecast cigarette consumption in the United States from 2001 through 2032. DRI•WEFA considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry

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* Market share information for the OPMs based on shipments may be materially different from Relative Market Share for purposes of the MSA and the respective obligations of the OPMs to contribute to Initial Payments, Annual Payments and Strategic Contribution Payments. See "SUMMARY OF THE MSA—Initial Payments," "—Annual Payments" and "—Strategic Contribution Payments." Additionally, aggregate market share based on shipments information as reported by Loews 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. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" and "TOBACCO INDUSTRY."

advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that capture the impact of anti-smoking regulations, legislation and health warnings. After extensive analysis, DRI•WEFA 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 2000 and an analysis of these variables, DRI•WEFA 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 DRI•WEFA's standard adult population growth forecast and adjustments for non-adult smoking, DRI•WEFA projected adult cigarette consumption out to 2032. DRI•WEFA's report, entitled *A Forecast of U.S. Cigarette Consumption (2001-2032) for the Tobacco Settlement Authority* (the "**DRI•WEFA 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 it reaches.

While the DRI•WEFA Report is based on United States cigarette consumption, MSA payments are computed based in part on cigarette shipments in or to the 50 United States, the District of Columbia and Puerto Rico. The DRI•WEFA 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 "DRI•WEFA REPORT." The projections and forecasts regarding future cigarette consumption included in the DRI•WEFA Report are estimates that 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 Authority.. The Authority is a public instrumentality and agency of the State, separate and distinct from the State, exercising public and essential governmental functions. The Authority was organized, and the Series 2002 Bonds are being issued, pursuant to Chapter 365 of Laws of 2002 of the State of Washington, codified as RCW 43.340.005, *et seq.,* as amended (the "**Act**"). Under authority of the Act the State is selling the Pledged TSRs to the Authority.

The Act prohibits the Authority from filing a voluntary petition under the federal bankruptcy code.

Securities Offered .... The Series 2002 Bonds will be issued pursuant to the Indenture.

It is expected that the Series 2002 Bonds will be delivered in book-entry form on or about November 5, 2002, (the "**Closing Date**") through the facilities of The Depository Trust Company, New York, New York ("**DTC**"). Individual purchases of beneficial ownership interests may be made in the principal amount of $5,000 or any integral multiple thereof. Beneficial owners of the Series 2002 Bonds will not receive physical delivery of bond certificates. See "THE SERIES 2002 BONDS—Book-Entry Only System."

Interest on the Series 2002 Bonds...........	Interest on the Outstanding principal amount of the Series 2002 Bonds will be payable on each June 1 and December 1 or the next succeeding Business Day if such day is not a Business Day (each, a "**Distribution Date**"), commencing June 1, 2003. Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months. Failure to pay the full amount of interest on the Series 2002 Bonds when due is an Event of Default. See "SECURITY—Flow of Funds."
Maturities...	The Series 2002 Bonds consist of Serial Bonds and Turbo Term Bonds maturing on June 1, as set forth on the inside cover (each such date a "**Maturity Date**"). Failure to pay interest, Serial Maturities and Turbo Term Bond Maturities when due will constitute an Event of Default under the Indenture. Failure to pay Turbo Redemptions or Sinking Fund Installments will not constitute an Event of Default under the Indenture. **The ratings of the Series 2002 Bonds address only the payment of interest on the Series 2002 Bonds when due and the payment of Serial Maturities and Turbo Term Bond Maturities when due.** Series 2002 Bonds will be paid from Collections and, if necessary, the Liquidity Reserve Account. Upon any Event of Default under the Indenture, all future payments will be made on a Pro Rata basis, to pay interest due to date, and then principal (whether or not due). See "SECURITY—Application of Revenues." "**Pro Rata**" means, for an allocation of available amounts to any payment of interest, principal or Swap Payments to be made under the Indenture, the application of a fraction to such available amounts (1) the numerator of which is equal to the amount due to the respective Bondholders, and any party who has entered into a Swap Contract with the Authority, to whom such payment is owing, and (2) the denominator of which is equal to the total amount due to all Bondholders and Swap Contract counterparties to whom such payment is owing.
Sinking Fund Installments	The "**Sinking Fund Installment**" of a Turbo Term Bond represents the amount of principal that the Authority is required to pay as of the specified Distribution Date, but only to the extent of available Collections and, if necessary, the Liquidity Reserve Account, as set forth in the schedules under "THE SERIES 2002 BONDS—Sinking Fund Installments." A failure by the Authority to pay the Sinking Fund Installment of a Turbo Term Bond when due will not constitute an Event of Default under the Indenture.
Turbo Redemptions................................	"**Turbo Redemptions**" represent the requirement contained in the Indenture to apply to the redemption of Turbo Term Bonds on each Distribution Date all Collections that are in excess of the requirements in the Indenture for the funding of the Operating Expenses, the deposits to the Debt Service Account for the funding of interest on the Bonds, Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments and maintenance of the Liquidity Reserve Account. Such Collections will be deposited in an account established and maintained by the Indenture Trustee under the Indenture (the "**Turbo Redemption Account**"). Turbo Redemptions will be credited against both Sinking Fund Installments and Turbo Term Bond Maturities in chronological order. Turbo Redemptions are not scheduled amortization payments and are to be made only from Collections as described above, if any, and from amounts on deposit in the Partial Lump Sum Payment Account with confirmation from each Rating Agency that no rating then in effect

with respect to the Bonds from such Rating Agency will be withdrawn, reduced or suspended. See the "Projected Final Turbo Redemption Dates" set forth on the inside cover and "THE SERIES 2002 BONDS—Turbo Redemptions."

Optional Redemption .... The Series 2002 Bonds maturing on or prior to June 1, 2012 are not subject to optional redemption. The Series 2002 Bonds maturing on June 1, 2026 and June 1, 2032 are subject to redemption (from sources other than Collections or from the proceeds of Refunding Bonds) at the option of the Authority: (1) with respect to Turbo Term Bonds, in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid but, as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (2) with respect to all Series 2002 Bonds, in whole or in part on or after June 1, 2013, from any maturity selected by the Authority in its discretion and Pro Rata within a maturity, in each case at a redemption price equal to 100% of the principal amount being redeemed.

"**Projected Turbo Redemption**" means, for a series of Bonds, each respective Turbo Redemption projected to be made pursuant to the Indenture, and for the Series 2002 Bonds means each projected Turbo Redemption set forth in the tables under "THE SERIES 2002 BONDS—Turbo Redemptions—Projected Turbo Redemptions."

Defeasance .... The Series 2002 Bonds are subject to defeasance in accordance with the provisions set forth in "THE INDENTURE—Defeasance."

Mandatory Clean-up Call....................... The Bonds are subject to mandatory redemption in whole at a redemption price equal to 100% of the principal amount being redeemed at any time that the available amounts on deposit in the Accounts (other than the Rebate Account, the Operating Account, the Operating Contingency Account and the Costs of Issuance Account) exceed the aggregate principal amount of, and accrued interest on, all Outstanding Bonds.

Liquidity Reserve Account .... A reserve account (the "**Liquidity Reserve Account**") will be established and maintained by the Indenture Trustee under the Indenture and funded from proceeds of the issuance of the Series 2002 Bonds in an amount equal to $45,534,106.25, which is equal to maximum annual debt service on the Series 2002 Bonds as of their date of issuance, based on the assumption that all Serial Maturities and Sinking Fund Installments are paid when due (the "**Liquidity Reserve Requirement**").

Amounts on deposit in the Liquidity Reserve Account will be available to pay interest on and Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments of the Bonds to the extent Collections are insufficient for such purpose. Amounts in the Liquidity Reserve Account will not be available to make Turbo Redemptions. Unless an Event of Default has occurred, amounts withdrawn from the Liquidity Reserve Account will be replenished from Collections available in accordance with the order of priority set forth in "SECURITY—Application of Revenues—*Transfers to Accounts.*"

Distributions and Priorities .... Promptly upon receipt, the Indenture Trustee will deposit all Collections (excluding investment earnings on amounts on deposit with the

Indenture Trustee under the Indenture) in the Collections Account. All Collections consisting of Partial Lump Sum Payments will be promptly transferred to the Partial Lump Sum Payment Account. All Collections consisting of Total Lump Sum Payments will be promptly applied in the manner described in the last paragraph under *"Distribution Date Transfers"* below. In addition, on the Business Day immediately preceding each Distribution Date, the Indenture Trustee will deposit in the Collections Account and apply as described in *"Transfers to Accounts"* (1) all Collections consisting of investment earnings on amounts on deposit with the Indenture Trustee under the Indenture (excluding amounts in the Costs of Issuance Account, the Rebate Account and the Partial Lump Sum Payment Account) and (2) all Collections consisting of gains from investments (other than investment earnings) determined pursuant to the valuation of investments in each Account by the Indenture Trustee as of each Distribution Date (excluding such gains in the Costs of Issuance Account, the Rebate Account and the Partial Lump Sum Payment Account).

"**Lump Sum Payment**" means a final payment from a PM that results in, or is due to, a release of that PM from all of its future payment obligations under the MSA. Lump Sum Payments do not include Partial Lump Sum Payments.

"**Partial Lump Sum Payment**" means any payment from a PM that results in, or is due to, a release of that PM from a portion, but not all, of its future payment obligations under the MSA.

"**Total Lump Sum Payment**" means a final payment from all of the PMs that results in, or is due to, a release of all of the PMs from all of their future payment obligations under the MSA.

Transfers to Accounts. As soon as is possible following each deposit of Collections to the Collections Account, but no later than the earlier of (1) the fifth Business Day following each Deposit Date, or (2) the start of business of the Indenture Trustee on the Distribution Date following each Deposit Date, the Indenture Trustee will withdraw the funds on deposit in the Collections Account and transfer such amounts in the priority set forth below:

(a) to the Operating Account, after June 30, 2004, an amount sufficient to cause the amount therein to equal the amount specified by the Officer's Certificate most recently delivered (or deemed delivered) in order to pay, for the Fiscal Year applicable to such Officer's Certificate, the Operating Expenses to the extent that the aggregate amount thereof does not exceed the Operating Cap in effect as of the date of such deposit;

(b) to the Debt Service Account, until June 1, 2003, all remaining Collections and thereafter an amount sufficient to cause the amount therein to equal the sum of (i) interest on the Outstanding Bonds and all Swap Payments that will come due (A) in the next succeeding Bond Year, if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, or (B) in the then current Bond Year, if the Deposit Date is on or after June 1 and on or before November 30 of any Bond Year, plus (ii) any such unpaid interest on the Bonds and Swap Payments from prior Distribution Dates (including interest at the stated rate on such unpaid interest, to the extent legally permissible); *provided,*

that the amount to be deposited pursuant to this paragraph (b) shall be calculated assuming that principal on the Bonds will have been paid as described in paragraphs (b), (c) and (d) under *"Distribution Date Transfers"*;

(c) to the Debt Service Account, an amount sufficient to cause the amount therein to equal the amount specified in paragraph (b) above plus the sum of (i) if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, the Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments, if any, due in or scheduled for the next succeeding Bond Year, plus (ii) any such Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments unpaid from prior Distribution Dates; *provided,* that the amount of any Turbo Redemptions or optional redemptions of Turbo Term Bonds will be credited against such Sinking Fund Installments in chronological order;

(d) unless an Event of Default has occurred, to the Liquidity Reserve Account an amount sufficient to cause the amount on deposit therein to equal the Liquidity Reserve Requirement;

(e) to the Operating Contingency Account an amount specified by an Officer's Certificate in order to pay, for the Fiscal Year applicable to such Officer's Certificate, the Operating Expenses in excess of the Operating Cap;

(f) to the Turbo Redemption Account until Turbo Term Bonds are no longer Outstanding, the amount remaining in the Collections Account; and

(g) from and after such time that no Turbo Term Bonds remain Outstanding, retained in the Collections Account.

"**Deposit Date**" means the date of each deposit of Collections in the Collections Account.

"**Operating Expenses**" means operating and administrative expenses of the Authority (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 Authority), fees and expenses incurred for the Indenture Trustee (including the reasonable fees and expenses of its counsel), any Paying Agents, professional consultants and fiduciaries, termination payments on Swap Contracts, 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 Tax-Exempt Bonds, and the costs related to enforcement of the Authority's or the Indenture Trustee's enforcement rights with respect to the Indenture, the Sales Agreement, the Authority Tax Certificate or the Bonds, and all other expenses so identified as Operating Expenses in the Indenture.

"**Operating Cap**" means (1) $250,000 in the Fiscal Year ending June 30, 2003, inflated in each following Fiscal Year by the percentage representing the fraction "x" over "y," where "x" equals the Inflation

Adjustment Percentage (as defined in the MSA) applicable to MSA payments due in such Fiscal Year, and "y" equals the Inflation Adjustment Percentage applicable to MSA payments due in the preceding Fiscal Year, plus (2) in each Fiscal Year, arbitrage payments, rebate, and penalties specified in an Officer's Certificate, plus (3) for the Fiscal Year ending June 30, 2003 only, an additional amount of $500,000.

"**Bond Year**" means, for so long as Bonds are Outstanding, the 12-month period ending each May 31.

Distribution Date Transfers. Unless an Event of Default has occurred, on each Distribution Date, the Indenture Trustee will apply amounts in the various Accounts in the following order of priority:

(a) from the Capitalized Interest Subaccount, the Debt Service Account, the Partial Lump Sum Payment Account and the Liquidity Reserve Account, in that order, to pay interest on the Bonds and Swap Payments due on such Distribution Date;

(b) from the Debt Service Account, the Partial Lump Sum Payment Account and the Liquidity Reserve Account, in that order, to pay, in the following order, the Serial Maturities, Turbo Term Bond Maturities and the Sinking Fund Installments, if any, due on or scheduled for such Distribution Date, plus any Sinking Fund Installments unpaid from prior Distribution Dates; *provided,* that the amount of any Turbo Redemptions or optional redemptions of Turbo Term Bonds will be credited against such Sinking Fund Installments in chronological order; and *further provided,* that the Indenture Trustee will not pay a Sinking Fund Installment pursuant to this paragraph unless the Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date;

(c) from the Turbo Redemption Account, to redeem Turbo Term Bonds in chronological order; and

(d) from the Partial Lump Sum Payment Account, but only as directed in an Officer's Certificate delivered by the Authority and accompanied by a Rating Confirmation, to redeem Turbo Term Bonds in chronological order.

Funds deposited in the Operating Account will be transferred, immediately upon such deposit, to or upon the order of the Authority and will be used by the Authority to pay Operating Expenses (other than termination payments on Swap Contracts, on investment contracts or investment agreements for Accounts, or on forward purchase contracts for investments in Accounts).

Funds in the Operating Contingency Account will be applied by the Indenture Trustee at any time, in accordance with directions in an Officer's Certificate, to pay Operating Expenses not otherwise paid from the Operating Account (or to fund an account of the Authority free and clear of the lien of the Indenture for the purpose of paying such Operating Expenses).

Upon the occurrence of any Event of Default and on each succeeding Distribution Date, the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum

	Payment Account and the Turbo Redemption Account to pay Pro Rata, *first,* the accrued interest on the Bonds and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, *second,* principal on all Bonds then Outstanding, whether or not such principal is then scheduled to be paid. Upon the receipt of a Total Lump Sum Payment, the Indenture Trustee will, after making provision for the amounts required to be deposited pursuant to paragraph (a) under *"Transfers to Accounts"* above, use all remaining proceeds of such Total Lump Sum Payment to pay Pro Rata, *first,* the accrued interest on the Bonds and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, *second,* principal on all Bonds then Outstanding, whether or not such principal is then scheduled to be paid.
Events of Default	The occurrence of any of the following events will constitute an "**Event of Default**" under the Indenture: (1) failure to pay, when due, interest on any Bond; (2) failure to pay, when due, any Serial Maturity or Turbo Term Bond Maturity; (3) failure of the Authority 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 Authority by the Indenture Trustee or to the Authority and the Indenture Trustee by the Holders of at least 25% in principal amount of the Bonds then Outstanding; or (4) a material breach by the State of certain covenants contained or referred to in the Indenture, which breach is not remedied within 60 days after written notice, specifying such default and requiring the same to be remedied, has been given to the Authority 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 clause (3) or (4), if the default is 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 Authority or the State, as applicable, within said 60-day period and diligently pursued until the default is corrected. Except as specified in clause (1) or (2), failure to make any payment or to make provision therefor, including any Turbo Redemption or any Sinking Fund Installment, 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.
Additional Bonds	With Rating Confirmation, one or more series of Refunding Bonds may be issued to refund Bonds (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance) but only if upon the issuance of such Refunding Bonds (1) the amount on deposit in the Liquidity Reserve Account will be at least equal to the Liquidity Reserve Requirement; (2) no Event of Default shall have occurred; and (3) the expected base case debt service on the proposed Refunding Bonds shall be less than or equal to the expected base case debt service on the refunded Bonds as of their date of original issuance in all years in which such refunding Bonds debt service is payable. No bonds other than the Series 2002 Bonds and Refunding Bonds may be issued under the Indenture. "**Refunding Bonds**" means Bonds, other than the Series 2002 Bonds, issued pursuant to the Indenture for the purposes of refunding any Outstanding Bonds. "**Bonds**" means the Series 2002 Bonds and any Refunding Bonds issued pursuant to the Indenture.

Covenants	The Authority and the State have made certain covenants for the benefit of the Bondholders. The Authority has covenanted not to impair the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes. The Authority has included in the Indenture the covenants of the State to (1) irrevocably direct the Escrow Agent and Independent Auditor (as such terms are defined in the MSA) to transfer all Pledged TSRs, pursuant to paragraph 5 of section 7 of the Act, directly to the Indenture Trustee, (2) enforce, at the expense of the State, the Authority's rights to receive the Pledged TSRs to the full extent permitted by the MSA (it being understood that the State may satisfy its obligation thereunder by taking such enforcement action through individual or joint or cooperative efforts with other states and their Attorneys General in a manner that it determines as most appropriate), (3) not agree to any amendment of the MSA in any manner that would materially and adversely affect the ability of the Authority to receive the Pledged TSRs, (4) not limit or alter the rights of the Authority to fulfill the terms of its agreements with benefited parties until the 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, (5) not fail to enforce the Qualifying Statute, and (6) not amend, supersede or repeal the Qualifying Statute in any way that would materially and adversely affect the ability of the Authority to receive the Pledged TSRs; (7) promptly pay to the Indenture Trustee any Pledged TSRs received by the State; (8) take all actions as may be required by law and the MSA fully to preserve, maintain, defend, protect and confirm the interest of the Authority in the Pledged TSRs and in the proceeds thereof in all material respects; (9) not take any action that will materially and adversely affect the Authority's legal right to receive the Pledged TSRs; and (10) not (a) release any PM from any of its covenants or obligations to make payment under the MSA or (b) agree to the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, or waive timely performance or observance by PMs under, the MSA, in each case if the effect thereof would be to materially and adversely affect the Authority's ability to receive the Pledged TSRs; *provided,* that if a Rating Confirmation is received relating to such proposed action, then such proposed action will be deemed not to be material or adverse. See "THE INDENTURE" for a summary of the covenants made by the Authority and "THE SALES AGREEMENT" for a summary of the covenants made by the State to the Authority in the Sales Agreement.
Ratings	The ratings for the Series 2002 Bonds address only the payment of interest on the Series 2002 Bonds when due and the payment of Serial Maturities and Turbo Term Bond Maturities when due. The ratings do not address the payment of Sinking Fund Installments or Turbo Redemptions. A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to revision or withdrawal at any time. See "RATINGS."
Legal Considerations	See "LEGAL CONSIDERATIONS" for a description of certain legal issues relevant to an investment in the Series 2002 Bonds.
Risk Factors	See "RISK FACTORS" for a description of certain considerations relevant to an investment in the Series 2002 Bonds.

Tax Matters .... In the opinions of Hawkins, Delafield & Wood and Preston Gates & Ellis LLP, as Co-Bond Counsel ("**Co-Bond Counsel**"), under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (1) interest on the Series 2002 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 "**Tax Code**"), and (2) interest on the Series 2002 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Tax 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. See "TAX MATTERS."

INTRODUCTORY STATEMENT

This Offering Circular sets forth information concerning the issuance by the Tobacco Settlement Authority (the "**Authority**") of $517,905,000 aggregate principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2002 (the "**Series 2002 Bonds**"). The Series 2002 Bonds are being issued pursuant to an Indenture between the Authority and U.S. Bank, N.A., Seattle, Washington, as trustee (the "**Indenture Trustee**") and the Series 2002 Supplement between the Authority and the Indenture Trustee, each dated as of October 1, 2002 (collectively, the "**Indenture**").

The Authority is a public instrumentality and agency of the State of Washington (the "**State**"), separate and distinct from the State, exercising public and essential governmental functions. The Authority consists of five members appointed by the governor of the State. For additional information regarding the organization of the Authority, see "THE AUTHORITY."

The Authority will apply the proceeds of the Series 2002 Bonds to (1) purchase the Pledged TSRs from the State; (2) fund a Liquidity Reserve Account; (3) capitalize a portion of the interest due on the Series 2002 Bonds through June 1, 2003; (4) capitalize certain Operating Expenses; and (5) pay the costs of issuance of the Series 2002 Bonds.

"**Pledged TSRs**" means the sum of (1) the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, and (2) 29.2% of:

(a) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto);

(b) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003; and

(c) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003.

"**Litigation Expense Reimbursements**" means the reimbursements and payments made or to be made to the State or any department or agency of the State pursuant to Section XVII(a) and (b) of the MSA.

The right of the Authority to receive the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, as Pledged TSRs, is prior to the claim of the State to all other payments received by the State under the MSA on and after the Closing Date and before July 1, 2003. The right of the Authority to receive the other Pledged TSRs on and after July 1, 2003, is valid and enforceable and on a parity with the claim of the State to the Unpledged TSRs.

The MSA, which was entered into on November 23, 1998, resolved cigarette smoking-related litigation between the Settling States and the OPMs and released the PMs from past and present smoking-related claims, and provides for a continuing release of future smoking-related claims in exchange for payments to be made to the Settling States, as well as, among other things, certain tobacco advertising and marketing restrictions. Under the MSA, the State is entitled to 2.0532582% of the Initial Payments and Annual Payments made by the PMs under the MSA and 5.7647432% of the Strategic Contribution Payments made by PMs under the MSA. Under the Act and the Sales Agreement, the State will sell the Pledged TSRs to the Authority. See "SUMMARY OF THE MSA" and "THE SALES AGREEMENT."

The State expects to use the proceeds of the sale of the Pledged TSRs to refinance and defease certain outstanding obligations of the State, to pay for certain capital projects and for working capital purposes. Funds received by the State as payment for the Pledged TSRs are not pledged to or accessible to Bondholders. The Authority will also issue a Residual Certificate to the State to evidence all of the Authority's right, title and interest in and to the Pledged TSRs following final payment of the Bonds and other obligations of the Authority under the Indenture.

Pursuant to the Act and under the Indenture, the Bonds are secured by a first-priority pledge of the Collections, the Liquidity Reserve Account, the Capitalized Interest Subaccount and amounts held in certain other funds and accounts established for the Bonds under the Indenture. See "SECURITY."

Interest on the Outstanding principal amount of the Series 2002 Bonds will be payable on each June 1 and December 1 or the next succeeding Business Day if such day is not a Business Day (each, a "**Distribution Date**"), commencing June 1, 2003. Principal of the Series 2002 Bonds is payable according to the schedules of Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments, subject to Turbo Redemptions, all as described under "THE SERIES 2002 BONDS."

Failure to pay interest, Serial Maturities and Turbo Term Bond Maturities when due will constitute an Event of Default under the Indenture. Failure to pay Turbo Redemptions or Sinking Fund Installments will not constitute an Event of Default under the Indenture. Certain methodologies and assumptions were used to establish the projected Turbo Redemptions, as described under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION." The amount and timing of payments on the Series 2002 Bonds may be affected by various factors. See "RISK FACTORS."

RISK FACTORS

Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2002 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 2002 Bonds and does not necessarily reflect the relative importance of the various risks. Potential purchasers of the Series 2002 Bonds are advised to consider the following factors, among others, and to review the other information in this Offering Circular in evaluating the Series 2002 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 2002 Bonds. There can be no assurance that other risk factors will not become material in the future.

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

Smoking Trends. As discussed in the DRI•WEFA Report, cigarette consumption in the United States has declined since its peak in 1981 of 640 billion cigarettes to 430 billion cigarettes in 2000. Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) has been declining since 1964. The DRI•WEFA Report forecasts a continued decline in total cigarette consumption at an average annual rate of 1.72% to 247 billion cigarettes in 2032 under its Base Case Forecast (as defined herein), which represents a decline in adult per capita consumption at an average rate of 2.55% per year. These consumption declines are based on historical trends which may not be indicative of future trends, as well as other factors that may vary significantly from those assumed or forecasted by DRI•WEFA. A decline in the overall consumption of cigarettes beyond the levels forecasted in the DRI•WEFA Report could materially effect the payments by PMs under the MSA and the amounts available to the Authority to pay principal of and/or interest on the Series 2002 Bonds and/or Turbo Redemptions of the Turbo Term Bonds.

Regulatory Restrictions and Legislative Initiatives. The tobacco manufacturers and tobacco products are the subject of numerous regulations and legislative proposals seeking, among other things, to impose liability upon the industry, further regulate the industry, prohibit public smoking and regulate labeling or advertising of cigarettes. 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. On June 14, 2002, Senators Kennedy, DeWine and others introduced Senate Bill 2626. The purpose of the bill is to provide the Food and Drug Administration (the "**FDA**") with certain authority to regulate tobacco products and to recognize the FDA as the primary federal regulatory authority with respect to the manufacture, marketing and distribution of tobacco products. Cigarettes are currently subject to substantial excise taxes in the United States. The Federal excise tax per pack of 20 cigarettes is $0.39. All states, and the District of Columbia, currently impose taxes ranging from $0.025 per pack to $1.50 per pack. According to the DRI•WEFA Report, at least 30 states have recently increased or are considering increases in excise taxes as a response to budget shortfalls. In addition, certain municipalities also impose an excise tax on cigarettes, ranging up to $1.50 per pack. These tax increases and other legislative or regulatory measures have severely increased the cost of cigarettes and could limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes. Without limiting the generality of the foregoing, on August 9, 2000, the United States Surgeon General issued a report, "Reducing Tobacco Use," that concludes that a comprehensive program, including increased excise taxation, can significantly reduce the prevalence of smoking. The Commonwealth of Massachusetts has enacted legislation to require cigarette manufacturers to report the flavorings and other ingredients used in each brand of cigarettes sold in the Commonwealth, and on a qualified, by-brand basis to provide "nicotine-yield ratings" for their products sold based on standards established by the Commonwealth. Cigarette manufacturers sued to have the statute declared unconstitutional, arguing that it could result in the public disclosure of valuable proprietary information. In September 2000, the federal district court granted the plaintiff's motion for summary judgment and permanently enjoined the defendants from requiring cigarette manufacturers to disclose brand-specific information on ingredients in their products. In October 2001, in *Philip Morris v. Reilly,* 267 F.3d 45 (1st Cir. 2001), the First Circuit Court of Appeals reinstated the statute, declaring it a "valid exercise of the police power" of the Commonwealth. The First Circuit subsequently granted the cigarette manufacturers' petition for rehearing *en banc* and withdrew its prior opinion. The First Circuit, sitting *en banc,* heard oral argument in January 2002 and a decision is pending. New York state law requires cigarettes to be "fire safe" or "self-extinguishing" beginning in 2003. Similar legislation is being considered by other states and localities, at the federal level and in foreign jurisdictions. Another New York statute, which was intended to become effective in November 2000, prohibited the shipment or delivery of cigarettes to any person in the State of New York who is not a licensed cigarette tax agent, wholesale or retail dealer or export warehouse proprietor. The statute would have banned mail order, Internet and telephone cigarette sales directly to consumers in the State of New York. One OPM and one SPM filed suit in a federal district court in New York seeking to overturn the statute, alleging that it was an unconstitutional interference with commerce. In June 2001, a federal district court declared the statute unconstitutional and permanently enjoined enforcement of the statute. As a result of these types of initiatives and other measures, the overall consumption of cigarettes may decrease materially more than forecasted in the DRI•WEFA Report and thereby have a material adverse effect on the amounts available to the Authority to pay principal of and/or interest on the Series 2002 Bonds and/or Turbo Redemptions of the Turbo Term Bonds. See "TOBACCO INDUSTRY—Regulatory Issues."

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, some of which are material. Such adjustments could reduce the aggregate amount of Pledged TSRs distributable to the Authority to a level below the amount required to pay principal of and/or interest on the Series 2002 Bonds and/or Turbo Redemptions of the Turbo Term

Bonds. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MSA."

The assumptions used to project Collections (the source of the payments on the Series 2002 Bonds) are based on the premise that certain adjustments of amounts payable by the PMs will occur, as set forth under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION." Actual adjustments could be materially different from what has been assumed and described herein.

Growth of NPM Market Share and Volume Adjustment. The assumptions used to project Collections and structure the Series 2002 Bonds contemplate declining consumption of cigarettes in the United States combined with a static relative market share of 1.5% for the NPMs.[*] See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION." 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. One NPM has announced that it has developed a tobacco product with virtually no nicotine. This NPM could use the product to capture market share causing a reduction in Annual Payments and Strategic Contribution Payments. In addition, if people 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, whether SPMs or NPMs, are less likely than OPMs to be subject to frequent litigation. NPMs may be entitled to refunds of a portion of their escrow deposits under a Qualifying Statute to the extent such amounts exceed the amount the NPM would have had to pay if it had been a PM. See "SUMMARY OF MSA—MSA Provisions Relating to Model/Qualifying Statutes." Because the price of cigarettes is a factor affecting consumption, NPM cost advantage could result in their increasing market share at the expense of the OPMs and SPMs. 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 on the amounts available to the Authority to pay principal of and/or interest on the Series 2002 Bonds and/or Turbo Redemptions of the Turbo Term Bonds. See "SUMMARY OF THE MSA—Adjustments to Payments" and "DRI•WEFA REPORT."

NPM Adjustment. The NPM Adjustment is based upon market share increases, measured by domestic sales of cigarettes by NPMs, and is designed to reduce the payments of the PMs under the MSA to compensate the PMs for losses in market share to NPMs during a calendar year as a result of the MSA. The adjustment is to be applied against the subsequent year's payments due to those Settling States that do not qualify for an exemption from the adjustment. See "SUMMARY OF THE MSA—Adjustments to Payments."

In general, any state that adopts, maintains and diligently enforces a 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 attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. Furthermore, it is unclear which party bears the burden of proving or disproving diligent enforcement by the Settling States. In January 2002, B&W disputed the recalculation of the Annual Payments due in 2000 and 2001, claiming that PricewaterhouseCoopers LLP, the independent auditor appointed under the MSA (the "**MSA Auditor**"), relied upon inappropriate data in calculating B&W's market share and that a larger NPM Adjustment should have been applied to the 2001 payment because a majority of the Settling States were not diligently enforcing their Qualifying

[*] The aggregate market share of NPMs utilized in the bond structuring assumptions may differ materially from the market share information utilized by the MSA Auditor in calculating the NPM Adjustment. See "SUMMARY OF THE MSA—Adjustment to Payments—Non-Participating Manufacturers Adjustment."

Statutes in 2000. In April 2002, the National Association of Attorneys General ("**NAAG**") in a public release reported that B&W had agreed to release approximately $204 million previously deposited in the Disputed Payments Account for payment to the Settling States. In press reports, B&W stated that it was doing so at this time because it now believed the data on which recalculation of the disputed Annual Payments was based were more reliable. The NAAG release did not indicate whether B&W continues to allege that a majority of the Settling States were not diligently enforcing their Qualifying Statutes.

In February 2002, the State received a letter from B&W, addressed to the Settling States' Attorneys General, requesting information relating to the enforcement of their applicable Qualifying Statute. The Washington Attorney General believes that the State is diligently enforcing its Qualifying Statute, and the State has agreed in the Sales Agreement to enforce its Qualifying Statute. See "SUMMARY OF THE MSA—MSA Provisions Related to Model/Qualifying Statutes" and "THE SALES AGREEMENT—Pledges; Protection of Title; Non-Impairment Covenant."

Should a PM be entitled to an NPM Adjustment in future years due to non-diligent enforcement of the Qualifying Statute by the State, the NPM Adjustment could impair the amount of Pledged TSRs paid to the Authority. See "*Disputed or Recalculated Payments.*" The structuring assumptions for the Series 2002 Bonds do not include any NPM Adjustments. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION."

Disputed or Recalculated Payments. Miscalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA could 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. Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). Certain of the Settling States and certain of the PMs are disputing the calculations of the Initial Payments which were due in January 2000, January 2001 and January 2002 and the Annual Payments which were due in April 2000, April 2001 and April 2002. As described above under "*NPM Adjustment*," B&W claimed that a larger NPM Adjustment should have been applied to the Annual Payment due in April 2001 because a majority of the Settling States were not diligently enforcing their Qualifying Statutes during calendar year 2000. B&W also challenged the appropriateness of the data used by the MSA Auditor in the recalculation of various payments. Since the Annual Payments due in April 2000 and April 2001 had already been paid by B&W, B&W claimed an offset against the Initial Payment due in January 2002 and deposited an amount equal to such offset in the Disputed Payments Account. In April 2002, NAAG in a public release reported that B&W had agreed to release approximately $204 million, which was substantially all of the money previously deposited in the Disputed Payments Account for payment to the Settling States. The $204 million in the Disputed Payments Account was distributed to the Settling States with the Annual Payment due April 15, 2002. The resolution of disputed payments may result in the application of an offset against subsequent Initial Payments, Annual Payments or Strategic Contribution Payments. Both the diversion of disputed payments to the Disputed Payments Account and the application of offsets against future payments could materially impair the amount of Pledged TSRs paid to the Authority. The structuring assumptions for the Series 2002 Bonds do not factor in an offset for miscalculated or disputed payments. See "SUMMARY OF THE MSA—Adjustments to Payments—*Offset for Miscalculated or Disputed Payments.*"

Risks Related to Enforceability or Modification of the MSA and Constitutionality of the Model Statute

MSA Litigation. Certain smokers, consumer groups, cigarette manufacturers, cigarette importers, cigarette distributors, native American tribes, taxpayers, taxpayers' groups and other parties have instituted litigation against various tobacco manufacturers, including the PMs, as well as certain of the Settling States and other public entities challenging the MSA. The terms of the MSA may continue to be

challenged in the future. In the event of an adverse court ruling, Bondholders could incur a complete loss of their investment. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, some of 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 moneys under the MSA, barring the PMs from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. On July 1, 2002, a civil complaint was filed as *Grand River Enterprises Six Nations, Ltd. v. Pryor* in the United States District Court for the Southern District of New York by six cigarette manufacturers, importers and distributors against 31 parties in their official capacity as Attorneys General of various states, including the Attorney General of the State. The suit alleges that the provisions of the Model Statute and the enforcement thereof by the defendants violate various provisions of the U.S. Constitution and federal laws. 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 *Operating Engineers Local 12 Health and Welfare Trust Fund v. State of California*, the plaintiff is seeking moneys for medical expenses incurred as a result of tobacco use by union members and alleges that it attempted to be a party to the MSA but was rebuffed. This case is currently pending in the Los Angeles County Superior Court. An earlier suit brought by this plaintiff in the San Diego Superior Court was dismissed on the basis that the MSA foreclosed claims for healthcare reimbursement under the California Business and Professions Code. To date, such challenges have not been successful, although appeals are still possible in California and elsewhere. On June 17, 2002, trial court judge Charles E. Ramos, sitting in New York County, New York, entered an order on his own motion in *State of New York v. Philip Morris, Inc.,* the 1997 New York State lawsuit that was settled by the MSA. Citing unspecified ethical concerns relating to the 2001 award of the arbitrators of attorneys' fees to lawyers representing the State of New York in connection with the MSA, Judge Ramos has ordered all interested parties to show cause why the court should not set aside the award of the arbitrators and take other action with respect to the attorneys and their fees. In so doing, the court also ordered interested parties to show cause why it should not vacate and set aside the New York State Supreme Court's prior approval of the MSA. At the July 25, 2002 hearing, Judge Ramos ordered the attorneys to file an application supporting their fees by August 30, 2002. On August 30, 2002, various plaintiffs' attorneys filed a motion to vacate that order, asserting that the Court had no jurisdiction over the fee award. On October 22, 2002, Judge Ramos froze further payments on the $625 million award of attorneys' fees and found that the only issue before him is the reasonableness of the fee award. On September 13, 2002, Lorillard filed suit in Delaware Chancery Court against NAAG, alleging that NAAG breached its fiduciary duty by failing to take action against the American Legacy Foundation, which allegedly violated the MSA by running advertisements vilifying the tobacco companies. NAAG has not yet filed a responsive pleading in the case On June 5, 2002, one SPM filed suit in Missouri alleging that it is required to make payments under the MSA only on those cigarettes on which the SPM itself had paid the federal excise tax, and that no payments under the MSA were due on cigarettes on which the SPM's affiliate had paid federal excise taxes. See "Tobacco Industry Litigation—*Risks Inherent in Litigation*" and "Limited Remedies." For a description of certain opinions to be delivered to the Authority by Hawkins, Delafield & Wood and the Attorney General of the State with respect to the MSA, see "LEGAL CONSIDERATIONS—MSA Enforceability."

Qualifying Statute. Under the MSA, downward adjustments are made to the Annual Payments and the 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. A Settling State may mitigate the effect of this adjustment by adopting and enforcing a Qualifying Statute, as hereinafter described. The State has adopted the Model Statute (which is a Qualifying Statute under the MSA) and has covenanted in the Sales Agreement to enforce its Qualifying Statute. Three cases that challenged the

enforceability of the MSA, brought by importers and distributors in one case, cigarette consumers in one case and by a manufacturer in the third, also challenged the Model Statute adopted by other Settling States. The case brought by the importers and distributors, *PTI Inc. v. Philip Morris Inc.,* has been dismissed. The case brought by cigarette consumers, *Mariana v. Fisher,* was also dismissed by the district court. The case brought by the manufacturers, *Star Scientific, Inc. v. Beales,* has been dismissed by the trial court, that dismissal was affirmed on appeal by the Fourth Circuit Court of Appeals and the plaintiff's petition for a writ of certiorari in the United States Supreme Court has been denied. Other cases have used an antitrust theory to challenge the Model Statute. *North American Trading Company and International Tobacco Partners, LLC v. NAAG* was filed in the United States District Court for the District of Columbia on July 24, 2001 against Attorneys Generals of various states, including the Attorney General of the State. The plaintiff, an importer of foreign-made cigarettes, has alleged that importers and wholesalers of foreign-made cigarettes intended for resale in the United States are not Tobacco Product Manufacturers as defined in the Model Statute and have no substantial nexus to a particular state. The plaintiff requested an injunction to prevent the enforcement of the application of the Model Statute against it. On September 18, 2001, the District Court dismissed the case, and the plaintiffs have appealed. Although a determination that the Model Statute is unconstitutional would have no effect on the enforceability of the MSA itself, such a determination could have an adverse effect on payments to be made under the MSA if one or more NPMs were to gain market share in the future. For a description of the opinions to be delivered to the Authority by Co-Bond Counsel with respect to the Qualifying Statute and a more detailed discussion of the constitutional challenges to the Qualifying Statute, see "LEGAL CONSIDERATIONS."

Severability. 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. 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 MSA—Severability."

Federal Legislation Offset. In the event that federal tobacco-related legislation enacted on or before November 30, 2002 provides for payments by the PMs to the federal government, and all or part of such payments are actually made available to any Settling State, the PMs are, in certain circumstances, entitled to a continuing dollar-for-dollar offset for amounts received by the Settling State. Such an event could have a material adverse effect on payments by the PMs under the MSA, which in turn could have a material adverse effect on the amounts available to the Authority to make payments on the Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments–Federal Tobacco Legislation Offset."

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 Authority is not a party to the MSA; accordingly, the Authority 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 Authority's ability to make payments to the Bondholders. See "SUMMARY OF THE MSA—Amendments and Waivers."

Reliance on State Enforcement of the MSA and State Impairment. The State may not convey and has not conveyed to the Authority or the Bondholders any right to enforce the terms of the MSA or the Consent Decree to assure receipt of payments required to be made under the MSA that constitute Tobacco Assets. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. The

State has agreed in the Sales Agreement to enforce, at the expense of the State, the Authority's rights to receive the Pledged TSRs to the full extent permitted by the MSA. No assurance can be given that the State will enforce any particular provision of the MSA. Failure to do so may have a material adverse effect on the Authority's ability to make payments to the Bondholders. It is possible that the State could attempt to claim some or all of the Pledged TSRs for itself or otherwise interfere with the security for the Series 2002 Bonds. See "THE SALES AGREEMENT—Pledges; Protection of Title; Non-Impairment Covenant." See also "LEGAL CONSIDERATIONS."

Tobacco Industry Litigation

The tobacco industry has been the target of litigation for decades. 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 "secondhand smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating in the billions of dollars. 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 belonging to the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Individual Lawsuits. One OPM has reported that as of August 1, 2002, there were approximately 1,500 smoking and health cases filed and served on behalf of individual plaintiffs in the United States against it and other tobacco industry defendants. In addition, one OPM reports that as of August 1, 2002, there were approximately 1,250 cases pending before a single West Virginia state court in a consolidated proceeding that is currently scheduled for trial in June 2003.

In addition, one OPM reports that as of August 1, 2002 there were approximately 2,800 additional individual cases (the "***Broin II*** **cases**") filed primarily in Florida by individual current and former flight attendants claiming personal injury as the result of exposure to environmental tobacco smoke in airline cabins. As of September 5, 2002, three individual *Broin II* flight attendant cases have gone to trial, one of which has resulted in a jury verdict against the tobacco industry defendants. See "TOBACCO INDUSTRY—Civil Litigation—*Individual Plaintiffs' Lawsuits*."

In the last four years, there have been at least twelve reported jury verdicts, including a 1996 jury verdict that was reinstated upon appeal, in individual smoking and health cases against the tobacco industry, including one or more PMs. The damages awarded in these cases varied from $165,000 to $35 million in compensatory damages and up to $28 billion in punitive damages. Many of these verdicts have been appealed and final decisions are pending. See "TOBACCO INDUSTRY—Civil Litigation—*Individual Plaintiffs' Lawsuits*."

On September 26, 2002, a Los Angeles, California jury awarded $750,000 in economic damages and $100,000 for pain and suffering to a smoker with lung cancer in *Bullock v. Philip Morris*. On October 4, 2002, the same jury awarded the plaintiff $28 billion in punitive damages. Philip Morris has announced that it would ask the court to reverse the jury's verdict and order a new trial, and if the request is denied, that it will appeal the verdict to the California Court of Appeals. Also on September 26, 2002, a Puerto Rico jury awarded two sons of a deceased smoker $500,000 each in *Cruz-Vargas v. R.J. Reynolds Tobacco Co.* The trial court vacated one of the awards on the grounds that the statute of limitations had run. On March 22, 2002, a Portland, Oregon jury awarded $168,000 in compensatory damages and $150 million in punitive damages to the family of a light cigarette smoker in *Schwarz v.*

Philip Morris Inc. The trial court subsequently reduced the total damages awarded to $100 million. Philip Morris appealed the final judgment to the Oregon Court of Appeals on July 2, 2002, and the plaintiff subsequently noticed a cross appeal. On February 22, 2002, a federal jury in Kansas City awarded $198,400 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, awarded the plaintiff $15 million in punitive damages. Reynolds Tobacco has appealed the verdict. On December 12, 2001, a Tampa, Florida jury awarded the plaintiff $165,000 in compensatory damages in *Kenyon v. R.J. Reynolds Tobacco Co.* The jury declined to award punitive damages on the basis that Reynolds Tobacco had marketed a defectively designed product. Reynolds Tobacco is appealing the final judgment. On June 6, 2001, a California state court jury found against Philip Morris on all six claims of fraud, negligence and making a defective product in *Boeken v. Philip Morris Inc*. The jury awarded the plaintiff $5.5 million in compensatory damages and $3 billion in punitive damages. The $3 billion punitive damages award has been reduced to $100 million post-trial. Philip Morris has filed a notice of appeal of the jury verdict. In November 2000, the Supreme Court of Florida reinstated the verdict by a Florida jury in *Carter v. Brown & Williamson Tobacco Corp.* 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 United States Supreme Court denied B&W's petition for a writ of certiorari, thus leaving the jury verdict intact. 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. The plaintiff has appealed the new trial ruling. In March 2000, a California jury in *Whiteley v. Raybestos-Manhattan, Inc.* returned a verdict in favor of the plaintiffs 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 court, which denied the defendants' post-verdict challenge. The defendants have appealed the verdict. In April 1999, a Maryland jury in *Connor v. Lorillard* awarded $225,000 in compensatory damages and $2 million in punitive 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 1999, an Oregon jury in *Williams-Branch v. Philip Morris* awarded $821,500 in compensatory damages and $79.5 million in punitive damages. The trial court subsequently reduced the punitive damages award to $32 million, but the reduction was overturned and the full amount of punitive damages awarded was reinstated by the Oregon Court of Appeals. A petition for reconsideration by the Oregon Court of Appeals was filed by Philip Morris on June 19, 2002. In February 1999, a California jury in *Henley v. Philip Morris* awarded $1.5 million in compensatory damages and $50 million in punitive damages (subsequently reduced by the trial court to $25 million in punitive damages). On November 7, 2001, the appellate court affirmed the verdict. Philip Morris has appealed that decision to the California Supreme Court, which accepted the appeal on a "grant and hold" basis (another appeal must be decided prior to ruling on the *Henley* petition).

Class Action Lawsuits. In addition to suits brought by individuals, plaintiffs have brought smoking and health lawsuits against the tobacco industry, including the PMs, as class actions. Generally, plaintiffs in class action smoking and health lawsuits allege essentially the same theories of liability against the tobacco industry as those in lawsuits brought by individuals. Other class action plaintiffs allege consumer fraud or violations of consumer protection or unfair trade statutes. The MSA does not release the PMs from liability in class action lawsuits. Classes have been certified and have withstood

preliminary challenges in at least seven states: California, Florida, Illinois, Louisiana, Massachusetts, North Carolina and West Virginia. In addition, a class has been certified in one federal district court. See *"Risks Inherent in Litigation"* and "TOBACCO INDUSTRY—Civil Litigation—*Class Action Lawsuits.*"

In *Engle v. R.J. Reynolds Tobacco Co.*, a Florida state trial court certified a class of Florida smokers who brought suit against tobacco industry defendants, including all four OPMs, 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 Phase I 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 Phase IIA, in April 2000, the same jury that heard Phase I awarded a total of $12.7 million in compensatory damages to the three named representative plaintiffs, finding that the defendant tobacco companies bore major responsibility for the plaintiffs' injuries. One OPM has requested that the court dismiss the award to one of the plaintiffs because of the jury's findings on a statute of limitations question. In July 2000, in Phase IIB, the same jury also assessed punitive damages of approximately $145 billion with respect to the entire class of possible plaintiffs. The punitive damages awarded against the OPM defendants are: Philip Morris, $73.96 billion; Reynolds Tobacco, $36.28 billion; B&W, $17.59 billion; Lorillard, $16.25 billion; and Liggett Group, Inc. ("**Liggett**"), $790 million. Phase III will determine compensatory damages for the remaining class members.

The *Engle* tobacco industry defendants filed a motion to set aside the verdict, direct judgment in favor of the defendants or decertify the class, or, in the alternative, for a new trial. The defendants removed the *Engle* case to federal court, but by order dated November 3, 2000, the federal district court remanded *Engle* to the Eleventh Judicial Circuit of Dade County, Florida. On November 6, 2000, the state trial court issued its final judgment and order in which it (1) denied substantially all of the tobacco company defendants' pending and post-trial motions, including the motion for reduction of the $145 billion punitive damages award or, in the alternative, a new trial, and (2) entered the punitive damage award as a final judgment. On November 7, 2000, the defendants in *Engle* filed an appeal with respect to the entry of judgment, class certification and other reversible errors that they allege occurred during the trial. As of August 1, 2002, the Florida Court of Appeal had not scheduled the appeal for oral argument.

The defendants have each posted a bond 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. 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 the amount of punitive damages, plus twice the statutory rate of interest, or 10% of a defendant's net worth, but in no case more than $100 million. Georgia, Kentucky, Louisiana, Nevada, North Carolina, Oklahoma, South Carolina, Virginia and West Virginia have enacted similar legislation. The Mississippi Supreme Court has also placed limitations on appeal bonds by court rule.

One OPM has reported that the *Engle* plaintiffs believe the Florida appeal bond legislation is unconstitutional. In the event that a court of final jurisdiction were to declare the legislation unconstitutional, one OPM has stated that, in a worst-case scenario, it is possible that a judgment for punitive damages could be entered in an amount not capable of being bonded, resulting in an execution of the judgment before it could be set aside on appeal. On May 7, 2001, the trial court approved a stipulation (the "**Stipulation**") among Philip Morris, Lorillard and Liggett (the "**Stipulating Defendants**"), the plaintiffs, and the plaintiff class that provides that execution or enforcement of the

punitive damages component of the *Engle* judgment will remain stayed against the Stipulating Defendants through the completion of all judicial review, regardless of a challenge, if any, to the Florida bond statute. Under the Stipulation, Philip Morris placed $1.2 billion into an interest-bearing escrow account. Should Philip Morris prevail in its appeal of the case, this escrow amount is to be returned to Philip Morris, together with its $100 million appeal bond previously posted. In addition, Philip Morris, Lorillard and Liggett also placed $500 million, $200 million (including Lorillard's appeal bond), and $9.72 million (including Liggett's appeal bond), respectively, into a separate interest-bearing escrow account for the benefit of the *Engle* class (the "**Guaranteed Amount**"). Even if the Stipulating Defendants prevail on appeal, the Guaranteed Amount will be paid to the court, and the court will determine how to allocate or distribute it consistent with the Florida Rules of Civil Procedure.

On September 6, 2000, in *In re Simon (II) Litigation*, lawyers for plaintiffs in ten tobacco-related cases pending in United States 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 include 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 seeks 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 February 8, 2001, Judge Weinstein issued an opinion stating that severing the issues of liability and punitive damages would help ensure an expeditious resolution due to the unusual complexity of the issues. On September 19, 2002, Judge Weinstein certified a nationwide punitive-damage class action lawsuit against the defendants. The class consists of all United States smokers first diagnosed, from April 9, 1993 through the date notice to the class is ordered disseminated, with certain diseases including lung cancer, emphysema and certain forms of heart disease. It has been reported that at least two of the OPM defendants will appeal the ruling to the Second Circuit.

Healthcare Cost Recovery Lawsuits. Plaintiffs in these cases also seek compensatory and punitive damages in the billions of dollars. The plaintiffs include the United States and foreign governmental entities or others, such as labor unions, private companies, HMOs, hospitals, other third-party payors, native American tribes or private citizens suing on behalf of taxpayers who seek reimbursement of healthcare costs allegedly incurred as a result of smoking, as well as other alleged damages. One OPM has reported that as of August 1, 2002, there were approximately 43 active healthcare cost recovery cases pending in courts in the United States against manufacturers of tobacco products, of which approximately ten were filed by union trust funds.

One lawsuit, filed by the United States Department of Justice against the OPMs and other defendants seeks to recoup unspecified damages pursuant to the Medical Care Recovery Act and the Medicare Secondary Payer Act for Medicare and other medical expenses allegedly incurred as a result of smoking-related illnesses, and to require defendants to disgorge profits pursuant to the federal Racketeer Influenced Corrupt Organizations ("**RICO**") statute. The federal government has alleged that the tobacco companies have engaged in consumer fraud for failing to disclose health risks. On September 28, 2000 the district court ruled that the government could not use the Medical Care Recovery Act or the Medicare Secondary Payer Act to recover Medicaid expenses related to ill smokers and granted the defendants' motions to dismiss these claims. The district court also ruled that the government could proceed with its other claims under the RICO statute. The federal government has requested that the court reinstate the dismissed claims. The court denied that motion on January 31, 2001. In February 2001, the government filed an amended complaint attempting to replead the Medicare Secondary Payer Act claim. In July 2001, the court dismissed the amended complaint. In June 2001, the Department of Justice began to work on a possible settlement of the federal lawsuit. The Department of Justice met with representatives of the tobacco industry on July 18, 2001. No settlement was reached. In December 2001, the Department of

Justice filed a pre-trial document setting forth some of the remedies it may seek in the lawsuit. In that document the Department of Justice indicated that it may seek severe limitations on the marketing and promotion of cigarettes. These limitations include requiring 50% of cigarette-pack surfaces to carry "graphic" health warnings and messages from the U.S. Surgeon General; requiring packs to carry health-leaflet inserts; eliminating slotting fees paid to retailers for favorable placement of tobacco products in stores; publicly disclosing manufacturing methods, marketing research, ingredients, additives and toxic chemicals; forbidding "light," "low-tar" or "mild" labels; banning vending machine sales; ending trade promotions and give-aways; and restricting all cigarette advertising to black-and-white-only formats, with 50% of the space dedicated to "graphic" health warnings. Trial is scheduled for July 2003 on the RICO claims. Several foreign countries or subdivisions thereof have filed actions in Florida state courts to recover the costs of treating persons with diseases associated with tobacco use. The tobacco companies removed the cases to federal district court, and the cases were transferred to the United States District Court for the District of Columbia. The district court remanded the cases brought by Venezuela, Ecuador, and the Brazilian states of Espirito Santo and Goias to Florida state court. In April 2002, in *Republic of Venezuela v. Philip Morris Inc.*, the D.C. Circuit Court of Appeals refused to review the remand decision for lack of appellate jurisdiction. The D.C. Circuit also refused to prohibit the district court from remanding similar cases brought by Russia and the Brazilian State of Mato Grosso Do Sol. The Florida Court has dismissed the Venezuela and Espirito Santo cases. In June 2001, a federal jury in the Eastern District of New York found that Philip Morris, R.J. Reynolds and B&W engaged in deceptive business practices in a case brought by Empire Blue Cross Blue Shield of New Jersey. The jury awarded damages up to $17.8 on statutory protection claims and $11.8 million on separate but overlapping claims. In February 2002, the court granted the plaintiffs' request for attorney fees in the approximate amount of $37.8 million. The defendants are pursuing a single appeal from the jury verdict and the award of attorney fees. See "TOBACCO INDUSTRY—Civil Litigation—*Healthcare Cost Recovery Lawsuits*."

Other Tobacco-Related Litigation. One or more PMs are also defendants in other litigation stemming from the production, sale or use of tobacco products. These cases include lawsuits brought by former asbestos manufacturers now seeking contribution or reimbursement for amounts they expended in connection with the defense of claims and payment of damages for asbestos injury allegedly caused, in whole or in part, by cigarette smoking. They also include cases by smokers alleging that the marketing of tobacco products involves deceptive and unfair trade practices. These cases seek injunctive and equitable relief, including restitution. In addition, certain PMs and/or their affiliates have been sued by foreign entities. For example, the European Community ("**EC**") brought suit against Reynolds Tobacco and Philip Morris alleging that the defendants engaged in a conspiracy to smuggle cigarettes into EC member states in an effort to evade taxes. On July 18, 2001, the United States District Court for the Eastern District of New York dismissed the case, stating that the EC had been unable to prove "that it has suffered any injury as a result of the defendants' illegal acts." On August 6, 2001, the EC and ten member states filed a complaint in the same court against RJR Nabisco, Inc. (Reynolds Tobacco's parent), Philip Morris and related companies. Other than the addition of the member states as parties, the EC complaint is essentially a resubmission of the first complaint filed on November 3, 2000. The second complaint seeks unspecified damages including compensatory damages, injunctive relief, and treble damages under RICO. On February 19, 2002, the district court dismissed the case, stating that the tobacco companies were immune to liability by foreign governments for unpaid taxes in U.S. courts. See "LEGAL CONSIDERATIONS" and "TOBACCO INDUSTRY—Civil Litigation—*Other Tobacco-Related Litigation.*"

Risks Inherent in Litigation. The outcome of pending and any future litigation against the tobacco industry and individual PMs and any other pending or future smoking and health or other lawsuits is uncertain. No assurance can be given that the tobacco industry defendants will not at some point in the future incur additional liability for substantial judgments. One or more adverse judgments could result in a decision by affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption beyond what is forecast in the DRI•WEFA Report, resulting in a reduction in

Pledged TSRs available to the Authority to make payments on the Series 2002 Bonds. See "DRI•WEFA REPORT." Substantial compensatory or punitive damages, if awarded, whether singly or in the aggregate, could, as to any or all of the PM defendants, materially adversely affect their financial condition and thus impair their continued ability to make payments under the MSA. Any one or more of these possibilities could materially adversely affect the payment of Pledged TSRs to the Authority and impair the payments required to be made to the Bondholders. In addition, developments in pending litigation or filing of new litigation at any time can impact the market for or prices of securities such as the Series 2002 Bonds payable from tobacco settlement payments made under the MSA. For a further discussion of these matters, see "TOBACCO INDUSTRY—Civil Litigation" and "LEGAL CONSIDERATIONS."

Uncertainty as to Timing of Amortization

No assurance can be given as to the timing of amortization of the Turbo Term Bonds. The timing of amortization payments will be based on the Authority's receipt of Collections. A certain level of Pledged TSRs has been forecast based on various assumptions including, among others, domestic cigarette consumption levels as set forth in the DRI•WEFA Base Case Forecast and adjustments to the payments by the PMs as required by the terms of the MSA. These assumptions, which were used to schedule interest on and Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments of the Series 2002 Bonds, as well as projected Turbo Redemptions, are discussed in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION—Effect of Changes in Cigarette Consumption on Turbo Redemptions." Actual results could and likely will vary from the assumptions. Such variance could be material and could affect the level of Pledged TSRs. Any material reduction would impair the generation of funds available for Turbo Redemptions and extend the average life of the Turbo Term Bonds. On the other hand, material increases would generate more funds available for Turbo Redemptions and shorten the average life of the Turbo Term Bonds. In addition, future increases in the rate of inflation above 3% per annum in the absence of other factors would materially shorten the life of the Turbo Term Bonds. No assurance can be given that these structuring assumptions will be realized. The timing of amortization of the Series 2002 Bonds could be affected by an Event of Default under the Indenture, which would result in Pro Rata payment of the Bonds rather than Turbo Redemptions in chronological order. Holders of the Turbo Term Bonds bear the reinvestment risk from faster than expected amortization as well as the extension risk from slower than expected amortization of the Turbo Term Bonds. Finally, the Bonds are subject in certain cases to partial redemption from the proceeds of Refunding Bonds. In such an event, Holders of the Turbo Term Bonds bear the reinvestment risk from faster than expected amortization of the Turbo Term Bonds that remain Outstanding due to lower debt service on the Refunding Bonds. See "Limited Nature of Ratings; Reduction, Suspension or Withdrawal of a Rating."

Bankruptcy of a PM May Delay or Reduce Payments

Because the only source of payment for the Series 2002 Bonds (other than amounts in the Liquidity Reserve Account and the Capitalized Interest Subaccount) is the Pledged TSRs that are paid by the PMs, if one or more PMs were to become a debtor in a case under Title 11 of the United States Code (the "**Bankruptcy Code**"), there could be delays or reductions in payments on the Series 2002 Bonds, and Bondholders could incur losses on their investments. 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 Authority, the Indenture Trustee or the Bondholders to collect any Pledged TSRs or any other amounts owing by the bankrupt PM. Even if the bankrupt PM wanted to continue paying 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 Pledged TSRs. If the MSA is an "executory contract" under the Bankruptcy Code, the PM may be able to repudiate the MSA and stop

making payments under it. Furthermore, payments previously made to the Bondholders might be avoidable as preferential payments, so that the Bondholders 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 Authority, the Indenture Trustee and the Bondholders. Finally, while there are provisions of the MSA that purport to deal with the bankruptcy of a PM, 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 payments to the Bondholders. For a further discussion of certain bankruptcy issues and a description of certain legal opinions to be delivered to the Authority by various counsel with respect to PM bankruptcy matters, see "LEGAL CONSIDERATIONS."

Bonds Secured Solely by the Collateral

The Bonds are payable only from the Collateral, which is substantially comprised of the Pledged TSRs. If the Collateral has been exhausted, no amounts will thereafter be paid on the Bonds. Investors in the Series 2002 Bonds must look solely to the Collateral for repayment of their investment. The Authority has no taxing power. **The Series 2002 Bonds shall not be obligations of the State and shall be obligations only of the Authority, payable solely from the special fund or funds created by the Authority for their payment. Payment of the principal of, interest on, and redemption premium, if any, on the Series 2002 Bonds shall be a valid claim only as against the special fund or funds relating thereto. Neither the faith and credit nor the taxing power of the State or any municipal corporation, subdivision, or agency of the State, other than the Authority as set forth in the Act, is pledged to the payment of the principal of, interest on, and premium, if any, on the Series 2002 Bonds.**

Limited Remedies

The Indenture Trustee is limited under the Sales Agreement to enforcing the terms of such agreement and to receiving the Pledged TSRs and applying them in accordance with the Indenture. If an Event of Default occurs, the Indenture Trustee cannot sell its rights under the Sales Agreement. The Authority is not a party to the MSA and has not made any representation or warranty that the MSA is enforceable. Remedies under the Sales Agreement do not include the repurchase by the State of the Pledged TSRs under any circumstances, including unenforceability of the MSA, the Model Statute or breach of any representation or warranty. The remedies of the Bondholders are no greater than those of the Indenture Trustee.

Limited Liquidity of the Series 2002 Bonds

There is currently a limited secondary market for securities such as the Series 2002 Bonds payable from tobacco settlement payments made under the MSA. While the Underwriters intend to make a secondary market in the Series 2002 Bonds, they are under no obligation to do so. There can be no assurance that a secondary market for the Series 2002 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 2002 Bonds. Consequently, any purchaser of the Series 2002 Bonds must be prepared to hold such securities for an indefinite period of time or until final redemption of such securities.

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

Any rating assigned to the Series 2002 Bonds by a Rating Agency will reflect such Rating Agency's assessment of the likelihood of the payment of interest when due on the Series 2002 Bonds and the payment of Serial Maturities and Turbo Term Bond Maturities of the Series 2002 Bonds when due.

No such rating will address the likelihood that the Turbo Redemptions will be made according to the Projected Turbo Schedule or the likelihood of payment of the Sinking Fund Installments when due. The ratings of the Series 2002 Bonds will not be a recommendation to purchase, hold or sell such Series 2002 Bonds, and such ratings will not address the marketability of such Series 2002 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, including, but not limited to, the evaluation by such Rating Agency of the financial outlook for the tobacco industry. 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 the Series 2002 Bonds.

IRS Audits

The Internal Revenue Service (the "**IRS**") examined several outstanding tax-exempt bond issues secured by tobacco settlement revenues. The IRS closed its examinations of the three earliest tax-exempt bond issues of this type with no change in the tax-exempt status of the interest on such bonds under Section 103 of the Tax Code. Other pending or future IRS audits of tax-exempt bonds of this type or others, however, could have an adverse effect on the market for, or the market price of, the Series 2002 Bonds. See "TAX MATTERS."

SUMMARY OF THE MSA

The following is a brief summary of certain provisions of the MSA and related information. This summary is not complete and is subject to, and qualified in its entirety by reference to, the copy of the MSA which is attached hereto as Appendix B.

General

The MSA is an industry-wide settlement of litigation between the Settling States and the OPMs and was entered into between the Settling States and the OPMs on November 23, 1998. The MSA provides for other tobacco companies (the "**SPMs**") to become parties to the MSA. The four OPMs together with the 37 SPMs are referred to as the "**PMs**." The settlement represents the resolution of a large potential financial liability of the PMs for smoking-related injuries, the costs of which have been borne and will likely continue to be borne by cigarette consumers. 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 NAAG, 37 SPMs have signed the MSA. Additional SPMs may sign the MSA in the future. The chart below identifies each of the PMs currently a party to the MSA:

OPMs	SPMs	
Brown & Williamson Tobacco Corporation	Alliance Tobacco Corp.	Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)
Lorillard Tobacco Company	Caribbean-American Tobacco Corp. (CATCORP)	P.T. Djarum
Philip Morris Incorporated	Chancellor Tobacco Company, PLC	Pacific Stanford Manufacturing Corporation
R.J. Reynolds Tobacco Company	Commonwealth Brands, Inc.	Peter Stokkebye International A/S
	Cutting Edge Enterprises, Inc.	Planta Tabak-manufaktur Gmbh & Co.
	Daughters & Ryan, Inc.	Poschl Tabak GmbH & Co. KG
	Dhanraj International, Inc.	Premier Manufacturing Incorporated
	Eastern Company S.A.E.	Santa Fe Natural Tobacco Company, Inc.
	House of Prince A/S	Sherman 1400 Broadway N.Y.C. Inc.
	Imperial Tobacco Limited/ITL (USA) Limited	Societe Nationale d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)
	Japan Tobacco International USA., Inc.	Tobacco & Candy International, Inc.
	King Maker Marketing	Top Tobacco, LP
	Konci G&D Management Group (USA) Inc.	Vector Tobacco Inc.
	Kretek International	Virginia Carolina Corporation, Inc.
	Lane Limited	Von Eicken Group
	Liggett Group, Inc.	Wind River Tobacco Company, LLC
	Lignum-2, Inc.	Winner Sales Company
	Mac Baren Tobacco Company A/S	ZNF International, LLC
	Medallion Company, Inc.	

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 apply only to the PMs and not to any other person or entity.

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 healthcare 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: (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 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 healthcare 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 Washington Attorney General and the Governor do not have the power or authority to bind any of the Washington 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."

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

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." 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 "Adjustment to Payments." SPMs are not required to make Initial Payments. Thus far, the OPMs have made the up-front Initial Payment and the Initial Payments for 2000, 2001 and 2002, and the OPMs and other PMs have made the Annual Payments for 2000, 2001 and 2002 (subject to certain withholdings described in "RISK FACTORS—Other Potential Payment Decreases Under the Terms of the MSA"). The Pledged TSRs are the sum of (1) the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, and (2) 29.2% of:

(a) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto);

(b) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003; and

* 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 State and are not available to Bondholders, and consequently are not discussed herein.

(c) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003.

See “Payments Made to Date.” 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. Pursuant to an escrow agreement (the “**MSA Escrow Agreement**”) established in conjunction with the MSA, the Initial Payments, Annual Payments and Strategic Contribution Payments are to be made to Citibank, N.A., as MSA Escrow Agent (the “**MSA Escrow Agent**”), which in turn will disburse the funds to the Settling States. The State has covenanted to irrevocably direct the MSA Escrow Agent and the Independent Auditor (as defined in the MSA) to transfer all Pledged TSRs directly to the Indenture Trustee.

Initial Payments

Initial Payments are 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 $2.15 billion due to various adjustments. The 2001 Initial Payment, which had a scheduled base amount of $2.546 billion, was paid in December 2000 in the approximate amount of $2.18 billion after taking into account various adjustments and an earlier overpayment. The 2002 Initial Payment, which had a scheduled base amount of $2.623 billion, was paid in December 2001, in the approximate amount of $2.16 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 final Initial Payment is due on or before January 10, 2003 in the base amount (before adjustment as discussed below) of approximately $2.701 billion. To the extent that the final Initial Payment is included in the first $30,000,000 of payments received by the State on and after the Closing Date and before July 1, 2003, the final Initial Payment is included in the Pledged TSRs. Adjustments to Initial Payments made to the State under the MSA prior to July 1, 2003 are also included in the Pledged TSRs. Finally, subsequent adjustments to the Initial Payments may impact future Annual Payments and Strategic Contribution Payments.

In the case of the up-front Initial Payment made in 1998, the relative payment responsibilities of the OPMs were calculated using their relative market capitalization percentages, as specified in the MSA. Thereafter, the respective payment responsibilities are to be recalculated each year based on the OPM’s Relative Market Share during the preceding calendar year. “**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 (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.

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 three Annual Payments due April 15, 2000, April 15, 2001 and April 15, 2002, the scheduled base amounts of which (before adjustments discussed below) were $4.5 billion, $5.0 billion and $6.5 billion, respectively. After application of the adjustments, (1) the Annual Payment made in April 2000 was approximately $3.5 billion, (2) the Annual Payment made in April 2001 was approximately $4.1 billion and (3) the Annual Payment made in April 2002 was approximately $5.2 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	Thereafter	9,000,000,000
2009	8,139,000,000		

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 that executed the MSA on or before February 22, 1999 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. If an SPM executed the MSA after February 22, 1999, its 1997 or 1998 market share, as applicable, is deemed to be zero.

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,
- the Federal Tobacco Legislation Offset,
- the Litigating Releasing Parties Offset and

* These Annual Payments are not pledged to the payment of the Bonds and have been paid directly to the State, free and clear of the lien of the Indenture. Subsequent adjustments to these Annual Payments may impact future Annual Payments and Strategic Contribution Payments.

- 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 2000, April 2001 and April 2002, as discussed below under "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.

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

Adjustments to Payments

The base amounts of the Initial Payments, 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 amount 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 (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 Adjustments are compounded annually on a cumulative basis beginning in 1999 and were first applied in 2000. Initial Payments are not subject to the Inflation Adjustment.

Volume Adjustment. Each of the Initial Payments, 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 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 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 Initial Payments, Annual Payments and Strategic Contribution Payments due from the PMs will be reduced to account for the absence of such state. This adjustment has no effect on the amounts to be collected by states that remain a party to the MSA, and the reduction is therefore not detailed.

Non-Participating Manufacturers Adjustment. If the aggregate market share of the PMs in any year falls more than 2% below the aggregate market share held by those same PMs in 1997, and if a nationally recognized team of economic consultants determines that the provisions of the MSA were a significant factor contributing to the market share loss for the year in question, an adjustment (the "**NPM Adjustment**") is applied to the Annual Payment and Strategic Contribution Payment due in the following year. The 1997 market share percentage for the PMs, less 2%, is defined as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate market share is between 0% and $16\frac{2}{3}$% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs will 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 $16\frac{2}{3}$%, the NPM Adjustment will be calculated as follows:

$$\text{NPM Adjustment} = 50\% + \{[50\%/(\text{Base Aggregate Participating Manufacturer Market Share} - 16\tfrac{2}{3}\%)] \times (\text{market share loss} - 16\tfrac{2}{3}\%)\}$$

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. 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 enforcing a Qualifying Statute. Any Settling State that adopts and diligently enforces a Qualifying Statute is exempt from the NPM Adjustment. The State has adopted 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 (1) did not enact and diligently enforce the Qualifying Statute, or (2) 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 a Model Statute, but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment will not exceed 65% of the amount of such state's allocated payment. If a Qualifying Statute that is not a 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 Model Statute or Qualifying Statute, as the case may be. See "MSA Provisions Relating to Model/Qualifying Statutes."

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, the same terms will be extended to all PMs.

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.

Federal Tobacco Legislation Offset. If federal tobacco-related legislation is enacted on or before November 30, 2002 and if such legislation provides for payments by any PM to the federal government all or part of which are actually made available to any Settling State, the MSA provides that each PM will receive a continuing dollar-for-dollar offset for such amounts paid to and received by such Settling State (the "**Federal Tobacco Legislation Offset**"). The Federal Tobacco Legislation Offset applies only to that portion of the federal funds directed to a Settling State that is either unrestricted as to its use or restricted to any form of healthcare or to any use related to tobacco.

The Federal Tobacco Legislation Offset does not generally apply to federal funds conditioned, or appropriately allocable, either to the relinquishment of rights or benefits under the MSA or to a consent decree or actions or expenditures by the Settling State. However, if the Settling State chooses to

undertake such action or expenditure, and if such actions or expenditures either (1) do not impose significant constraints on public policy choices, or (2) are both related to health or tobacco and do not require the Settling State to expend state matching funds in an amount that is significant in relation to the amount of federal funds made available to the applicable Settling State, the Federal Tobacco Legislation Offset applies. The Federal Tobacco Legislation Offset does not reduce the total amounts payable by the PM to the Settling States under the MSA by an amount greater than the amount of federal funds that the Settling States could elect to receive.

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, the Releasing Party must (1) 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 (2) 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 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. Seventeen of the current 37 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 (1) the difference between that SPM's Market Share for the preceding year and its Base Share, divided by (2) 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

The MSA Escrow Agent has disbursed to the State its allocable portions of the first four Initial Payments and the first three Annual Payments due under the MSA totaling $446.2 million, as well as a tax refund of $1.0 million received in November 2001. The State's share of these payments is not pledged to payment of the Bonds, and was paid free and clear of the liens of the Indenture. Under the MSA, the information on which computation of Initial Payments, Annual Payments and Strategic Contribution Payments by the MSA Auditor is based is confidential and may not be used for purposes other than those stated in the MSA. Since no Strategic Contribution Payments are required to be made until April 15, 2008, Strategic Contribution Payments are not discussed here.

With respect to each of the Initial Payments and the Annual Payments made to date, the following table sets forth: (1) the State's allocable portion of the scheduled base amount of such payment under the MSA before taking into account any adjustments; and (2) the State's allocable portion of the actual amount paid by the PMs under the MSA after all adjustments.

	Base Payment Allocable to the State	**State's Actual Receipts***
Up-Front Initial Payment	$49.3 million	$50.7 million
January 2000 Initial Payment	50.7 million	44.3 million
April 2000 Annual Payment	80.9 million	73.2 million
January 2001 Initial Payment	52.3 million	45.0 million
April 2001 Annual Payment	89.9 million	83.8 million
January 2002 Initial Payment	53.8 million	42.4 million
April 2002 Annual Payment	116.8 million	106.9 million

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* As reported by the State, amounts reflect the State's actual receipts after applicable adjustments or disputes. Any subsequent recalculation is reflected in the period that it impacted the State's receipts.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the headings "Initial Payments," "Annual Payments" and "Adjustment to Payments." Both the Settling States and the PMs are disputing the calculations of the Initial Payments for 2000, 2001 and 2002 and Annual Payments for 2000, 2001 and 2002. 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 NPM than the MSA does to the PMs, the terms of the MSA will be deemed modified to match the NPM settlement, but only with respect to the particular Settling State. In the event that any Settling State agrees to reduce the burden placed upon any PM by the terms of the MSA, the MSA will be deemed modified so that each PM enjoys the same reduction in burden, 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.

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 (1) 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 (2) 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 (1) 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 (2) 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 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 Authority or the Bondholders.

Disbursement of the funds by the MSA Escrow Agent from the escrow accounts is to 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: (1) use any cartoon characters in advertising, promoting, packaging or labeling Tobacco Products; (2) 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 (3) provide to any underage person any item in exchange for the purchase of Tobacco Products or for the furnishing of proofs-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: (1) 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; (2) 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; (3) the sale or distribution in the Settling States of any non-tobacco items containing tobacco brand names or selling messages; and (4) 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.

Termination of MSA

The MSA is terminated as to a Settling State if (1) 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 (2) 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 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 the aggregate market share of the PMs in any year falls more than 2% below the aggregate market share held by those same PMs in 1997, and if a nationally recognized team of economic consultants determines that the provisions of the MSA were a significant factor contributing to the market share loss for the year in question.

Settling States may 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**,") as defined in 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.

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 MSA provides an economic incentive for most states to adopt and diligently enforce a Qualifying Statute. 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 Model Statute or 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 Model Statute or Qualifying Statute, as the case may be.

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 will 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 into an escrow account an amount for each unit (cigarette) it sells (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 in 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 (1) to pay a judgment or settlement on any released claim brought against such NPM by the applicable Settling State or any Releasing Party located within such state; (2) 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 Participating Manufacturer under the MSA (as determined before certain adjustments or offsets); or (3) 25 years after the date that the funds were placed into escrow (less any amounts paid out pursuant to clause (1) or (2)).

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: (1) 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; (2) 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 (3) 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. Under the State's Qualifying Statute the term tobacco product manufacturer means an entity that, on or after July 1, 1999, directly, and not exclusively through any affiliate:

> (1) Manufactures cigarettes anywhere which the manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer. However, any entity that manufactures cigarettes that it intends to be sold in the United States is not a tobacco product manufacturer under this subdivision if the cigarettes are sold in the United States exclusively through an importer that is an original participating manufacturer, as that term is defined in the MSA, that will be responsible for the payments under the MSA with respect to such cigarettes as a result of the provisions of subsections II(mm) of the MSA and that pays the taxes specified in subsection II(z) of the MSA, and if 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 subdivision (1) or (2).

The term does not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within subdivision (1), (2) or (3).

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—Risks Related to Enforceability or Modification of the MSA and Constitutionality of the Model Statute—*Qualifying Statute.*"

Washington Qualifying Statute. The Washington Qualifying Statute is codified at Chapter 70.157 of the Revised Code of Washington. By agreement dated February 7, 2001, each of the OPMs has acknowledged that the Washington Qualifying Statute, if maintained in the current form without modification or addition other than as agreed to by the PMs, is a Model Statute under the MSA (which means it is also a Qualifying Statute).

WASHINGTON CONSENT DECREE

*The following summary describes certain provisions of the Consent Decree and Final Judgment (the "**Consent Decree**"). This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Consent Decree. Copies of the Consent Decree may be obtained upon written request to the Authority, 1000 Second Avenue, Suite 2700, Seattle, Washington 98104.*

On November 23, 1998, the Consent Decree, which governs the State's action against the tobacco companies, was entered in the Superior Court of Washington for King County. The Consent Decree is final and not subject to further appeal. However, the Court retained continuing jurisdiction over the matter for the purpose of implementing and enforcing the MSA and Consent Decree. The Consent Decree provides that, whenever possible, the State and the PMs shall seek to resolve any issues that may exist as to compliance with the Consent Decree by discussion among appropriate designees named pursuant to subsection XVIII(m) of the MSA.

The Consent Decree provides no rights to, and is not enforceable by, any person or entity other than the State or a Released Party. The Pledged TSRs do not include any right to enforce any provision of the Consent Decree. Except as expressly provided otherwise in the MSA, the Consent Decree may not be modified unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions. If certain sections of the Consent Decree are modified without the consent of the State and all affected PMs, the Consent Decree will become void and of no further effect. Changes in economic conditions of the parties are not grounds for modification.

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 publicly available analyses of the tobacco industry and other public sources. Certain of the companies file annual, quarterly and other reports with the SEC. Such reports are available on the SEC's website (www.sec.gov) and upon request from the Office of Public Reference of the SEC, 450 Fifth Street, NW, Room 1300, Washington, D.C. 20549-0102 (phone: (202) 942-8090; fax: (202) 628-9001; e-mail: publicinfo@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 industry participants or the financial performance or capability of such participants. Although the Authority has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Authority 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 Washington Attorney General has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2002 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2002 Bonds is consistent with their investment objectives.

Retail market share information, based upon 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 OPMs to contribute to Initial Payments and 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 MSA—Initial Payments," "—Annual Payments"

and "—Strategic Contribution Payments." In addition, aggregate market share information, based upon shipments as reported by Loews and reflected in the chart below entitled "Manufacturers' Domestic Market Share Based on Shipments" is different from that used in the bond structuring assumptions. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION."

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 DRI•WEFA 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.

Industry Overview

According to their own publicly available documents, the four leading manufacturers of tobacco products in the United States in 2001 collectively accounted for approximately 94% of domestic cigarette industry retail market share when measured by sales volume and for approximately 94% of the domestic cigarette retail industry when measured by shipment volume. The market for cigarettes in the United States divides generally into premium and discount sales, approximately 74% and 26%, respectively, measured by volume of all domestic cigarette sales in 2001.

Philip Morris, a subsidiary of Philip Morris Companies Inc., is the largest tobacco company in the United States. On April 25, 2002, the shareholders of Philip Morris Companies Inc. granted the Company's Board of Directors the authority to change the name of the holding company to Altria Group, Inc. The Board retained the discretion to determine when to effect the name change. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2001, Philip Morris reported that its domestic retail market share based on sales in 2001 was 50.8%, which represents an increase of 0.3 share points from its self-reported 2000 domestic retail market share based on sales of 50.5%. In its Form 10-Q for the quarter ended June 30, 2002, Philip Morris reported that its domestic retail market share based on shipments for the first six months of 2002 was 49.4%, which represents a decrease of 2.2 share points from the comparable period for 2001. Philip Morris's major premium brands are Marlboro, Virginia Slims, Parliament, Merit and Benson & Hedges. Its principal discount brands are Basic and Cambridge. Marlboro is the largest selling cigarette brand in the United States, with approximately 38.4% of the United States domestic retail share during the first six months of 2002, and has been the world's largest-selling cigarette brand since 1972.

Reynolds Tobacco is the second largest tobacco company in the United States. In its Annual Report on Form 10-K filed with the SEC by Reynolds Tobacco's parent company relating to its results for the year ended December 31, 2001, Reynolds Tobacco reported that its domestic retail market share in 2001 was 23.4% (measured by sales volume), which represents a decrease of 0.2 share points from its self-reported 2000 domestic retail market share. In its Form 10-Q for the quarter ended June 30, 2002, Reynolds Tobacco reported that its domestic retail market share was 22.86%, which represents a decrease of 0.63 share points from the comparable period for 2001. For the quarter ended June 30, 2002, Reynolds Tobacco reported that its domestic retail market share based on shipments was 22.86%, which represents a decrease of 1.3 share points from the comparable period for 2001. This market share information includes the domestic volume of Santa Fe Natural Tobacco Company, Inc., which was acquired by Reynolds Tobacco on January 24, 2002, but excludes Puerto Rico and other United States territories volume. Reynolds Tobacco's major premium brands are Winston, Camel, Salem, Vantage, More and Now. Its discount brands include Doral, Monarch and Best Value.

B&W, with headquarters in Louisville, Kentucky, is a wholly-owned subsidiary of British American Tobacco p.l.c., a holding company based in London, England. B&W is the third largest tobacco company in the United States. According to publicly available documents on its website, B&W reported that its domestic retail market share based on sales in 2001 was 10.4% (measured by sales volume), which represents a decrease of 1.3 share points from its self-reported 2000 domestic retail market share. B&W's largest selling brand is GPC, a discount brand. Its other major brands are Kool, Carlton and Lucky Strike.

Lorillard, a wholly-owned subsidiary of Loews, is the fourth largest tobacco company in the United States. On February 6, 2002, in an initial public offering, Loews issued shares of Carolina Group stock, which is intended to reflect the economic performance of Loews' stock in Lorillard. Carolina Group is not a separate legal entity. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2001, Lorillard's parent reported that its domestic retail market share in 2001 was 9.5% (measured by shipment volume), which represents a decrease of 0.3 share points from its self-reported 2000 domestic retail market share. In its Form 10-Q for the quarter ended June 30, 2002, Lorillard reported that its domestic retail share (based on shipments) was 9.62%, which represents an increase of 0.17 share points from the comparable period for 2001. Lorillard's major brands are Newport, Kent, True, Maverick, and Old Gold. Its largest selling brand is Newport, which accounted for approximately 88% of Lorillard's unit sales in 2001.

Based on the domestic retail market shares discussed above, the remaining share of the United States retail cigarette market in 2001 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett, a wholly-owned subsidiary of Brooke Group, Ltd., the predecessor of Vector Group Ltd. ("**Vector**") Liggett, the operating successor to the Liggett & Meyers Tobacco Company, is the fifth largest tobacco company in the United States. As reported in Vector's Form 10-K filed with the SEC for the year ended December 31, 2001, Liggett reported that its domestic retail market share in 2001 was 2.2% (measured by shipment volume), which represents an increase of 0.7 share points from its self-reported 2000 domestic retail market share. Liggett currently produces two premium brands, Eve and Jade, in addition to certain discount brands including Pyramid. In November 2001, Vector launched OMNI, which Vector claims is the first reduced-carcinogen cigarette that tastes, smokes and burns like other premium cigarettes. In addition, Vector has announced that it expects to introduce a nicotine-free cigarette under the brand name QUEST. Liggett and Vector are SPMs under the MSA.

The following table sets forth the approximate comparative positions of the leading producers in the United States domestic tobacco industry, each of which is an OPM under the MSA, based upon cigarette retail sales:

Manufacturers' Domestic Retail Market Share Based On Sales*

Manufacturer	1997	1998	1999	2000	2001
Philip Morris	51.0%	49.4%	49.9%	50.5%	50.8%
Reynolds Tobacco	25.4	25.2	23.9	23.6	23.4
B&W/American Brands	16.1	15.0	13.4	11.7	10.4
Lorillard	8.8	9.3	10.7	10.0	N.A.
Other**	—	1.1	2.1	4.2	N.A.

N.A. means not available.

* Totals may not equal 100% as the retail market shares of each of the OPMs has been obtained from their own publicly available documents. These amounts may differ from amounts reported by other OPMs.

** The retail market share of tobacco manufacturers other than the OPMs has been determined by subtracting the total retail market share percentages of the OPMs as reported in their own publicly available documents (noted above) from 100%. In 1997, the total retail market share of each of the OPMs as reported by their own publicly available documents, when aggregated, was in excess of 100%.

Shipment Trends

The following table sets forth the approximate comparative positions of the leading producers in the United States domestic tobacco industry, each of which is an OPM under the MSA, based upon cigarette shipments:

Manufacturers' Domestic Market Share Based on Shipments*

Manufacturer	1997	1998	1999	2000	2001
Philip Morris	48.7%	49.4%	49.0%	48.7%	50.9%
Reynolds Tobacco	24.2	24.0	22.7	22.2	22.3
B&W/American Brands	16.0	15.0	13.2	11.3	10.9
Lorillard	8.7	9.1	10.3	9.3	9.5
Other**	2.4	2.5	4.8	8.5	6.4

* The shipment market shares of each of the OPMs has been obtained from publicly available documents of Loews. These amounts may differ from amounts reported by other OPMs.

** The market share based on shipments of tobacco manufacturers other than the OPMs has been determined by subtracting the total market share percentages of the OPMs as reported in the publicly available documents of Loews (noted above) from 100%.

The following table sets forth the industry's cigarette shipments in the United States for the five years ended December 31, 2001. The MSA payments are calculated in part on industry shipments rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)*
1997	482.9
1998	460.8
1999	419.3
2000	419.8
2001	406.3

* As reported in SEC filings and other publicly available documents of Philip Morris.

Both Philip Morris and Reynolds Tobacco reported for the quarter ended June 30, 2002 that industry shipments during the quarter decreased by 7.0%. Both attributed the decline in part to trade inventory depletions following April 2002 price increases, the timing of promotions and increased price competition. Philip Morris estimates that the industry volume continued to decline at an annualized rate of 1 to 2%.

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 Initial Payments, Annual Payments and Strategic Contribution Payments under the MSA.

Consumption Trends

According to a September 2002 release by the United States Department of Agriculture (the "**USDA**") Economic Research Service ("**USDA-ERS**"), smokers in the United States will consume an estimated 420 billion cigarettes in 2002, which would represent a decrease of approximately 1.2% from the previous year. Annual per capita consumption (per adult over 16) dropped from 2,453 cigarettes in 1993 to an estimated 1,955 in 2002. The following chart sets forth domestic cigarette consumption from 1997 through 2002:

Years Ended December 31	U.S. Domestic Consumption (Billions of Cigarettes)*
1997	480
1998	465
1999	435
2000	430
2001	425
2002	420**

* USDA-ERS. The MSA payments are calculated in part based on domestic industry shipments rather than consumption. The DRI•WEFA 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 time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

** Estimated, subject to change.

Tax Collections

According to an April 2002 release by the USDA-ERS, federal cigarette excise tax collections in fiscal year 2001 (October 2000-September 2001) reached $7.4 billion. State sales tax collections in calendar year 2001 reached $2.9 billion. In addition, state excise taxes have risen dramatically in the past five years. According to the Federation of Tax Administrators, as of July 2002, 22 states imposed taxes of $0.50 or more per pack and nine states had rates of $1.00 or more per pack. In April 2002, the excise tax in New York State increased to $1.50 per pack, then the highest in the nation, which was matched by New Jersey in July 2002. As of April 2002, the average state tax (weighted by sales) was over $0.44 per pack. The federal excise tax for cigarettes was raised by $0.05 per pack in January 2002 to $0.39 per pack. According to the DRI•WEFA Report, at least 30 states have recently increased or are considering increases in excise taxes as a response to budget shortfalls.

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 and where permitted by law, 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 has been prohibited in the United States. The domestic tobacco manufacturers have agreed to marketing restrictions in the United States 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.

Gray Market

According to the USDA-ERS, during 1998 and 1999, the differential between the manufacturer's wholesale price and the export price of United States cigarettes created an opportunity for arbitrage. Independent traders exported United States manufactured cigarettes and then re-imported them into the United States, paying import duties and excise taxes. Because cigarettes sold for export are priced so low, it was possible to import cigarettes into the United States in this fashion and make a profit, while selling them at a lower price than cigarettes produced for the domestic market. In 1999, gray market imports were estimated at 3.0 to 4.5 billion pieces, less than 1% of total consumption. The United States federal government and 49 states have enacted legislation prohibiting the sale and distribution of gray market cigarettes. According to the USDA-ERS, gray market sales are expected to cease. In addition, one OPM reports that it has taken legal action against certain distributors and retailers who engage in such practices.

Regulatory Issues

General. The manufacture, sale and use of tobacco continue to be the focus of numerous regulatory initiatives, both domestically and abroad. Among other things, these initiatives seek to ameliorate the adverse health effects associated with smoking and exposure to environmental tobacco smoke ("**ETS**"). Reports concerning the harmful physical effects of cigarette smoking and other forms of tobacco use have been publicized for many years, and the sale, promotion and use of cigarettes and other tobacco products continue to be the subject of increasing governmental and private sector regulation.

Federal Regulation. Since 1964, the Surgeon General of the United States and the Secretary of Health and Human Services have released a number of reports linking cigarette smoking to a broad range of health hazards, including various types of cancer, heart disease and chronic lung disease, and have recommended various governmental measures to reduce the incidence of smoking. Since 1965, federal law has required that health warnings be printed on each pack of cigarettes.

In recent years, various members of the United States Congress have introduced legislation, some of which has been the subject of hearings or floor debate, that would subject cigarettes to various regulations under the Department of Health and Human Services or regulation under the Consumer

Products Safety Act, establish educational campaigns relating to tobacco consumption or tobacco control programs, provide additional funding for governmental tobacco control activities, further restrict the advertising of cigarettes, require additional warnings, including graphic warnings, on packages and in advertising, eliminate or reduce the tax deductibility of tobacco advertising, provide that the Federal Cigarette Labeling and Advertising Act and the Smoking Education Act cannot be used as a defense against liability under state statutory or common law, and allow state and local governments to restrict the sale and distribution of cigarettes.

The Federal Trade Commission, which has regulated the manner in which cigarette manufacturers test and disclose the tar, nicotine, and carbon monoxide levels of cigarettes, has proposed revisions to the test methodology and reporting procedures established by a 1970 voluntary agreement among domestic cigarette manufacturers. In 1992, the adoption of the Federal Alcohol, Drug Abuse and Mental Health Act required states to adopt a minimum age of 18 for purchases of tobacco products and establish a monitoring system to prevent underage purchases. In 1992, the United States Environmental Protection Agency (the "**EPA**") issued a report that included a risk assessment of the relationship between ETS and lung cancer in nonsmokers and a determination by the EPA designating ETS as a "Group A" carcinogen, a designation indicating that there is sufficient evidence to conclude that ETS causes cancer in humans. Certain parties, including Reynolds Tobacco, filed suit to challenge the validity of the EPA report and the methodology and procedures used by the EPA to reach its conclusions. The United States District Court for the Middle District of North Carolina ruled in 1998 that the EPA's classification of ETS was invalid and vacated those portions of the report dealing with lung cancer. The EPA submitted an appeal and oral argument was held before the Fourth Circuit Court of Appeals in June 1999. As of June 30, 2002, the court's decision was still pending.

In 1994, the United States Occupational Safety and Health Administration ("**OSHA**") announced proposed regulations that would restrict smoking in the workplace to designated smoking areas that have separate exhaust systems, but no such regulations have been adopted to date. In December 2001, OSHA announced the withdrawal of its proposed regulations, stating that most of the activity on workplace smoking restrictions was taking place on the state and local levels. OSHA further stated that the announcement did not preclude future agency action, but claimed that 70% of employees now work where smoke-free workplace policies exist.

In August 1996, the FDA adopted regulations on the advertising, promotion and sale of cigarettes and smokeless tobacco. The FDA regulations included severe restrictions on the distribution, marketing and advertising of cigarettes, and required the tobacco industry to comply with a wide range of labeling, reporting, record keeping, manufacturing and other requirements. The FDA's action was based on its determination that nicotine was a drug and that cigarettes and smokeless tobacco were medical devices which delivered nicotine to the body within the purview of the Food, Drug and Cosmetic Act. On March 21, 2000, the United States Supreme Court affirmed a 1998 decision of the Fourth Circuit Court of Appeals invalidating the FDA's regulations. The Supreme Court held that the Food, Drug and Cosmetic Act as a whole, along with subsequent tobacco-specific legislation enacted by Congress, made it clear that Congress had precluded the FDA from regulating tobacco products as customarily marketed.

The invalidated FDA regulations included severe restrictions on the distribution, marketing and advertising of cigarettes, and required the tobacco industry to comply with a wide range of labeling, reporting, record keeping, manufacturing and other requirements. One OPM has stated that the FDA's exercise of jurisdiction, had it not been reversed by judicial action, could have led to more expansive FDA-imposed restrictions on cigarette operations than those set forth in the original regulations, and could have materially and adversely affected the business, volume, results or operations, cash flows and financial position of the tobacco manufacturers.

Although the FDA has withdrawn its regulations, there are currently several bills in Congress that would give the FDA authority to regulate the sale, distribution, marketing and promotion of tobacco products to children, require tobacco companies to disclose ingredients contained in cigarettes and update warning labels. Members of Congress have also introduced legislation (some of which has been the subject of hearings or floor debate) that would, among other things, subject cigarettes to additional regulatory oversight, establish and provide additional funding for anti-smoking programs, further restrict the advertising of cigarettes and eliminate certain defenses against liability under state statutory or common law. On June 14, 2002, Senators Kennedy, DeWine and others introduced Senate Bill 2626. The purpose of the bill is to provide the FDA with certain authority to regulate tobacco products and to recognize the FDA as the primary federal regulatory authority with respect to the manufacture, marketing and distribution of tobacco products. At least one tobacco company has stated that, while it continues to oppose FDA regulation of cigarettes as "drugs" or "medical devices," it would support new legislation that would provide for reasonable regulation by the FDA of cigarettes as cigarettes.

Federal law prohibits smoking on all scheduled flights on U.S. airlines and on all scheduled passenger flights of foreign air carriers into or out of the United States. In addition, the United States Interstate Commerce Commission has banned smoking on buses transporting passengers interstate.

On August 9, 2000, the United States Surgeon General issued a report, "Reducing Tobacco Use," that assessed the value and efficacy of the approaches (educational, clinical, regulatory, economic and comprehensive) that have been used to reduce tobacco use. The report stated that widespread dissemination of approaches and methods that have been shown to be effective, especially in combination, would, among other things, substantially reduce the number of young people who will become addicted to tobacco, increase the success rate of young people and adults trying to quit using tobacco, and reduce the level of exposure of non-smokers to environmental tobacco smoke. The report concluded that substantial increases in the excise taxes on cigarettes would have a considerable impact on the prevalence of smoking and, in the long term, reduce the adverse health effects caused by tobacco. The report cited as examples the $0.75 per pack proposal contained in the Clinton administration's Health Security Act of 1993 (which did not pass) and the proposal contained in *Healthy People 2010*, the national action plan prepared by the Department of Health and Human Services to improve the health of all people living in the United States in the first decade of the 21st century, which set as a goal an average state and federal excise tax of $2.00. The report's conclusions are not formal policy recommendations, but are intended as a summary of the scientific literature concerning successful methods of reducing tobacco consumption.

The Surgeon General's Report documents evidence of the effectiveness of five major methods 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 minors' access contribute to lessening smoking prevalence. Lastly, according to the Surgeon General's report, excise tax increases reduce cigarette consumption. The report's conclusions are not formal policy recommendations, but are intended as a summary of the scientific literature concerning successful methods of reducing tobacco consumption.

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 ensuring that public health does not suffer in the process. The commission recommended moving from the current quota system to what would be called a Tobacco Equity Reduction Program. The program would allow compensation to be rendered to quota growers 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: for states to increase funding on tobacco cessation and prevention programs; for the FDA to regulate tobacco products in a "fair and equitable" manner; and for funding to be included in Medicaid and Medicare coverage for smoking cessation. To be able to fund these recommendations, the commission calls 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.

State and Local Regulation. In addition to federal regulation, most of the states and many local jurisdictions have enacted legislation and regulations restricting displays and advertising of tobacco products, establishing fire safety standards for cigarettes, raising the minimum age to possess or purchase tobacco products, requiring the disclosure of ingredients used in the manufacture of tobacco products, imposing restrictions on public smoking and restricting the sale of tobacco products directly to consumers or other unlicensed recipients or over the Internet. According to the DRI•WEFA Report, at least 30 states have recently increased or are considering increases in excise taxes on cigarettes as a response to budget shortfalls. A number of states have enacted legislation designating a portion of increased cigarette excise taxes to fund anti-smoking programs, healthcare programs and/or cancer research. Several states require disclosure of ingredients used in the manufacture of cigarette products.

For example, the Commonwealth of Massachusetts has enacted legislation to require cigarette manufacturers to report the flavorings and other ingredients used in each brand of cigarettes sold in Commonwealth, and on a qualified, by-brand basis to provide "nicotine-yield ratings" for their products based on standards established by the Commonwealth. Cigarette manufacturers sued to have the statute declared unconstitutional, arguing that it could result in the public disclosure of valuable proprietary information. In September 2000, the district court granted the plaintiff's motion for summary judgment and permanently enjoined the defendants from requiring cigarette manufacturers to disclose brand specific information on ingredients in their products. In October 2001, in *Philip Morris v. Reilly,* 267 F.3d 45 (1st Cir. 2001), the Court of Appeals for the First Circuit reinstated the statute, declaring it a "valid exercise of the police power" of the Commonwealth. The First Circuit subsequently granted the cigarette manufacturers' petition for rehearing *en banc* and withdrew its prior opinion. The First Circuit, sitting *en banc,* heard oral argument in January 2002 and a decision is pending.

In August 2000, legislation was adopted in the State of New York which requires cigarettes sold in the state to be "fire safe" or "self-extinguishing" beginning in 2003. Similar legislation is being considered by other states and localities, at the federal level and in foreign jurisdictions. Another statute, which was intended to become effective in New York State in November 2000, prohibited the shipment or delivery of cigarettes to any person in the state who is not a licensed cigarette tax agent, wholesale or retail dealer or export warehouse proprietor. The statute would have banned mail order, Internet and telephone cigarette sales directly to consumers in the state. One OPM and one SPM filed suit in a federal district court in New York seeking to overturn the statute, alleging that it was an unconstitutional interference with commerce. In June 2001, a federal district court judge declared the statute unconstitutional and permanently enjoined enforcement of the statute.

It has been reported recently that on August 13, 2002, the Mayor of New York City has proposed a ban on all smoking in a wide range of the City's public spaces, including bars, restaurants, bingo parlors and bowling alleys. The measure also requires private offices and other workplaces to eliminate smoking lounges and to remove ashtrays from corridors and hallways.

Voluntary Private Sector Regulation. In recent years, many employers have initiated programs restricting or eliminating smoking in the workplace, 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.

Civil Litigation

In recent years there has been a substantial increase in the number of tobacco-related cases. The tobacco industry has entered into settlements of certain lawsuits based on smoking-related claims. These include its settlement of *Broin I,* the lawsuits settled by the Previously Settled States, lawsuits filed by the Settling States that were settled by the MSA and others.

Pending claims related to tobacco products generally fall within four categories: (1) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (2) 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, (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 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; class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices; 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.

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 and/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 without limitation 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.

One OPM has reported that as of August 1, 2002, there were approximately 1,500 smoking and health cases filed and served on behalf of individual plaintiffs in the United States against it and other tobacco industry defendants. In addition, one OPM reports that as of August 1, 2002, there were approximately 1,250 cases pending before a single West Virginia state court in a consolidated proceeding that is currently scheduled for trial in June 2003.

In addition, one OPM reports that as of August 1, 2002 there were approximately 2,800 additional individual cases (the "***Broin II*** **cases**") filed primarily in Florida by individual current and former flight attendants claiming personal injury as the result of exposure 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* ("***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. The defendants' subsequent appeal was dismissed as premature without a ruling on the merits.

On April 5, 2001, a jury returned a verdict for the defendants in the case of *Fontana v. Philip Morris Inc.*, the first of the *Broin II* cases to go to trial. The plaintiff filed motions for a mistrial, a new trial and a judgment notwithstanding the verdict, which the trial court denied on October 1, 2001. The plaintiffs have appealed the judgment. On June 18, 2002, a Florida jury found against the tobacco industry defendants and awarded the plaintiff $5.5 million in the case of *French v. Philip Morris,* finding that the flight attendant's sinus disease was caused by ETS. It has been reported that the trial court reduced the award to $500,000 in September 2002. On September 5, 2002, and October 4, 2002, the juries in two other *Broin II* cases rejected the plaintiffs' claims that their sinusitis resulted from on-the-job exposure to tobacco smoke. As of August 1, 2002, one OPM reports that approximately 15 additional *Broin II* cases are scheduled for trial between August 2002 and March 2003.

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 and some have been appealed, some have been overturned and others have been affirmed. In only one case, *Carter v. Brown & Williamson Tobacco Corp.,* have all post-trial motions and appeals been exhausted and a plaintiff in an individual case has been paid.

By way of example only, and not as an exclusive or complete list, the following individual matters are illustrative of individual cases. In the last four years, there have been at least twelve reported jury verdicts, including a 1996 verdict that was reinstated on appeal, in individual smoking and health cases against the tobacco industry, including one or more PMs. In February 1999, a California jury in *Henley v. Philip Morris* awarded $1.5 million in compensatory damages and $50 million in punitive damages (subsequently reduced by the trial court to $25 million in punitive damages). On November 7, 2001, the appellate court affirmed the verdict. Philip Morris has appealed that decision to the California Supreme Court, which accepted the appeal on a "grant and hold" basis (another appeal must be decided prior to ruling on the *Henley* petition). In March 1999, an Oregon jury in *Williams-Branch v. Philip Morris* awarded $821,500 in compensatory damages and $79.5 million in punitive damages. The trial court subsequently reduced the punitive damages award to $32 million, but the reduction was overturned and the full amount of punitive damages awarded was reinstated by the Oregon Court of Appeals. A petition for reconsideration by the Oregon Court of Appeals was filed by Philip Morris on June 19, 2002. In April 1999, a Maryland jury in *Connor v. Lorillard* awarded $225,000 in compensatory damages and $2 million in punitive 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 plaintiffs 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 court, which denied the defendants' post-verdict challenge. The defendants have appealed the 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. The plaintiff has appealed the new trial ruling. In November 2000, the Supreme Court of Florida reinstated the verdict by a Florida jury in *Carter v. Brown & Williamson Tobacco Corp.* 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 United States Supreme Court denied B&W's petition for a writ of certiorari, thus leaving the jury verdict intact. On June 6, 2001, a California state court jury found against Philip Morris on all six claims of fraud, negligence and making a defective product in *Boeken v. Philip Morris Inc.* The jury awarded the plaintiff $5.5 million in compensatory damages and $3 billion in punitive damages. The $3 billion punitive damages award has been reduced to $100 million post-trial. Philip Morris has filed a notice of appeal of the jury verdict. On December 12, 2001, a Tampa, Florida jury awarded the plaintiff $165,000 in compensatory damages in *Kenyon v. R.J. Reynolds Tobacco Co.* The jury declined to award punitive damages on the basis that Reynolds Tobacco had marketed a defectively designed product. Reynolds Tobacco is appealing the final judgment. On February 22, 2002, a federal jury in Kansas City awarded $198,400 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, awarded the plaintiff $15 million in punitive damages. Reynolds Tobacco has appealed the verdict. On March 22, 2002, a Portland, Oregon jury awarded $168,000 in compensatory damages and $150 million in punitive damages to the family of a light cigarette smoker in *Schwarz v. Philip Morris Inc*. The trial court subsequently reduced the total damages awarded to $100 million. Philip Morris appealed the final judgment to the Oregon Court of Appeals on July 2, 2002, and the plaintiff subsequently noticed a cross appeal. On September 26, 2002, a Puerto Rico jury awarded two sons of a deceased smoker $500,000 each in *Cruz-Vargas v. R.J. Reynolds Tobacco Co.* The trial court vacated one of the awards on the grounds that the statute of limitations had run. Also on September 26, 2002, a Los Angeles, California jury awarded $750,000 in economic damages and $100,000 for pain and suffering to a smoker with lung cancer in *Bullock v. Philip Morris*. On October 4, 2002, the same jury awarded the plaintiff $28 billion in punitive damages. Philip Morris has announced that it would ask the court to reverse the jury's verdict and order a new trial, and if the request is denied, that it will appeal the verdict to the California Court of Appeals. In addition, the California Supreme Court in *Naegele v. Raybestos-Manhattan, Inc.* and *Myers v. Philip Morris, Inc.* will assess the retroactive effect of 1998 amendments to a California statute which repealed the classification of tobacco as an "inherently unsafe" consumer product that is immune from liability. Whereas *Naegele* will consider whether the 1998 amendments apply to claims that accrued prior to January 1, 1998, *Myers* will address whether the 1998 amendments apply to claims that accrued after January 1, 1998, but which are based on conduct occurring prior to January 1, 1998. Oral arguments have been heard, and a decision is pending. In August 2002, the California Supreme Court issued a decision restricting the introduction of evidence of wrongdoing by tobacco companies between 1988 and 1998, which may impact the *Henley, Whiteley* and *Boeken* cases.

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. 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. One OPM reports that class certification has been denied or reversed in 29 smoking and health class actions.

One OPM reports that as of August 1, 2002, there were approximately 21 smoking and health cases pending as purported class actions in the United States against cigarette manufacturers and other defendants, compared with approximately 36 such cases on December 31, 2000, and approximately 50 such cases on December 31, 1999. 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.

By way of example only, and not as an exclusive or complete list, the following individual matters are illustrative of class action cases. Published federal cases that have considered the question to

date have denied class certification, including two federal court of appeals decisions. In May 1996, the Fifth Circuit Court of Appeals overturned the certification of a nationwide class of smokers in *Castano v. American Tobacco Company Inc.* In May 1999, the United States Supreme Court declined to review the Third Circuit's decertification of the class in *Barnes v. American Tobacco Company, Inc.* (formerly, *Arch v. American Tobacco Company*). In March 2001, in *Guillory v. American Tobacco Co., Inc.*, the United States District Court for the Northern District of Illinois refused to certify a class defined as "all Illinois residents who smoke or smoked cigarettes manufactured by the defendants, who started smoking while a minor, who purchase or purchased cigarettes in Illinois and who desire to participate in a program designed to assist them in the cessation of smoking and/or monitor their medical condition to promote early detection of disease caused by, contributed to by, or exacerbated by cigarette smoking." In May 2001, in *Brown v. Philip Morris, Inc.*, the Third Circuit Court of Appeals affirmed the trial court's dismissal of a proposed class action alleging the violation of civil rights by the targeting of "African-American smokers." On June 29, 2001, the United States District Court for the District of Nevada denied plaintiffs' motions for class certification in three cases involving casino workers exposed to environmental tobacco smoke and one case involving smokers with injuries allegedly caused by smoking. In October 2001 in *Estate of Mahoney v. R.J. Reynolds Tobacco Co.*, the United States District Court for the Southern District of Iowa denied plaintiffs' motions for class certification of a class defined as individuals who had smoked the defendants' cigarettes for more than 20 years and who now suffered or had died from lung cancer.

On September 6, 2000, in *In re Simon (II) Litigation*, lawyers for plaintiffs in ten tobacco-related cases pending in United States 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 include 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 seeks 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 February 8, 2001, Judge Weinstein issued an opinion stating that severing the issues of liability and punitive damages would help ensure an expeditious resolution due to the unusual complexity of the issues. On September 19, 2002, Judge Weinstein certified a nationwide punitive-damage class action lawsuit against the defendants. The class consists of all United States smokers first diagnosed, from April 9, 1993 through the date notice to the class is ordered disseminated, with certain diseases including lung cancer, emphysema and certain forms of heart disease. It has been reported that at least two of the OPM defendants will appeal the ruling to the Second Circuit. Two of the ten 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.

On May 23, 2001, a lawsuit was filed in the United States District Court for the District of Columbia, *Sims v. Philip Morris Incorporated*, which seeks class action status for millions of youths who began smoking cigarettes before their 18th birthday. Plaintiffs seek to recover moneys that underage smokers spent on cigarettes before their 18th birthday, whether or not they have suffered health problems, and/or profits the tobacco manufacturers have earned from sales to children. The lawsuit alleges that tobacco manufacturers concealed the addictive nature of cigarettes and concealed the health risks of smoking in their advertising.

Plaintiffs have also sought class certification from federal courts in actions against the tobacco industry other than smoking and health cases. In April 2002, in *Deloach v. Philip Morris,* a federal district court in North Carolina granted class certification to a group of farmers from Alabama, Florida, Georgia, North Carolina, South Carolina and Tennessee accusing cigarette manufacturers of conspiring to set prices offered for tobacco. The defendants' petition for review of the certification by the Fourth

Circuit Court of Appeals was denied in June 2002, and the case is currently expected to be completed on or before July 1, 2003.

A number of state courts have also 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 class certification 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 class defined as all New York residents, including their heirs, representatives, and estates, who contracted lung and/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 November 2000, a New York state appellate court reversed a trial court ruling that would have permitted eight separate individual personal injury suits against tobacco companies to be brought in a joint trial. In *Glussi v. Fortune Brands, Inc.*, 714 N.Y.S.2d 516 (N.Y. App. 2000) (also known as the *Apostolou* case), the state's appellate division for the Second Department held that combining the various plaintiffs' claims into a single suit would be too unwieldy and awkward to permit the claims to be fairly heard. Although not technically a class action, the appellate holding confirms the general reasoning behind other decertifications of and refusals to certify anti-tobacco class actions. In January 2001, the jury in the *Apostolou* case ruled in favor of the defendants and no punitive damages were awarded.

To date, plaintiffs have successfully maintained class certification in state court class action cases in at least the following states: California, Florida, Illinois, Louisiana, Massachusetts, North Carolina and West Virginia. By way of example only, and not as an exclusive or complete list, the following class actions were certified.

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 Phase I 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 Phase IIA, in April 2000, the same jury that heard Phase I awarded a total of $12.7 million in compensatory damages to the three named representative plaintiffs, finding that the defendant tobacco companies bore major responsibility for the plaintiffs' injuries. One OPM has requested that the court dismiss the award to one of the plaintiffs because of the jury's findings on a statute of limitations question. In July 2000, in Phase IIB, the same jury also assessed punitive damages of approximately $145 billion with respect to the entire class of possible plaintiffs. The punitive damages awarded against the OPM defendants are: Philip Morris, $73.96 billion; Reynolds Tobacco, $36.28 billion; B&W, $17.59 billion; Lorillard, $16.25 billion; and Liggett, $790 million. Phase III will determine compensatory damages for the remaining class members.

On July 24, 2000, the defendants filed a motion with the trial court to, among other things, set aside the verdict, direct judgment in favor of the defendants or decertify the class, and/or order a new trial. On July 14, 2000, the Southeastern Iron Workers Union filed a motion to intervene in *Engle* seeking to protect its members' subrogation rights under the federal Employment Retirement Income and Security Act. Based on the federal question raised in that motion, defendants removed the case to federal district court in Miami on July 24, 2000. By order dated November 3, 2000, the United States District Court for the Southern District of Florida remanded *Engle* to the Eleventh Judicial Circuit of Dade County, Florida. On November 6, 2000, the state trial court issued its final judgment and order in which it (1) denied substantially all of the tobacco company defendants' pending and post-trial motions, including the motion for reduction of the $145 billion punitive damages award or, in the alternative, a new trial, and (2) entered the punitive damage award as a final judgment. On November 7, 2000, the defendants in *Engle* filed an appeal with respect to the entry of judgment, class certification and other reversible errors that they allege occurred during the trial. As of August 1, 2002, the Florida Court of Appeal had not scheduled the appeal for oral argument. The defendants have each posted a bond 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. 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 the amount of punitive damages, plus twice the statutory rate of interest, or 10% of a defendant's net worth, but in no case more than $100 million. Georgia, Kentucky, Louisiana, Nevada, North Carolina, Oklahoma, South Carolina, Virginia and West Virginia have enacted similar legislation. The Mississippi Supreme Court has also placed limitations on appeal bonds by court rule.

One OPM has reported that the *Engle* plaintiffs believe the Florida appeal bond legislation is unconstitutional. In the event that a court of final jurisdiction were to declare the legislation unconstitutional, one OPM has stated that, in a worst-case scenario, it is possible that a judgment for punitive damages could be entered in an amount not capable of being bonded, resulting in an execution of the judgment before it could be set aside on appeal. On May 7, 2001, the trial court approved a stipulation (the "**Stipulation**") among Philip Morris, Lorillard and Liggett (the "**Stipulating Defendants**"), the plaintiffs, and the plaintiff class that provides that execution or enforcement of the punitive damages component of the *Engle* judgment will remain stayed against the Stipulating Defendants through the completion of all judicial review, regardless of a challenge, if any, to the Florida bond statute. Under the Stipulation, Philip Morris placed $1.2 billion into an interest-bearing escrow account. Should Philip Morris prevail in its appeal of the case, this escrow amount is to be returned to Philip Morris, together with its $100 million appeal bond previously posted. In addition, Philip Morris, Lorillard and Liggett also placed $500 million, $200 million (including Lorillard's appeal bond), and $9.72 million (including Liggett's appeal bond), respectively, into a separate interest-bearing escrow account for the benefit of the *Engle* class (the "**Guaranteed Amount**"). Even if the Stipulating Defendants prevail on appeal, the Guaranteed Amount will be paid to the court, and the court will determine how to allocate or distribute it consistent with the Florida Rules of Civil Procedure.

One *Engle* class member has already gone to trial. In *Lukacs v. Reynolds Tobacco,* a Florida appellate court granted Lukacs the right to proceed before he died, but stated that any award in favor of the plaintiff will 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. The tobacco companies are appealing this verdict. One OPM reports that there are at least six similar suits pending in Florida courts where plaintiffs allege they are members of the *Engle* class and trial should begin immediately. That OPM argues that such trials should be stayed during the pendency of the *Engle* appeal.

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.*" 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 also retained the right to bring individual claims, although they are limited to non-fraud type claims and may not seek punitive damages. One OPM reports that as of July 18, 2002, approximately 2,807 of these individual cases (*Broin II* cases) had been brought. See *"Individual Plaintiffs' Lawsuits."* In October 2000, the court 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. In October 2001, without ruling on the merits, the court of appeals dismissed the appeal on the basis that the appeal was premature and that the court lacked jurisdiction over the appeal. In addition, the court of appeals denied the defendants' motion for rehearing and rehearing *en banc,* and for certification of the October 2001 ruling to the Florida Supreme Court. In July 2002, the Florida Supreme Court denied the defendants' motion to review the rulings of the trial court and the court of appeals.

State courts also upheld class certification in *Scott v. American Tobacco Company, Inc.* and *In re Tobacco Litigation*. In *Scott*, 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/or to 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 bring individual smoking and health lawsuits, if they desire. The trial court's certification of the class has survived initial appeal. Trial began in June 2001. Defendants appealed the jury selection process to the Louisiana Fourth Circuit Court of Appeal on July 18, 2001. On September 4, 2001, the Court of Appeal dismissed two jurors because of bias, but declined to dismiss jurors with immediate family members who were members of the class. On September 5, 2001, defendants sought review by the Louisiana State Supreme Court. On September 25, 2001, the Louisiana State Supreme Court dismissed seven additional jurors because they have immediate family members who are members of the class and the seven jurors expressed a desire that those family members receive medical monitoring or smoking cessation assistance. On October 9, 2001, the defendants asked the Louisiana Supreme Court to declare a mistrial because of the irregularities in the jury selection process. This petition was denied on October 15, 2001. Jury selection resumed again on October 22, 2001, and a full complement of 12 jurors and 10 alternates was selected. In March 2002, the Louisiana Supreme Court granted the application for a supervisory writ and struck four jurors due to possible bias. Jury selection has been reopened. As of August 1, 2002, the trial court had not announced when the jury as finally constituted would begin hearing evidence in the trial.

In August 2000, in *In re Tobacco Litigation* (formerly known as *Blankenship*), a West Virginia state court conditionally certified a class of West Virginia residents, but only to the extent of medical monitoring. 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 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 defendant's 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. Plaintiffs' motion for retrial was denied in January 2002.

One OPM reports that in West Virginia, all smoking and health cases alleging personal injury have been consolidated for trial by the state's Mass Litigation Panel. The transferred cases include individual cases as well as putative class actions. All actions filed in or transferred to the court before September 8, 2000 (numbering approximately 1,250) are to be included in a single trial. The trial court's order provides for the trial to be conducted in two phases. Phase One of that trial will address general liability issues common to all defendants as well as entitlement to punitive damages and a punitive damages multiplier. Phase two of the trial will address the individual claims of plaintiffs. Trial is scheduled to begin in June 2003.

In *Daniels v. Philip Morris*, a California state court case, the 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. It has been reported that on September 12, 2002, the court issued a preliminary ruling dismissing the suit and declaring that cigarette advertising is protected by the First Amendment. It has also been reported that in a companion ruling, the court also declared that the suit was preempted by the federal cigarette labeling act that specified the warnings that appear on cigarette packs and advertisements.

In addition, in *Daniels v. Philip Morris Companies, Inc.*, a separate class action was certified that contends Philip Morris and other cigarette manufacturers violated the state's unfair business practice laws. The court did not allow the plaintiffs' claims for punitive damages under the state's consumer protection laws. The plaintiffs are seeking over $1 billion in restitution for the state's smokers. Philip Morris has indicated that it will appeal the class certification.

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 plaintiff's 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 Professional Code Sections 17200 and 17500. The court denied the motion for class certification as to plaintiffs' claims under the California Legal Remedies Act. Defendants' appeal of the trial court's class certification ruling was denied on January 16, 2002. The trial has been scheduled for March 2003.

In *Miles v. Philip Morris Cos., Inc.*, an Illinois state court judge 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 do not have a claim for personal injury resulting from the purchase or consumption of the cigarettes. The plaintiffs in that case allege consumer fraud claims and seek economic damages in the form of a refund of purchase costs of the cigarettes. Trial is scheduled for January 2003. Illinois courts certified similar classes in *Turner v. R.J. Reynolds Tobacco Co.* and *Howard v. Brown & Williamson.* Trial is scheduled for October 2003. In addition, in *Aspinall v. Philip Morris Companies*, a Massachusetts state court judge has certified a similar class claiming analogous violations of Massachusetts' consumer protection statutes. In February 2002, a Florida state court certified a class action alleging that Philip Morris engaged in deceptive practices in marketing certain cigarettes as low tar and low nicotine.

Healthcare Cost Recovery Lawsuits. Plaintiffs in the healthcare cost recovery cases include the United States and foreign governmental entities or others, such as labor unions, private companies, HMOs, hospitals, other third-party payors, native American tribes or private citizens suing on behalf of taxpayers who seek reimbursement of healthcare costs allegedly incurred as a result of smoking, as well as other alleged damages. The PMs are exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims belonging to the Settling States. One OPM has reported that as of

June 30, 2002, there were approximately 45 active healthcare cost recovery cases pending in courts in the United States against manufacturers of tobacco products, of which approximately ten were filed by union trust funds. On May 22, 2001, three of such union trust fund lawsuits were dismissed by the United States Court of Appeals for the District of Columbia. The Court held that plaintiffs' claims were too remote because the alleged injuries were to union members, not union healthcare trust funds. On March 3, 2000, a New York state court granted motions to dismiss ten union cases, brought by 14 union trust funds, in *Eastern States Health & Welfare Fund v. Philip Morris, Inc.* This group of cases is on appeal to the Appellate Division of the Supreme Court of New York.

Eight federal courts of appeals have issued rulings in healthcare cost recovery actions favorable to the tobacco industry. The Courts of Appeals for the Second, Third, Fifth, Seventh, Eighth, Ninth, Eleventh and D.C. Circuits, relying primarily on grounds that the plaintiffs' claims were too remote, have affirmed dismissals of, or reversed trial courts that had refused to dismiss, such actions. In January 2000, the United States Supreme Court denied plaintiffs' petitions for writs of certiorari in the cases decided by the Court of Appeals for the Second, Third, Ninth and D.C. Circuits, effectively refusing to consider plaintiffs' appeals. Although there have been decisions to the contrary, a number of lower courts that have decided motions in these cases have dismissed all or substantially all of the claims against the tobacco industry.

Several foreign countries or subdivisions thereof have filed actions in Florida state courts to recover the costs of treating persons with diseases associated with tobacco use. The tobacco companies removed the cases to federal district court, and the cases were transferred to the United States District Court for the District of Columbia. The District Court remanded the cases brought by Venezuela, Ecuador, and the Brazilian states of Espirito Santo and Goias to Florida state court. In April 2002, in *Republic of Venezuela v. Philip Morris Incorporated*, the D.C. Circuit Court of Appeals refused to review the remand decision for lack of appellate jurisdiction. The D.C. Circuit also refused to prohibit the district court from remanding similar cases brought by Russia and the Brazilian State of Mato Grosso Do Sol. The Florida state court has dismissed the Venezuela and Espirito Santo cases.

On June 4, 2001, a federal jury in the Eastern District of New York found that Philip Morris, R.J. Reynolds and B&W engaged in deceptive business practices in a case brought by Empire Blue Cross Blue Shield of New Jersey. The jury awarded damages up to $17.8 million on statutory protection claims and $11.8 million on separate subrogated claims on behalf of individuals insured by the plaintiff. The jury rejected the plaintiffs' RICO claim. On October 4, 2001, the court denied the defendants' post-trial motions. In February 2002, the court granted the plaintiffs' request for attorney fees in the approximate amount of $37.8 million. The defendants are pursuing a single appeal from the jury verdict and the award of attorney fees.

In September 1999, the United States Department of Justice filed a lawsuit against the OPMs, certain related parent companies, and two tobacco industry research and lobbying organizations. Among other things, the federal lawsuit sought to recoup Medicare and other medical expenses of the federal government pursuant to the Medical Care Recovery Act and the Medicare Secondary Payer Act relating to smoking-related illnesses, and alleges violations of the federal RICO statute. The lawsuit seeks unspecified damages, disgorgement of profits by the OPMs under the RICO statute and certain other relief, including an injunction requiring the defendants to make certain public statements in the marketing and promotion of their products regarding the health risks of tobacco and to fund anti-smoking education campaigns and smoking cessation programs. In December 1999, defendants filed a motion to dismiss this lawsuit on several grounds, including that the statutes invoked by the government do not provide a basis for the relief sought. On September 28, 2000 the district court ruled that the government could not use the Medical Care Recovery Act or the Medicare Secondary Payer Act to recover Medicaid expenses related to ill smokers and granted the defendants' motions to dismiss these claims. The district court also

ruled that the government could proceed with its other claims under the RICO statute. The federal government has requested that the court reinstate the dismissed claims. The court denied that motion on January 31, 2001. In February 2001, the government filed an amended complaint attempting to replead the Medicare Secondary Payer Act claim. In July 2001, the court dismissed the amended complaint. In June 2001, the Department of Justice began to work on a possible settlement of the federal lawsuit. The Department of Justice met with representatives of the tobacco industry on July 18, 2001. No settlement was reached. In December 2001, the Department of Justice filed a pre-trial document setting forth some of the remedies it may seek in the lawsuit. In that document the Department of Justice indicated that it may seek severe limitations on the marketing and promotion of cigarettes. These limitations include requiring 50% of cigarette-pack surfaces to carry "graphic" health warnings and messages from the U.S. Surgeon General; requiring packs to carry health-leaflet inserts; eliminating slotting fees paid to retailers for favorable placement of tobacco products in stores; publicly disclosing manufacturing methods, marketing research, ingredients, additives and toxic chemicals; forbidding "light," "low-tar" or "mild" labels; banning vending machine sales; ending trade promotions and give-aways; and restricting all cigarette advertising to black-and-white-only formats, with 50% of the space dedicated to "graphic" health warnings. Trial is scheduled for July 2003 on the RICO claims. Philip Morris has stated that it believes it has a number of valid defenses to the lawsuit and will continue to vigorously defend it.

In *A.O. Fox Memorial Hospital v. American Tobacco Company, Inc.*, a group of 175 New York State hospitals filed suit in May 2000 in New York Supreme Court, Nassau County, against various defendants, including PMs, seeking to recover unreimbursed and under-reimbursed costs in connection with past, present and future healthcare provided to patients suffering from tobacco-related illnesses. The lawsuit seeks a minimum of $3.6 billion in damages. By order dated December 14, 2001, the trial court granted the defendants' motion to dismiss the complaint. An appeal was taken and is pending. In October 2001, in *Allegheny General Hospital v. Philip Morris, Inc.*, the Third Circuit affirmed the dismissal of a complaint against the tobacco industry brought by a group of Pennsylvania hospitals seeking to recover unreimbursed healthcare costs. The Ninth Circuit has affirmed the dismissal of similar claims brought by a group of Washington hospitals in *Association of Washington Public Hospital Districts v. Philip Morris, Inc.* In October 2001, the U.S. Supreme Court denied the plaintiffs' motion for a writ of certiorari.

A number of foreign countries have filed suit in state and federal courts in the United States against tobacco industry defendants to recover funds for healthcare and medical and other assistance paid by those foreign governments to their citizens. In *Marshall Islands v. American Tobacco Co.*, the Republic of the Marshall Islands brought a healthcare cost recovery suit against Reynolds Tobacco and other cigarette manufacturers. On May 9, 2002, the Supreme Court of the Marshall Islands affirmed the dismissal of all claims. Of the 29 cases pending as of June 30, 2002, 26 are pending in state court and three are pending in federal court. Two are pending outside the United States (in Canada and Israel). Five of these cases have been transferred to the Judicial Panel on Multi-District Litigation in the United States District Court for the District of Columbia. Other foreign governments and entities have stated that they are considering filing such actions in the United States. In October 2001, the United States Supreme Court denied certiorari, letting stand an appellate decision dismissing claims by Guatemala, Nicaragua and Ukraine seeking reimbursement of money spent treating tobacco-related illness.

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

- Asbestos contribution cases whereby former asbestos manufacturers, their personal injury settlement trusts and insurers seek 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. As of August 1, 2002, an estimated nine suits were pending on behalf of former asbestos manufacturers, asbestos manufacturers' personal injury settlement trusts and an insurance company against tobacco manufacturers. On May 24, 2001, a Mississippi state court rejected claims by asbestos manufacturer Owens Corning that the tobacco companies should reimburse it for payment of asbestos related injury claims that were allegedly caused by cigarette smoking. The Court held that Owens Corning's alleged injuries were too remote to recover damages for the asbestos injury claims. Owens Corning has appealed and has filed a similar suit in California. In addition, in *Falise v. American Tobacco Company, Inc.*, the United States District Court for the Eastern District of New York dismissed similar claims on consent after mistrial.

- California "Proposition 65" cases, whereby two California cities seek damages for failure to warn that exposure to ETS may cause illness under a law requiring that California residents be informed if they are exposed to substances that are alleged to cause cancer or birth defects. Both cases settled. The two settlement agreements collectively resolve all claims that were, or could have been, brought in these two actions. In November 2000, the court granted defendants' motion seeking approval of both settlements and entry of a final judgment in both cases.

- According to one OPM, as of February 28, 2002, there were approximately 40 lawsuits filed by tobacco wholesalers, or indirect purchasers, against domestic cigarette manufacturers, alleging that cigarette manufacturers combined and conspired to set the price of cigarettes, in violation of antitrust statutes and various state unfair business practices statutes. The plaintiffs are asking the court to certify the lawsuits as class actions, and to allow the respective plaintiffs to pursue the lawsuits as representatives of other persons in individual states or throughout the United States, and throughout the world, that purchased cigarettes directly from one or more of the defendants. The federal cases have been consolidated and sent by the Judicial Panel on Multidistrict Litigation for pre-trial in the United States District Court for the Northern District of Georgia. On November 30, 2000, that court dismissed plaintiffs' claims of fraudulent concealment, claims concerning conduct outside the United States, and allegations relating to non-price conduct. The court again dismissed the fraudulent concealment claims on June 19, 2001, after plaintiffs attempted to replead them. On July 11, 2002, the court dismissed all of the plaintiffs' antitrust claims. The plaintiffs have appealed to the Eleventh Circuit Court of Appeals. State court cases on behalf of indirect purchasers have been dismissed in New York. An Arizona indirect purchaser suit was dismissed by the trial court, but the dismissal was reversed on appeal in May 2002. A Minnesota court denied class certification on November 21, 2001. A Kansas court granted class certification on November 15, 2001.

- Separate federal lawsuits commenced by 22 Colombian states (May 2000) and Ecuador (June 2000) allege that various OPMs engaged in sophisticated conspiracies to smuggle cigarettes into those countries in an effort to evade duties and/or taxes. Plaintiffs seek unspecified amounts in actual damages, treble damages, punitive damages and equitable relief in each of the suits. A similar lawsuit brought by several Canadian provinces was dismissed in July 2000, and the United States Court of Appeals for the Second Circuit upheld that dismissal in October 2001. In February 2002, a federal court in Miami dismissed similar claims brought by Ecuador, Belize and Honduras.

- On November 3, 2000, the European Community ("**EC**") commenced an action in the United States District Court for the Eastern District of New York against Reynolds Tobacco, Philip Morris, and related companies. The EC complaint alleges several claims, including RICO,

common law fraud, public nuisance, and unjust enrichment. The EC also alleges that Philip Morris, Reynolds Tobacco, and related companies engaged in a conspiracy to smuggle cigarettes into EC member states, thereby depriving the EC and its member states of custom duties and value added taxes. The complaint seeks unspecified damages including compensatory damages, injunctive relief, and treble damages under RICO. On July 18, 2001, the court dismissed the case, stating that the EC had been unable to prove "that it has suffered any injury as a result of the defendants' illegal acts." On August 6, 2001, the EC and ten member states filed a complaint in the same court against RJR Nabisco, Inc. (Reynolds Tobacco's parent), Philip Morris and related companies. Other than the addition of the member states as parties, the EC complaint is essentially a resubmission of the first complaint filed on November 3, 2000. The second complaint seeks unspecified damages including compensatory damages, injunctive relief, and treble damages under RICO. On February 19, 2002, the district court dismissed the case, stating that the tobacco companies were immune to liability by foreign governments for unpaid taxes in U.S. courts. The EC has appealed.

- There are six actions against Reynolds Tobacco alleging various violations of the MSA. Four states, Arizona, California, New York and Washington, allege that the posting of signage advertising Reynolds Tobacco's brand name sponsorships violates a provision of the MSA governing the times during which such signs may be posted. In November 2001, trial courts in Arizona and California ruled in favor of the state. On February 1, 2002, however, a New York state trial court upheld Reynolds Tobacco's position. Appeals of all of these decisions are pending. The Washington matter has been dismissed. The fifth action by the State of Ohio alleges that Reynolds Tobacco's purchase of advertising space on matchbooks distributed by an independent third party violates a provision of the MSA governing brand name merchandise. On April 25, 2002, the trial court in Ohio ruled against the state on the basis that the distribution did not violate the MSA because the matchbooks were not merchandise. The state has filed an appeal. The sixth action by the State of California has alleged that the publications in which Reynolds Tobacco places advertising evidences the direct or indirect targeting of youth, which is prohibited by the MSA. In June 2002, the trial court fined Reynolds Tobacco $20 million for violating the MSA, and ordered it to take reasonable measures to reduce youth exposure to cigarettes. Reynolds Tobacco has indicated that it will appeal the ruling.

- On June 28, 2001, in *Lorillard Tobacco Company v. Reilly*, the U.S. Supreme Court ruled that the Commonwealth of Massachusetts could not impose its own advertising restrictions on tobacco beyond the federal law that bans cigarette advertising and requires warning labels on packages. Based on the First Amendment, the Court found that the attorney general failed to show that Massachusetts' outdoor advertising regulations for smokeless tobacco and cigars were not more extensive than necessary to advance the state's interest in preventing underage tobacco use.

- On July 1, 2002, a civil complaint was filed as *Grand River Enterprises Six Nations, Ltd. v. Pryor* in the United States District Court for the Southern District of New York by six cigarette manufacturers, importers and distributors against 31 parties in their official capacity as Attorneys General of various states, including the Attorney General of the State. The suit alleges that the provisions of the Model Statute and the enforcement thereof by the defendants violate various provisions of the U.S. Constitution and federal laws.

- Lawsuits 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.

- Civil rights claims alleging improper marketing of cigarettes to African-American smokers. In one such case, *Jesse Brown v. Philip Morris*, the Third Circuit affirmed the district court's dismissal of the lawsuit.

- In January 2001, in *In re Cigarette Antitrust Litigation (Federal Multidistrict Litigation Panel, N.D. Ga.)* the court hearing seven consolidated federal class action cases alleging that the defendants conspired to fix cigarette prices in violation of antitrust laws, certified a class of plaintiffs who made direct purchase between February 1996 and February 2000.

Tobacco-Related Litigation in General. The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon the Authority'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 other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2002 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 2002 Bonds payable from tobacco settlement payments made under the MSA.

DRI•WEFA REPORT

The following information has been extracted from the DRI•WEFA Report, a copy of which is attached as Appendix A. This summary does not purport to be complete, and the DRI•WEFA Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The DRI•WEFA 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 as a result of various factors such as inventory adjustments. **The projections and forecasts regarding future cigarette consumption included in the DRI•WEFA Report are estimates that 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.**

General

DRI•WEFA, Inc., formerly known as WEFA, Inc., has prepared a report dated October 10, 2002 (the "**DRI•WEFA Report**") for the Authority regarding the consumption of cigarettes in the United States from 2001 through 2032 entitled, "A Forecast of U.S. Cigarette Consumption (2001-2032) for the Tobacco Settlement Authority." DRI•WEFA is an internationally recognized econometric and consulting firm. DRI•WEFA is a privately held subsidiary of Global Insight, Inc., a publicly traded company which is a provider of financial, economic and market research information. DRI•WEFA has announced that it intends to change its name to Global Insight (USA), Inc.

DRI•WEFA has developed a cigarette consumption model based on historical United States data between 1965 and 2000. This econometric model, coupled with a long term forecast of the United States

economy, has been used to project total United States cigarette consumption from 2001 through 2032. The DRI•WEFA Report differs slightly from one presented in 2001 for other issuers of securities such as the Series 2002 Bonds payable from tobacco settlement payments made under the MSA. In the year 2000, lower than expected prices resulted in higher than expected consumption. The USDA now estimates a consumption level for year 2000 of 430 billion, 7 billion more than DRI•WEFA's forecast in 2001. DRI•WEFA has also revised its year 2001 consumption projection upwards, to 419 billion from 408 billion. The DRI•WEFA Report also differs somewhat from a report prepared for other issuers earlier in 2002. While that forecast anticipated some state excise tax increases in response to state budget difficulties, a slightly greater number of states than expected have raised taxes on cigarette purchases, and as a result, consumption is projected to be lower in the near term. Cigarette consumption is now expected to fall to 403 billion in 2002, 2 billion fewer than the forecast of early 2002, and to 394 billion in 2003, 4 billion fewer than the earlier forecast.

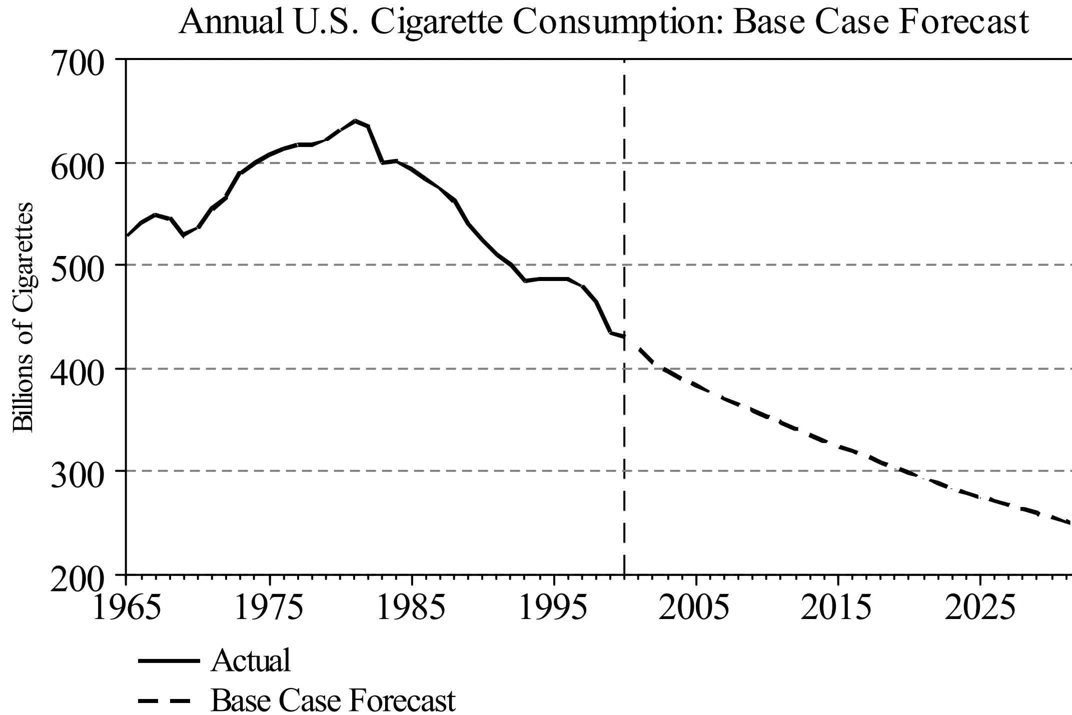
DRI•WEFA constructed its cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth, and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building its 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), DRI•WEFA 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 regression analysis for the period 1965 to 1999 showed: (1) long run price elasticity of demand of -0.31; (2) income elasticity of consumption of 0.27; and (3) a trend decline in adult per capita cigarette consumption of 2.32% per year holding other recognized significant factors constant.

DRI•WEFA's model, coupled with its long term forecast of the United States economy, was then used to project total United States cigarette consumption from 2001 through 2032 (the "**Base Case Forecast**"). The Base Case Forecast indicates that total United States cigarette consumption in 2032 will be 247 billion cigarettes (approximately 12.4 billion packs), a 43% decline from the 2000 level. Cigarette consumption is projected to decline by 3.7% in 2002, and 2.4% in 2003. After 2003, the rate of decline is projected to moderate and average less than 2% per year. From 2000 through 2032, the average annual rate of decline is projected to be 1.72%. On a per capita basis, consumption is projected to fall at an average annual rate of 2.55% per year. Total consumption of cigarettes in the United States is projected to fall from an estimated 430 billion in 2000 to under 400 billion by 2003, under 300 billion by 2020, and to reach 247 billion in 2032. The DRI•WEFA Report states that DRI•WEFA believes that the assumptions on which the Base Case Forecast is based are reasonable. The results of the Base Case Forecast are shown in the following table:

DRI•WEFA Base Case Forecast of Cigarette Consumption

Calendar Year	Cigarettes (Billions)	Calendar Year	Cigarettes (Billions)
2001	419.00	2017	314.11
2002	403.38	2018	308.83
2003	393.62	2019	303.49
2004	386.96	2020	298.55
2005	381.69	2021	293.59
2006	376.09	2022	288.83
2007	370.57	2023	284.10
2008	365.00	2024	279.72
2009	358.90	2025	275.39
2010	353.27	2026	271.14
2011	347.65	2027	267.00
2012	341.81	2028	262.94
2013	335.90	2029	258.94
2014	329.95	2030	255.01
2015	324.71	2031	251.03
2016	319.48	2032	247.16

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



The DRI•WEFA Report also presents alternative forecasts that project higher and lower paths of cigarette consumption, predicting that by 2032 total United States cigarette consumption could be as low as 230 billion or as high as 260 billion.

Comparison with Prior Forecasts

On October 25, 1999, DRI•WEFA presented a similar study, "A Forecast of US Cigarette Consumption (1999-2042)," with long-run conclusions quite similar to those in the DRI•WEFA Report. By the final year of this forecast, 2032, the current forecast is 4% greater than the 1999 forecast, 247 billion versus 237 billion.

DRI•WEFA incorporated this and other new data in 2000. DRI•WEFA increased its retail price assumption for 2000 from $3.03 to $3.39. However, aggressive discounting at the retail level resulted in a lower average price for the year of $3.20 per pack. Similarly, in 2001, retail prices averaged $3.44 per pack, 4.4% lower than the $3.60 the forecast had assumed. The DRI•WEFA Report states that increased consumption due to lower than anticipated prices explains most of the revision to the 2000 and 2001 consumption forecasts. For 2001, the DRI•WEFA Report projects a consumption level of 419 billion, or 11 billion more than was projected in the 2001 forecast. The DRI•WEFA Report also differs somewhat from a report prepared for other issuers earlier in 2002. While that forecast anticipated some state excise tax increases in response to state budget difficulties, a slightly greater number of states than expected have raised taxes on cigarette purchases, and as a result, consumption is projected to be lower in the near term. Cigarette consumption is now expected to fall to 403 billion in 2002, 2 billion fewer than the forecast of early 2002, and to 394 billion in 2003, 4 billion fewer than the earlier forecast.

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. 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. 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 1980s and 1990s, reaching a level of 465 billion cigarettes in 1998 and 430 billion cigarettes in 2000.

While the historical trend in cigarette 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, exceeding previous levels by 1934. Following the release of the United States Surgeon General's 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 then the decline for 1999 accelerated to 6.45%. These sharp recent declines are correlated with large price increases in 1998 and 1999.

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 recent

declines are correlated with large price increases in 1998 and 1999. All percentages are based upon compound annual growth rates.

The following table sets forth United States domestic cigarette consumption for the six years ended December 31, 2000. The data in this table vary from statistics on cigarette shipments in the United States. While the DRI•WEFA Report is based on consumption, payments made 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.

Historical Cigarette Consumption

Calendar Year	Cigarettes Billions	Percentage Change
2000	430	-1.15%
1999	435	-6.45
1998	465	-3.13
1997	480	-1.44
1996	487	0.00
1995	487	0.21

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 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. According to a Centers for Disease Control and Prevention (the "**CDC**") study released in July 2002, approximately 46.5 million American adults were current smokers in 2000, representing approximately 23.3% of the population age 18 and older. 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 (the "**incidence**") declined from 42.4% in 1965 to 25.5% in 1990, the incidence rate declined relatively slowly through the next decade. The National Center for Health Statistics also presents a preliminary estimate of adult incidence for 2000 of 23.3%.

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 2001, however, the incidence had fallen to 28.5%, just 3.6% above the 1991 level. The Youth Tobacco Surveillance (YTS) report, issued in November 2001 by the CDC, is a supplement to the Youth Risk Behavior Survey. The YTS covers calendar year 2000 and provides more comprehensive data on tobacco use among both middle and high school students as well as data on secondhand smoke exposure, ability to obtain tobacco products and knowledge of, and attitudes about, tobacco and tobacco advertising (both pro- and anti-tobacco). Some of the results pertaining to cigarette use can be found in the table below.

Youth Risk Behavior Survey

	Middle School Students Grades 6-8	High School Students Grades 9-12
Ever Used Tobacco	36.3%	64.0%
Current Cigarette Users	11.0	28.0
Ever Smoked Cigarettes Daily	5.5	20.6
First Smoked Before Age 11	8.4	6.7

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 among 8th, 10th and 12th graders was lower in June 2001 than in June 2000, the fourth consecutive annual decline. However, incidence levels for 10th and 12th graders continue to remain higher than in June 1991. Smoking incidence for 8th graders has fallen below its level in 1991. The figures from June 2001 represent a decrease from the 1991 figures of 14.7% for 8th graders, but represent an increase from the 1991 figures of 2.4% for 10th graders and 4.24% for 12th graders. The 2001 figures alone, however, represent a decrease from the 2000 figures of 16.4% for 8th graders, 10.9% for 10th graders and 6.1% for 12th graders.

The 2000 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 55.7 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 25.8% in 1999. The same survey found that an estimated 13.4% of youths age 12 to 17 were current cigarette smokers in 2000, a decrease from 14.9% in 1999.

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. In other words, as the price of cigarettes increases by 1%, the quantity demanded decreases by 0.3% to 0.5%. A few researchers have estimated price elasticity to be as high as -1.23. Research focused on youth smoking has found price elasticity levels of up to -1.41.

Two studies recently 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 1997. 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 1990s 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. A study by Tauras and Chaloupka also found an inverse relationship between price and cigarette consumption among high school seniors. The price elasticity of cessation for males averaged 1.12 and for females averaged 1.19. According to the DRI•WEFA Report, 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.

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, smoking participation and the amount of cigarettes consumed per smoker. According to the DRI•WEFA Report, 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 10% increase in cigarette prices will reduce smoking participation among college students by 2.6% and will reduce the level of smoking among current college students by 6.2%.

Tauras *et al.* (2001) conducted a study that looked at the effects of price on teenage smoking initiation. 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 1-5 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 1-5 cigarettes, and -0.96 for smoking at least one-half pack of cigarettes. These results indicate that a 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.

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. 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."

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. Their results suggest that workplace smoking bans reduce smoking prevalence by five 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 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: (1) general population growth, (2) price increases, (3) changes in disposable income, (4) youth consumption, (5) trend over time, (6) smoking bans in public places, (7) nicotine dependence and (8) 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.

General Population Growth. DRI•WEFA forecasts that the United States population will increase from approximately 272 million in 1999 to approximately 365 million in 2032. This forecast is consistent with the Bureau of the Census forecast based on the 1990 Census. On December 28, 2000, the Bureau reported results from the 2000 Census that estimate the United States population on April 1, 2000 to be 281 million. DRI•WEFA has not yet incorporated these data into its analysis because they have yet to be reconciled by the Bureau to its 1990 estimate. That 1990 Census estimate likely suffered from a significant undercount of population. As the USDA, in its estimate of per capita consumption, also uses

the estimates based on the 1990 Census, the DRI•WEFA forecast is consistent with its history. When the correct population data from 1990 to 2000 is released, it is expected to show that per capita consumption of cigarettes was slightly lower than originally thought, but that its growth trend is the same. DRI•WEFA does not expect the revised population and per capita consumption levels to affect its forecast of total cigarette consumption.

Price Elasticity of Demand and Price Increases. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5. Based on DRI•WEFA's multivariate regression analysis using data from 1965 to 1999, the long run price elasticity of consumption for the entire population is -0.31; that is, a 1% increase in the price of cigarettes decreases consumption by 0.31%.

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 intended to offset the costs of the MSA and the agreements with the Previously Settled States. The cigarette manufacturers have since increased wholesale prices on seven occasions: in August 1999 by $0.18 per pack, in January 2000 by $0.13 per pack, in June 2000 by $0.06 per pack, in December 2000 by $0.14 per pack, on April 25, 2001 by $0.14 per pack, on October 29, 2001 by $0.05 per pack, and on April 1, 2002 by $0.12 per pack. 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, Maine, Rhode Island, Washington, West Virginia and Wisconsin all increased their tax on cigarettes. They were followed, in January 2002, by a scheduled increase in the federal excise tax of $0.05 per pack, and in April 2002 by excise tax increases in New York and Connecticut. As a result of these increases, DRI•WEFA estimates that average retail prices across the United States had risen, in May 2002, to $3.64 per pack.

For the year 2000, DRI•WEFA estimates that the average price per pack was $3.20, representing a nominal growth in the price of cigarettes of 11.0% from 1999. For 2001, DRI•WEFA estimates that the average price was $3.45.

On July 1, 2002, excise tax increases went into effect in Illinois, Indiana, Kansas, Louisiana, Maryland, New Jersey, New York City, Ohio, Pennsylvania, Rhode Island, Utah and Vermont. Also, Hawaii, Massachusetts, Michigan, Nebraska, Oregon and Tennessee have scheduled tax increases later in 2002. These increases range from $0.07 per pack in Tennessee to $1.42 per pack in New York City. They average $0.47 per pack, and will boost the nationwide average retail price by $0.18. The average state excise tax is now over $0.60 per pack. These states are among at least 30 states that have considered increases in excise taxes as a response to state budget shortfalls following the 2001 recession. This will result in an average price per pack that increases from $3.50 at the start of 2002 to $3.80 in July and to over $4.00 in 2003. Over the longer term, DRI•WEFA's forecast expects price increases to continue to exceed the general rate of inflation due to costs related to the MSA and further increases in excise taxes, among other reasons.

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 customers to reduce the cost of smoking. Under the MSA, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped.

Changes in Disposable Income. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found that cigarette consumption in the United States increases as disposable income increases. However, a few studies found cigarette consumption

decreases as disposable income increases. Based on its multivariate regression analysis using data from 1965 to 1999, DRI•WEFA found that the income elasticity of consumption is 0.27; in other words, a 1% 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, almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20. One study examines cohort effects of youth smoking on adult smoking. 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.

DRI•WEFA compiled data from the CDC that 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. The percentage, after falling since the early 1970s, began to increase in 1990 and increased through the decade. DRI•WEFA assumes that this recent trend peaked in the late 1990s and that youth smoking has resumed its longer term decline.

Trend Over Time. 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 DRI•WEFA, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. DRI•WEFA'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 that are difficult to quantify.

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 1964 Surgeon General's Report 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. Beginning November 1, 1970, the Public Health Smoking Act of 1969 required all cigarette packages sold in the United States to carry an updated version of the warning, stating that it was a Surgeon General's warning. 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 DRI•WEFA's model may represent the cumulative impact of various health warnings since 1966.

Smoking Bans in Public Places. Beginning in the 1970s, numerous states have passed laws banning smoking in public places as well as in private workplaces. As of 1999, 48 states and the District of Columbia required smoke-free indoor air to some degree or in some public places. Based on its regression analysis using data from 1965 to 1999, DRI•WEFA found that the restrictions on public smoking appear to have an independent effect on per capita cigarette consumption. DRI•WEFA estimates that the restrictions instituted beginning in the late 1970s have reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. The trend variable included in DRI•WEFA's econometric analysis is likely to incorporate some part of the cumulative effect of the various smoking bans and restrictions.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General and the American Medical Association both conclude that nicotine is an addictive drug that

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," 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 addition, 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 of up to 25% of their annual MSA settlement proceeds, which is far higher than the approximately 9% allocated from the first year's MSA settlement payments.

The Surgeon General's Report documents evidence of the effectiveness of five major methods 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 access to minors 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. They estimate that tobacco control program expenditures between 1988 and 1998 resulted in a decline in cigarette sales of 3%.

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 ensuring that public health does not suffer in the process. The commission recommended moving from the current quota system to what would be called a Tobacco Equity Reduction Program. The program would allow compensation to be rendered to quota growers 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: for states to increase funding on tobacco cessation and prevention programs; for the FDA to regulate tobacco products in a "fair and equitable" manner; and for funding to be included in Medicaid and Medicare coverage for smoking cessation. To be able to fund these recommendations, the commission calls 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.

DRI•WEFA's research has indicated (and its model incorporates) a negative impact on cigarette consumption of 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 that restrict smoking. DRI•WEFA's model and forecast acknowledge the efficacy of these activities in reducing smoking and assume that the effectiveness of such anti-smoking efforts will continue. For example, in 2001, Canada required cigarette labels to include large graphic depictions of adverse health consequences of smoking. Similarly, the United States Department of Justice has indicated that as part of a lawsuit against tobacco companies, it may seek to require graphic health warnings covering 50% of cigarette packs, prohibit in-store promotions, and require that all advertising and packaging be black-and-white. DRI•WEFA goes on to state that, 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, which DRI•WEFA views as the common principle of diminishing returns.

In August 2000, New York State mandated that by the year 2003 manufacturers provide only cigarettes that self-extinguish. DRI•WEFA expects that by that year an agreement will have been reached on a nationwide standard. DRI•WEFA does not believe that either the New York statute or a nationwide agreement will affect consumption noticeably. DRI•WEFA believes that this will probably raise the cost of manufacture slightly, but is viewed by DRI•WEFA as the continuation of a long series of government actions that contribute to the trend decline in consumption and has been incorporated into DRI•WEFA's model.

On January 16, 2001, Vector announced plans to introduce a virtually nicotine-free cigarette. This non-addictive product might be used as a tool to quit or reduce smoking. DRI•WEFA views this as a continuation of efforts to provide products, such as the nicotine patch, that are intended to reduce smoking addiction. These products have likely contributed to the trend decline in consumption incorporated into the DRI•WEFA model. In its forecast, DRI•WEFA expects such efforts to continue to reduce per capita cigarette consumption.

SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION

Introduction

The following discussion describes the methodology and assumptions used to calculate projections of Collections to be received by the Authority (the "**Cash Flow Assumptions**"), as well as the methodology and assumptions used to structure the Serial Maturities, Sinking Fund Installments and Turbo Term Bond Maturities for the Series 2002 Bonds and calculate the projected Turbo Redemptions (the "**Bond Structuring Methodology**"). In addition, sensitivity analyses are provided that evaluate the impact of different consumption levels on Turbo Redemptions.

Cash Flow Assumptions

In calculating projections of Collections to be received by the Authority, different assumptions of cigarette consumption in the United States, including the forecast developed by DRI•WEFA described as the Base Case Forecast, were applied to calculate Initial Payments to be made by the OPMs and Annual Payments and Strategic Contribution Payments to be made by the PMs pursuant to the MSA. The calculations of payments required to be made were 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 94% for the OPMs, 4.5% for the SPMs and 1.5% for the NPMs.[*] It was further assumed that each company that is currently a PM remains such throughout the term of the Series 2002 Bonds.

In applying consumption forecasts from the DRI•WEFA Report, it was assumed that United States consumption, which was forecasted by DRI•WEFA, was equal to the number of cigarettes shipped

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[*] The aggregate market share information used in the Cash Flow Assumptions may differ materially from the market share information used by the MSA Auditor in calculating adjustments to Initial Payments, Annual Payments and Strategic Contribution Payments. See "SUMMARY OF THE MSA—Adjustments to Payments."

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 DRI•WEFA 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.

Initial Payment

The amount of the Initial Payment due to be made by the OPMs on or before January 10, 2003 was calculated by applying the adjustments applicable to Initial Payments in accordance with the MSA as follows:

Volume Adjustment. The Volume Adjustment was applied to the schedule of base amounts for the Initial Payment due on or before January 10, 2003 set forth in the MSA. The Volume Adjustment was calculated by applying the projected cigarette consumption to the market share of the OPMs for the prior year. No add back or benefit was assumed for the Income Adjustment. See "SUMMARY OF THE MSA—Adjustments to Payments—*Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

Non-Settling States Reduction. The Non-Settling States Reduction was not applied to the Initial Payment, because such reduction has no effect on the amount of payments to be received by a state that remains a party to the MSA. Thus, the Cash Flow Assumptions include an assumption that Washington will remain a party to the MSA.

Offset for Miscalculated or Disputed Payments. The Cash Flow Assumptions include an assumption that there will be no adjustments to the Initial Payment due to miscalculated or disputed payments.

State Allocation Percentage for Washington. The amount of the Initial Payment, after application of the Volume Adjustment, was multiplied by the State Allocation Percentage for the State pursuant to the MSA (equal to 2.0532582%) in order to determine the portion of the Initial Payment to be made by the OPMs that is to be allocated to the Washington State-Specific Account.

Pledged TSRs Allocated to the Authority. To the extent that the final Initial Payment is included in the first $30,000,000 of payments received by the State on and after the Closing Date and before July 1, 2003, $30,000,000 of the final Initial Payment is assumed to be included in the Pledged TSRs.

Annual Payments and Strategic Contribution Payments

For each projection, the amount of Annual Payments and Strategic Contribution Payments to be made by the PMs was calculated by applying the adjustments applicable to the Annual Payments and Strategic Contribution Payments in the order and in the amounts set forth in the MSA, as follows:

Inflation Adjustment. The Inflation Adjustment was applied to the schedule of base amounts for the Annual Payments and Strategic Contribution Payments set forth in the MSA. For 2000, 2001 and 2002, the Inflation Adjustment was 3.0%, 3.4% and 3.0%, respectively, which was calculated based on the greater of 3% or the actual Consumer Price Index for all Urban Consumers as published by the Bureau of Labor Statistics (released each December). For all subsequent years, the Inflation Adjustment was assumed to be the minimum provided in the MSA, 3.0% per annum, compounded annually, for the entire forecast period.

Volume Adjustment. The Annual Payments and Strategic Contribution Payments calculated for each year after application of the Inflation Adjustment were adjusted for the Volume Adjustment by applying the projected cigarette consumption for each scenario 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 MSA—Adjustments to Payments—*Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

Previously-Settled States Reduction. 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 Annual Payments owed by the OPMs. The Previously-Settled States Reduction does not apply to Strategic Contribution Payments. 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. For the reasons described above under "Initial Payments," the Non-Settling States Reduction was not applied to the Annual Payments and Strategic Contribution Payments.

NPM Adjustment. The NPM Adjustment will not apply to the Annual Payments and Strategic Contribution Payments payable to any state that enacts and diligently enforces the Model Statute, where such statute is not held to be unenforceable. The Cash Flow Assumptions include an assumption that the State will enforce a Model Statute that is not held to be unenforceable. For a discussion of the Washington Model Statute, see "SUMMARY OF THE MSA—MSA Provisions Relating to Model Statute/Qualifying Statute—*Washington Model Statute*." For a description of the opinion of Hawkins, Delafield & Wood to be delivered to the Authority with respect to the Model Statute, see "LEGAL CONSIDERATIONS—Qualifying Statute Constitutionality."

Offset for Miscalculated or Disputed Payments. The Cash Flow Assumptions include an assumption that there will be no adjustments to the Annual Payments and Strategic Contribution Payments due to miscalculated or disputed payments.

Federal Tobacco Legislation Offset. The Cash Flow Assumptions include an assumption that the Federal Tobacco Legislation Offset will have no effect on payments under the MSA. As of the date hereof, no legislation has been introduced in the United States Congress that would cause this offset to apply. Unless federal legislation is enacted on or prior to November 30, 2002, this offset will not apply.

Litigating Releasing Parties Offset. The Cash Flow Assumptions include an assumption that the Litigating Releasing Parties Offset will have no effect on payments.

Offset for Claims-Over. The Cash Flow Assumptions include an assumption that the Offset for Claims-Over will not apply.

Subsequent Participating Manufacturers. The Cash Flow Assumptions assume that the relative market share of the SPMs remains constant at 4.5%. Because the 4.5% market share is greater than 3.125% (125% of 2.5%, the SPM's estimated 1997 market share), the SPMs are required to make Annual Payments and Strategic Contribution Payments in each year. Based on the Cash Flow Assumptions and the SPM Payment formula, the aggregate payments to be made by the PMs will be lower in future years

than if the relative aggregate market share of the OPMs were 97%, their aggregate estimated 1997 market share.

State Allocation Percentage for Washington. The amounts of Annual Payments and Strategic Contribution Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled States Reduction (where applicable) for each year were multiplied by the respective State Allocation Percentages for the State (2.0532582% for Annual Payments and 5.7647432% for Strategic Contribution Payments) in order to determine the amount of Annual Payments and Strategic Contribution Payments to be made by the PMs in each year to be allocated to the Washington State-Specific Account.

Pledged TSRs Allocated to the Authority. Between the Closing Date and July 1, 2003, the amount of the Annual Payments to be allocated to the Washington State-Specific Account is assumed to be zero, since the $30,000,000 of Pledged TSRs are expected to come entirely from the Initial Payment in that year. On and after July 1, 2003, the amount of Annual Payments and Strategic Contribution Payments in each year to be allocated to the Washington State-Specific Account, calculated as described in the preceding paragraph, were multiplied by the percentage of such payments allocated to the Authority and pledged to the Bonds pursuant to the Indenture (equal to 29.2%) in order to determine the amount of Annual Payments and Strategic Contribution Payments assumed to be received by the Authority in each year.

Interest Earnings

The Cash Flow Assumptions assume that ten days after January 10, 2003, the Indenture Trustee will receive the Authority's share of the Initial Payments owed by the OPMs. It is assumed that ten days after April 15, the Indenture Trustee will receive the Authority's share of the Annual Payments owed by the PMs in 2003 and each year thereafter. It is further assumed that ten days after April 15, the Indenture Trustee will receive the Authority's share of Strategic Contribution Payments in each year from 2008 through 2017. Interest is assumed to be earned on the Initial Payments, Annual Payments and Strategic Contribution Payments received by the Indenture Trustee at the rate of 3.0% per annum until the applicable Distribution Date. Interest earnings have been assumed to begin accruing upon receipt by the Indenture Trustee of the Initial Payments, Annual Payments and Strategic Contribution Payments.

All amounts on deposit in the Accounts established under the Indenture are assumed to be invested at the rate of 3.0% per annum except for amounts on deposit in the Capitalized Interest Subaccount, which is assumed to be invested at a rate of 0% per annum.

Other Assumptions

Serial Maturities. The schedule of Serial Maturities is as set forth on the inside cover.

Turbo Term Bond Maturities. The schedule of Turbo Term Bond Maturities is as set forth on the inside cover.

Sinking Fund Installments. The schedule of Sinking Fund Installments is as indicated under the heading "THE SERIES 2002 BONDS—Sinking Fund Installments."

Capitalized Interest. A portion of the interest due on the Series 2002 Bonds will be capitalized through June 1, 2003.

Liquidity Reserve Account. The Liquidity Reserve Account Requirement was established for the Series 2002 Bonds at $45,534,106.25. This amount equals the maximum annual debt service calculated based on the schedule of Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments in effect upon the issuance of the Series 2002 Bonds.

Operating Expense Assumptions. Annual operating expenses of the Authority have been assumed at the Operating Cap of $250,000 for the period through June 30, 2003. Thereafter for each 12-month period ending June 30, the Operating Cap was assumed to be inflated at 3% per year. No arbitrage rebate expense was assumed since it has been assumed that the yield on the Authority's investments will not exceed the yield on the Series 2002 Bonds.

Closing Date. The Series 2002 Bonds were assumed to be issued on November 5, 2002.

Interest Rates. The Series 2002 Bonds were assumed to bear interest at the rates set forth on the inside cover

Miscellaneous. The Cash Flow Assumptions assume that there are no Turbo Redemptions prior to June 1, 2004, that there is no optional redemption of the Series 2002 Bonds, that no Event of Default occurs, that no Lump Sum Payment, Partial Lump Sum Payment or Total Lump Sum Payment is received and that there is no Mandatory Clean-up Call. It is further assumed that all Distribution Dates occur on each June 1 and December 1, whether or not such date is a Business Day.

Bond Structuring Methodology

The Series 2002 Bonds have been structured utilizing the DRI•WEFA Base Case Forecast. The following tables present the forecasts of Initial Payments, Annual Payments, Strategic Contribution Payments and total payments to be received by the Authority in each year through 2032, calculated in accordance with the Cash Flow Assumptions and using DRI•WEFA's Base Case Forecast. DRI•WEFA's Base Case Forecast for United States cigarette consumption is set forth under "DRI•WEFA REPORT." See Appendix A for a discussion of the assumptions underlying the projections of cigarette consumption contained in the DRI•WEFA Report.

Projection of Annual Payments to be Received by the Authority[*]

Year	DRI•WEFA Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Annual Payments	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Subtotal	Authority's Allocation of OPM Annual Payments (29.2%[**] of 2.0532582%)	Authority's Allocation of SPM Annual Payments (29.2%[**] of 2.0532582%)	Total Annual Payments
2004	386,960,000,000	363,742,400,000	$8,000,000,000	$1,310,208,876	$(2,026,633,309)	$(906,805,158)	$6,376,770,409	$38,232,016	$638,772	$38,870,788
2005	381,690,000,000	358,788,600,000	8,000,000,000	1,589,515,143	(2,211,121,522)	(918,610,006)	6,459,783,615	38,729,723	647,088	39,376,810
2006	376,090,000,000	353,524,600,000	8,000,000,000	1,877,200,597	(2,378,265,591)	(933,617,408)	6,565,317,598	39,362,453	657,659	40,020,112
2007	370,570,000,000	348,335,800,000	8,000,000,000	2,173,516,615	(2,559,950,280)	(947,889,009)	6,665,677,326	39,964,161	667,712	40,631,874
2008	365,000,000,000	343,100,000,000	8,139,000,000	2,521,789,910	(2,796,532,001)	(962,378,778)	6,901,879,131	41,380,313	689,698	42,070,011
2009	358,900,000,000	337,366,000,000	8,139,000,000	2,841,613,607	(2,998,880,058)	(976,754,714)	7,004,978,835	41,998,448	700,001	42,698,449
2010	353,270,000,000	332,073,800,000	8,139,000,000	3,171,032,015	(3,222,461,276)	(989,706,408)	7,097,864,331	42,555,345	709,283	43,264,627
2011	347,650,000,000	326,791,000,000	8,139,000,000	3,510,332,976	(3,446,154,616)	(1,003,853,747)	7,199,324,613	43,163,651	719,422	43,883,073
2012	341,810,000,000	321,301,400,000	8,139,000,000	3,859,812,965	(3,680,136,961)	(1,017,987,628)	7,300,688,377	43,771,379	729,551	44,500,930
2013	335,900,000,000	315,746,000,000	8,139,000,000	4,219,777,354	(3,930,322,444)	(1,031,421,685)	7,397,033,226	44,349,016	739,178	45,088,194
2014	329,950,000,000	310,153,000,000	8,139,000,000	4,590,540,675	(4,193,932,658)	(1,044,534,413)	7,491,073,604	44,912,836	748,576	45,661,412
2015	324,710,000,000	305,227,400,000	8,139,000,000	4,972,426,895	(4,470,837,907)	(1,057,381,328)	7,583,207,659	45,465,227	757,783	46,223,010
2016	319,480,000,000	300,311,200,000	8,139,000,000	5,365,769,702	(4,742,013,164)	(1,072,331,430)	7,690,425,107	46,108,051	768,497	46,876,548
2017	314,110,000,000	295,263,400,000	8,139,000,000	5,770,912,793	(5,025,165,790)	(1,087,259,862)	7,797,487,141	46,749,943	779,195	47,529,138
2018	308,830,000,000	290,300,200,000	9,000,000,000	6,842,842,068	(5,888,231,921)	(1,101,643,526)	8,852,966,621	53,078,085	873,023	53,951,107
2019	303,490,000,000	285,280,600,000	9,000,000,000	7,318,127,330	(6,231,743,854)	(1,116,226,441)	8,970,157,034	53,780,702	884,579	54,665,281
2020	298,550,000,000	280,637,000,000	9,000,000,000	7,807,671,150	(6,592,520,174)	(1,130,476,711)	9,084,674,264	54,467,291	895,872	55,363,163
2021	293,590,000,000	275,974,600,000	9,000,000,000	8,311,901,284	(6,955,923,363)	(1,146,061,560)	9,209,916,361	55,218,182	908,223	56,126,405
2022	288,830,000,000	271,500,200,000	9,000,000,000	8,831,258,323	(7,335,888,148)	(1,161,487,636)	9,333,882,538	55,961,423	920,448	56,881,870
2023	284,100,000,000	267,054,000,000	9,000,000,000	9,366,196,073	(7,725,276,551)	(1,177,595,097)	9,463,324,424	56,737,494	933,212	57,670,706
2024	279,720,000,000	262,936,800,000	9,000,000,000	9,917,181,955	(8,130,326,855)	(1,193,745,301)	9,593,109,799	57,515,624	946,011	58,461,634
2025	275,390,000,000	258,866,600,000	9,000,000,000	10,484,697,413	(8,539,519,865)	(1,211,266,319)	9,733,911,229	58,359,801	959,896	59,319,696
2026	271,140,000,000	254,871,600,000	9,000,000,000	11,069,238,336	(8,964,003,764)	(1,228,979,296)	9,876,255,275	59,213,226	973,933	60,187,159
2027	267,000,000,000	250,980,000,000	9,000,000,000	11,671,315,486	(9,403,068,409)	(1,247,019,347)	10,021,227,730	60,082,411	988,229	61,070,640
2028	262,940,000,000	247,163,600,000	9,000,000,000	12,291,454,950	(9,855,873,475)	(1,265,537,687)	10,170,043,788	60,974,639	1,002,904	61,977,544
2029	258,940,000,000	243,403,600,000	9,000,000,000	12,930,198,599	(10,323,986,318)	(1,284,420,830)	10,321,791,451	61,884,445	1,017,869	62,902,313
2030	255,010,000,000	239,709,400,000	9,000,000,000	13,588,104,557	(10,808,690,871)	(1,303,588,452)	10,475,825,234	62,807,956	1,033,059	63,841,015
2031	251,030,000,000	235,968,200,000	9,000,000,000	14,265,747,694	(11,310,032,005)	(1,323,099,207)	10,632,616,482	63,748,000	1,048,520	64,796,521
2032	247,160,000,000	232,330,400,000	9,000,000,000	14,963,720,124	(11,834,046,305)	(1,342,350,573)	10,787,323,246	64,675,547	1,063,776	65,739,323

[*] No payments are shown prior to 2004, when the Authority will begin to receive 29.2% of all MSA payments. In 2003, the Authority will receive the first $30,000,000 of payments received by the State under the MSA.

[**] The allocation percentage of 29.2% applies to all MSA payments after 2003.

Projection of Strategic Contribution Payments to be Received by the Authority

Year	DRI•WEFA Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Strategic Payments	Inflation Adjustment	Volume Adjustment	Subtotal	Authority's Allocation of OPM Strategic Contribution Payments (29.2% of 5.7647432%)	Authority's Allocation of SPM Strategic Contribution Payments (29.2% of 5.7647432%)	Total Strategic Contribution Payments
2004	386,960,000,000	363,742,400,000	$0	$0	$0	$0	$0	$0	$0
2005	381,690,000,000	358,788,600,000	0	0	0	0	0	0	0
2006	376,090,000,000	353,524,600,000	0	0	0	0	0	0	0
2007	370,570,000,000	348,335,800,000	0	0	0	0	0	0	0
2008	365,000,000,000	343,100,000,000	861,000,000	266,772,467	(295,836,596)	831,935,872	$14,004,018	$204,846	$14,208,864
2009	358,900,000,000	337,366,000,000	861,000,000	300,605,641	(317,242,380)	844,363,262	14,213,209	207,906	14,421,115
2010	353,270,000,000	332,073,800,000	861,000,000	335,453,811	(340,894,355)	855,559,455	14,401,675	210,663	14,612,338
2011	347,650,000,000	326,791,000,000	861,000,000	371,347,425	(364,558,192)	867,789,233	14,607,540	213,674	14,821,214
2012	341,810,000,000	321,301,400,000	861,000,000	408,317,848	(389,310,471)	880,007,377	14,813,208	216,683	15,029,891
2013	335,900,000,000	315,746,000,000	861,000,000	446,397,383	(415,776,831)	891,620,553	15,008,693	219,542	15,228,236
2014	329,950,000,000	310,153,000,000	861,000,000	485,619,305	(443,663,352)	902,955,953	15,199,503	222,333	15,421,836
2015	324,710,000,000	305,227,400,000	861,000,000	526,017,884	(472,956,314)	914,061,570	15,386,444	225,068	15,611,512
2016	319,480,000,000	300,311,200,000	861,000,000	567,628,420	(501,643,118)	926,985,303	15,603,990	228,250	15,832,240
2017	314,110,000,000	295,263,400,000	861,000,000	610,487,273	(531,596,971)	939,890,302	15,821,221	231,427	16,052,648

Projection of Total Payments to be Received by the Authority*

Year	DRI•WEFA Base Case Consumption Forecast	OPM-Adjusted Consumption	Annual Payments	Strategic Contribution Payments	Total Payments to the Authority
2004	386,960,000,000	363,742,400,000	$38,870,788	$0	$38,870,788
2005	381,690,000,000	358,788,600,000	39,376,810	0	39,376,810
2006	376,090,000,000	353,524,600,000	40,020,112	0	40,020,112
2007	370,570,000,000	348,335,800,000	40,631,874	0	40,631,874
2008	365,000,000,000	343,100,000,000	42,070,011	14,208,864	56,278,875
2009	358,900,000,000	337,366,000,000	42,698,449	14,421,115	57,119,564
2010	353,270,000,000	332,073,800,000	43,264,627	14,612,338	57,876,965
2011	347,650,000,000	326,791,000,000	43,883,073	14,821,214	58,704,286
2012	341,810,000,000	321,301,400,000	44,500,930	15,029,891	59,530,821
2013	335,900,000,000	315,746,000,000	45,088,194	15,228,236	60,316,430
2014	329,950,000,000	310,153,000,000	45,661,412	15,421,836	61,083,248
2015	324,710,000,000	305,227,400,000	46,223,010	15,611,512	61,834,522
2016	319,480,000,000	300,311,200,000	46,876,548	15,832,240	62,708,788
2017	314,110,000,000	295,263,400,000	47,529,138	16,052,648	63,581,786
2018	308,830,000,000	290,300,200,000	53,951,107	0	53,951,107
2019	303,490,000,000	285,280,600,000	54,665,281	0	54,665,281
2020	298,550,000,000	280,637,000,000	55,363,163	0	55,363,163
2021	293,590,000,000	275,974,600,000	56,126,405	0	56,126,405
2022	288,830,000,000	271,500,200,000	56,881,870	0	56,881,870
2023	284,100,000,000	267,054,000,000	57,670,706	0	57,670,706
2024	279,720,000,000	262,936,800,000	58,461,634	0	58,461,634
2025	275,390,000,000	258,866,600,000	59,319,696	0	59,319,696
2026	271,140,000,000	254,871,600,000	60,187,159	0	60,187,159
2027	267,000,000,000	250,980,000,000	61,070,640	0	61,070,640
2028	262,940,000,000	247,163,600,000	61,977,544	0	61,977,544
2029	258,940,000,000	243,403,600,000	62,902,313	0	62,902,313
2030	255,010,000,000	239,709,400,000	63,841,015	0	63,841,015
2031	251,030,000,000	235,968,200,000	64,796,521	0	64,796,521
2032	247,160,000,000	232,330,400,000	65,739,323	0	65,739,323

* No payments are shown prior to 2004, when the Authority will begin to receive 29.2% of all MSA payments. In 2003, the Authority will receive the first $30,000,000 of payments received by the State under the MSA.

Debt Service Coverage

The following table shows estimated debt service for the Series 2002 Bonds and the resulting estimated debt service coverage ratios, assuming cigarette consumption is consistent with the DRI•WEFA Base Case Forecast, Collections are received in accordance with the Cash Flow Assumptions, no Turbo Redemptions are made in advance of the Sinking Fund Installments and interest rates for the Series 2002 Bonds are as described above under "Bond Structuring Assumptions." As used herein, "**debt service coverage ratio**" means, for any period, a fraction, expressed as a multiple, the numerator of which is the amount of Collections received in such period (including earnings on the Liquidity Reserve Account and earnings on Pledged TSRs until the applicable Distribution Date) and the denominator of which is the sum of interest, Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments required to be paid in such period plus Operating Expenses at the Operating Cap. The denominator does not include Turbo Redemptions, and Sinking Fund Installments are based on the assumption that no Turbo Redemptions will occur. Based on the DRI•WEFA Base Case Forecast, the average debt service coverage ratio is 1.52x (excluding 2003) with a minimum debt service coverage ratio in 2004 and 2005 of 1.21x.

Estimated Debt Service Coverage[1]

Revenue Year	Total Available Funds[2]	Serial Maturities and Sinking Fund Installments	Interest	Operating Expenses[3]	Total Debt Service and Operating Expenses[4]	Debt Service Coverage for Series 2002 Bonds
2004	$40,444,261.33	$0.00	$33,285,598.75	$257,500.00	$33,543,098.75	1.21x
2005	41,088,365.80	550,000.00	33,276,248.75	265,225.00	34,091,473.75	1.21x
2006	41,730,286.81	110,000.00	33,264,808.75	273,181.75	33,647,990.50	1.24x
2007	42,341,712.90	0.00	33,262,718.75	281,377.20	33,544,095.95	1.26x
2008	58,015,924.51	10,675,000.00	32,995,843.75	289,818.52	43,960,662.27	1.32x
2009	58,849,306.72	10,060,000.00	32,464,893.75	298,513.07	42,823,406.82	1.37x
2010	59,600,136.88	9,620,000.00	31,948,293.75	307,468.47	41,875,762.22	1.42x
2011	60,430,324.15	13,285,000.00	31,280,612.50	316,692.52	44,882,305.02	1.35x
2012	61,251,761.69	14,325,000.00	30,471,518.75	326,193.30	45,122,712.05	1.36x
2013	62,028,637.24	14,605,000.00	29,602,918.75	335,979.09	44,543,897.84	1.39x
2014	62,790,451.46	16,595,000.00	28,588,918.75	346,058.47	45,529,977.22	1.38x
2015	63,533,753.20	17,910,000.00	27,467,506.25	356,440.22	45,733,946.47	1.39x
2016	64,398,921.86	19,125,000.00	26,263,868.75	367,133.43	45,756,002.18	1.41x
2017	65,262,538.54	20,560,000.00	24,974,106.25	378,147.43	45,912,253.68	1.42x
2018	55,607,921.69	16,370,000.00	23,773,881.25	389,491.85	40,533,373.10	1.37x
2019	56,313,307.57	17,285,000.00	22,680,093.75	401,176.61	40,366,270.36	1.40x
2020	57,002,633.71	18,550,000.00	21,515,456.25	413,211.91	40,478,668.16	1.41x
2021	57,756,057.85	19,645,000.00	20,274,118.75	425,608.27	40,344,727.02	1.43x
2022	58,501,550.62	20,980,000.00	18,953,806.25	438,376.51	40,372,182.76	1.45x
2023	59,278,779.12	22,010,000.00	17,556,631.25	451,527.81	40,018,159.06	1.48x
2024	60,059,631.93	23,960,000.00	16,062,606.25	465,073.64	40,487,679.89	1.48x
2025	60,905,462.12	25,560,000.00	14,453,206.25	479,025.85	40,492,232.10	1.50x
2026	61,758,313.38	26,620,000.00	12,757,356.25	493,396.63	39,870,752.88	1.55x
2027	62,627,571.54	28,265,000.00	10,955,928.13	508,198.53	39,729,126.65	1.58x
2028	63,520,291.56	30,415,000.00	9,012,153.13	523,444.48	39,950,597.61	1.59x
2029	64,429,729.59	32,700,000.00	6,921,468.75	539,147.82	40,160,616.57	1.60x
2030	65,351,979.78	35,170,000.00	4,673,275.00	555,322.25	40,398,597.25	1.62x
2031	66,289,751.79	37,810,000.00	2,255,812.50	571,981.92	40,637,794.42	1.63x
2032	67,152,146.24	15,145,000.00	501,678.13	589,141.38	16,235,819.50	4.14x

(1) No payments are shown prior to 2004, when the Authority will begin to receive 29.2% of all MSA payments. In 2003, the Authority will receive the first $30,000,000 of payments received by the State under the MSA and will apply such payments to interest due on the Series 2002 Bonds. Based on the DRI•WEFA Base Case Forecast, MSA Payments allocated to the State in 2003 are expected to be $151.98 million.

(2) Includes total payments to the Authority plus earnings on the Liquidity Reserve Account and other Accounts (except the Rebate Account, the Operating Account, the Operating Contingency Account and the Costs of Issuance Account) until distributed.

(3) Includes Operating Expenses at the Operating Cap.

(4) Includes interest, Serial Maturities, Sinking Fund Installments and Turbo Term Bond Maturities on the Series 2002 Bonds and Operating Expenses at the Operating Cap.

The estimated debt service coverage ratios shown in the preceding table assume that Collections are received in accordance with the Cash Flow Assumptions and applied, subject to the payment priorities set forth in the Indenture, to pay Operating Expenses, interest when due, Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments. The above table does not reflect the actual amortization of Series 2002 Bonds that will occur if the DRI•WEFA Base Case Forecast is realized. If actual Collections are received in the amounts assumed based on the DRI•WEFA Base Case Forecast and the Cash Flow Assumptions, Collections would be applied to make Turbo Redemptions as required pursuant to the Indenture. See "THE SERIES 2002 BONDS—Effect of Changes in Cigarette Consumption Levels on Turbo Redemptions."

Allocation of Principal Payments

Due to a number of factors, including the actual consumption of cigarettes in the United States, the amount of Collections may fluctuate from year to year. Unless an Event of Default has occurred, Collections available to make principal payments on the Bonds on any Distribution Date will be allocated to Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments due prior to allocations to Turbo Redemptions. Collections available to make Turbo Redemptions will be credited against both Sinking Fund Installments and Turbo Term Bond Maturities in chronological order.

If less than all the Outstanding Bonds are to be redeemed pursuant to the payment of a Sinking Fund Installment, a Turbo Redemption or optional redemption, the particular Bonds of a Maturity Date and series to be redeemed will be selected by the Indenture Trustee by such method as it may deem fair and appropriate, and the Indenture Trustee may provide for the selection for redemption of portions (equal to any authorized denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination.

Upon the occurrence of any Event of Default and on each succeeding Distribution Date, the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Turbo Redemption Account to pay Pro Rata, *first,* the accrued interest on the Bonds and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, *second,* principal on all Bonds then Outstanding, whether or not such principal is then scheduled to be paid.

Effect of Changes in Cigarette Consumption Levels on Turbo Redemptions

Weighted Average Lives and Final Principal Payments. The tables below have been prepared to show the effect of changes in cigarette consumption on the weighted average lives and final principal payments of the Series 2002 Bonds. The tables are based on the Cash Flow Assumptions and the Bond Structuring Methodology, except that the annual cigarette consumption varies in each case. In addition to the DRI•WEFA Base Case Forecast, several alternative cigarette consumption scenarios are presented below, including four alternative forecasts of DRI•WEFA (the DRI•WEFA High Forecast, the DRI•WEFA Low Case 1, the DRI•WEFA Low Case 2 and the DRI•WEFA Low Case 3, each as hereinafter defined) and two other consumption scenarios prepared by DRI•WEFA (assuming 3.5% and 4% annual consumption declines). A seventh alternative scenario is presented under which consumption is assumed to average 67% of the DRI•WEFA Base Case Forecast, no Collections available for Turbo Redemptions are assumed to be generated and the Series 2002 Bonds are redeemed pursuant to the schedule of Sinking Fund Installments with no Turbo Redemptions. In each scenario, if actual cigarette consumption in the United States is as forecast and assumed, and events occur as assumed by the Cash Flow Assumptions, the final principal payments and weighted average lives (in years) of each of the Series 2002 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 varies from the alternative scenarios presented below, the weighted average lives (and final principal payment dates) for the Series 2002 Bonds will be either shorter (sooner) or longer (later) than projected below.

Series 2002 Turbo Term Bonds
Maturing June 1, 2026

Consumption Forecast	Weighted Average Life (years)	Final Principal Payment Date
DRI•WEFA Base Case Forecast	9.1	June 1, 2016
DRI•WEFA High Forecast	8.9	June 1, 2015
DRI•WEFA Low Case 1	9.5	June 1, 2016
DRI•WEFA Low Case 2	9.8	June 1, 2016
DRI•WEFA Low Case 3	12.5	June 1, 2020
3.5% Annual Consumption Decline	11.1	June 1, 2019
4.0% Annual Consumption Decline	12.2	June 1, 2021
No Surplus Collections*	17.7	June 1, 2026

Series 2002 Turbo Term Bonds
Maturing June 1, 2032

Consumption Forecast	Weighted Average Life (years)	Final Principal Payment Date
DRI•WEFA Base Case Forecast	14.7	June 1, 2019
DRI•WEFA High Forecast	14.4	June 1, 2018
DRI•WEFA Low Case 1	15.2	June 1, 2019
DRI•WEFA Low Case 2	15.9	June 1, 2020
DRI•WEFA Low Case 3	19.4	June 1, 2024
3.5% Annual Consumption Decline	19.0	June 1, 2024
4.0% Annual Consumption Decline	21.6	June 1, 2027
No Surplus Collections*	27.0	June 1, 2032

* If consumption averages 67% of the DRI•WEFA Base Case Forecast, no Collections available for Turbo Redemptions would be generated, and the Turbo Term Bonds would not be redeemed pursuant to Turbo Redemptions, but would be paid pursuant to the schedule of Sinking Fund Installments.

Turbo Redemptions. The tables below have been prepared to show the effect of changes in cigarette consumption on the projected outstanding principal balances of the Series 2002 Turbo Term Bonds. The tables are based upon the same assumptions and utilize the same alternative DRI•WEFA forecasts as shown in the preceding paragraph and tables.

Projected Outstanding Principal Balances for Series 2002 Turbo Term Bonds Maturing June 1, 2026*

Date	DRI•WEFA Base Case Forecast	DRI•WEFA High Forecast	DRI•WEFA Low Case 1	DRI•WEFA Low Case 2	DRI•WEFA Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline	No Surplus Collections**
Settlement	$279,775,000	$279,775,000	$279,775,000	$279,775,000	$279,775,000	$279,775,000	$279,775,000	$279,775,000
June 1, 2004	272,625,000	272,380,000	273,140,000	273,565,000	277,000,000	273,345,000	273,940,000	279,775,000
June 1, 2005	264,900,000	264,330,000	266,025,000	266,980,000	275,970,000	267,115,000	268,535,000	279,775,000
June 1, 2006	255,535,000	254,545,000	257,395,000	259,000,000	273,845,000	260,210,000	262,700,000	279,775,000
June 1, 2007	244,805,000	243,290,000	247,550,000	249,965,000	270,935,000	252,935,000	256,750,000	279,775,000
June 1, 2008	227,915,000	225,570,000	232,030,000	235,735,000	264,915,000	242,015,000	247,920,000	279,775,000
June 1, 2009	207,855,000	204,550,000	213,620,000	218,860,000	256,605,000	229,460,000	237,835,000	279,775,000
June 1, 2010	184,700,000	180,265,000	192,400,000	199,465,000	246,095,000	215,355,000	226,600,000	279,775,000
June 1, 2011	162,255,000	156,515,000	172,185,000	181,360,000	237,275,000	203,675,000	218,220,000	279,775,000
June 1, 2012	137,710,000	130,465,000	150,175,000	161,775,000	227,390,000	191,725,000	210,020,000	279,775,000
June 1, 2013	95,520,000	86,560,000	110,850,000	125,195,000	200,960,000	164,035,000	186,555,000	265,170,000
June 1, 2014	49,735,000	38,835,000	68,285,000	85,720,000	172,105,000	134,755,000	162,005,000	248,575,000
June 1, 2015	130,000	0	22,295,000	43,215,000	140,675,000	103,775,000	136,290,000	230,665,000
June 1, 2016	0	0	0	0	106,395,000	70,980,000	109,325,000	211,540,000
June 1, 2017	0	0	0	0	69,070,000	36,245,000	81,025,000	190,980,000
June 1, 2018	0	0	0	0	37,685,000	7,635,000	58,815,000	174,610,000
June 1, 2019	0	0	0	0	3,585,000	0	35,500,000	157,325,000
June 1, 2020	0	0	0	0	0	0	11,000,000	138,775,000
June 1, 2021	0	0	0	0	0	0	0	119,130,000
June 1, 2022	0	0	0	0	0	0	0	98,150,000
June 1, 2023	0	0	0	0	0	0	0	76,140,000
June 1, 2024	0	0	0	0	0	0	0	52,180,000
June 1, 2025	0	0	0	0	0	0	0	26,620,000
June 1, 2026	0	0	0	0	0	0	0	0
Average Life (years):	9.1	8.9	9.5	9.8	12.5	11.1	12.2	17.7

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* Outstanding amounts represent principal balances after application of available Collections to Sinking Fund Installments and Turbo Redemptions on the referenced date.

** If consumption averages 67% of the DRI•WEFA Base Case Forecast, no Collections available for Turbo Redemptions would be generated, and the Turbo Term Bonds would not be redeemed pursuant to Turbo Redemptions, but would be paid pursuant to the schedule of Sinking Fund Installments.

Projected Outstanding Principal Balances for Series 2002 Turbo Term Bonds Maturing June 1, 2032*

Date	DRI•WEFA Base Case Forecast	DRI•WEFA High Forecast	DRI•WEFA Low Case 1	DRI•WEFA Low Case 2	DRI•WEFA Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline	No Surplus Collections**
Settlement	$179,505,000	$179,505,000	$179,505,000	$179,505,000	$179,505,000	$179,505,000	$179,505,000	$179,505,000
June 1, 2004	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2005	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2006	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2007	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2008	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2009	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2010	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2011	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2012	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2013	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2014	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2015	179,505,000	166,540,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2016	125,795,000	110,230,000	151,975,000	176,775,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2017	67,400,000	49,075,000	98,045,000	127,175,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2018	15,035,000	0	50,150,000	83,610,000	179,505,000	179,505,000	179,505,000	179,505,000
June 1, 2019	0	0	0	36,635,000	179,505,000	156,810,000	179,505,000	179,505,000
June 1, 2020	0	0	0	0	146,095,000	124,625,000	179,505,000	179,505,000
June 1, 2021	0	0	0	0	105,925,000	90,450,000	164,720,000	179,505,000
June 1, 2022	0	0	0	0	62,370,000	54,145,000	137,545,000	179,505,000
June 1, 2023	0	0	0	0	15,175,000	15,565,000	108,875,000	179,505,000
June 1, 2024	0	0	0	0	0	0	78,600,000	179,505,000
June 1, 2025	0	0	0	0	0	0	46,605,000	179,505,000
June 1, 2026	0	0	0	0	0	0	12,770,000	179,505,000
June 1, 2027	0	0	0	0	0	0	0	151,240,000
June 1, 2028	0	0	0	0	0	0	0	120,825,000
June 1, 2029	0	0	0	0	0	0	0	88,125,000
June 1, 2030	0	0	0	0	0	0	0	52,955,000
June 1, 2031	0	0	0	0	0	0	0	15,145,000
June 1, 2032	0	0	0	0	0	0	0	0
Average Life (years):	14.7	14.4	15.2	15.9	19.4	19.0	21.6	27.0

* Outstanding amounts represent principal balances after application of available Collections to Sinking Fund Installments and Turbo Redemptions on the referenced date.

** If consumption averages 67% of the DRI•WEFA Base Case Forecast, no Collections available for Turbo Redemptions would be generated, and the Turbo Term Bonds would not be redeemed pursuant to Turbo Redemptions, but would be paid pursuant to the schedule of Sinking Fund Installments.

Explanation of Alternative DRI•WEFA Forecasts. The alternative DRI•WEFA forecasts of cigarette consumption used in the analysis above are based upon the assumptions described below. See also "DRI•WEFA Report" and Appendix A.

DRI•WEFA's high forecast of consumption (the "**DRI•WEFA High Forecast**") deviates from the Base Case Forecast by using a lower price forecast, under which prices are increasing at an annual

rate of 0.5% more slowly than the DRI•WEFA Base Case Forecast. Based on the DRI•WEFA High Forecast, the average annual rate of decline in cigarette consumption is reduced slightly, from an average annual rate in the Base Case Forecast of 1.72%, to 1.56%, resulting in cigarette consumption of 260 billion in 2032.

DRI•WEFA's low forecast of consumption (the "**DRI•WEFA Low Case 1**") deviates from the Base Case Forecast by assuming a sharper price elasticity of demand. The DRI•WEFA Base Case Forecast employs a price elasticity of demand of –0.31. However, in order to develop the lowest consumption forecast that DRI•WEFA believes may be reasonably anticipated, a price elasticity of –0.4 is used. Based on the DRI•WEFA Low Case 1 Forecast, the average annual rate of decline in consumption is increased from an average annual rate in the Base Case Forecast of 1.72%, to 1.93%, resulting in cigarette consumption of 230 billion in 2032.

Although beyond the range of DRI•WEFA's reasonably anticipated decline in consumption, DRI•WEFA also prepared an alternative low case (the "**DRI•WEFA Low Case 2**") that deviates from the Base Case Forecast by assuming a price elasticity of demand of –0.5. This produces a decline in consumption at an average annual rate of 2.17% to 213 billion in 2032. DRI•WEFA prepared another alternative low case (the "**DRI•WEFA Low Case 3**") that deviates from the Base Case Forecast by assuming an adverse federal government settlement or tort claims of three times the size of the MSA occurs in 2003, resulting in an immediate real price increase of 57% and a decline of 17.7% in consumption over two years. Based on the DRI•WEFA Low Case 3, the average annual rate of decline in consumption increases from an average annual rate in the Base Case Forecast of 1.72%, to 2.25%, resulting in cigarette consumption of 207 billion in 2032.

Average Annual Rate of Cigarette Consumption Decline (2001-2032)

DRI•WEFA Base Case Forecast	DRI•WEFA High Forecast	DRI•WEFA Low Case 1	DRI•WEFA Low Case 2	DRI•WEFA Low Case 3
1.72%	1.56%	1.93%	2.17%	2.25%

Finally, for comparative purposes DRI•WEFA calculated the volume of total cigarette consumption under two alternative annual rates of decline, 3.5% and 4.0%. DRI•WEFA states that at 3.5% per year consumption falls to 138 billion by 2032 and at 4.0% it falls to 116 billion.

No assurance can be given that actual total cigarette consumption in the United States during the term of the Series 2002 Bonds will be as assumed, or that the other assumptions underlying the Cash Flow 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 Cash Flow Assumptions, the amount of Collections available to pay debt service will be affected and the resulting weighted average lives and final principal payment dates of the Series 2002 Bonds will vary. See "RISK FACTORS."

USE OF PROCEEDS

The Authority will apply the proceeds of the Series 2002 Bonds to (1) purchase the Pledged TSRs from the State; (2) fund the Liquidity Reserve Account; (3) capitalize a portion of the interest due on the Series 2002 Bonds through June 1, 2003; (4) capitalize certain Operating Expenses; and (5) pay the costs of issuance of the Series 2002 Bonds. The State expects to use the proceeds of the sale of the Pledged TSRs to refinance and defease certain outstanding obligations of the State, to pay for certain capital

projects and for working capital purposes. Funds received by the State as payment for the Pledged TSRs are not pledged to or accessible to Bondholders.

The expected application of such amounts is set forth below:

Payment to the State for Pledged TSRs:	$ 450,000,000.00
Liquidity Reserve Account Deposit:	45,534,106.25
Capitalized Interest Subaccount Deposit:	4,907,889.84
Costs of Issuance, including Underwriters' Discount:	5,908,111.76
Capitalized Operating Expenses:	825,000.00
Original Issue Discount:	10,729,892.15
Total	$ 517,905,000.00

THE AUTHORITY

The Authority is a public instrumentality and agency of the State, separate and distinct from the State, exercising public and essential governmental functions, established pursuant to the Act. The Authority is empowered to:

(1) establish a stable source of revenue to be used for the purposes designated in the Act;

(2) enter into sales agreements with the State for a purchase of a portion of the amounts otherwise due to the State under the MSA, and of the State's rights to receive such amounts;

(3) issue bonds in one or more series, and to refund or refinance its debt and obligations;

(4) sell, pledge or assign, as security, all or a portion of the revenues derived by the Authority under any sales agreement, to provide for and secure the issuance of its bonds;

(5) provide for the investment of any funds, including funds held in reserve;

(6) manage its funds, obligations and investments; and

(7) implement the purposes of the Act.

Pursuant to the Act, prior to 366 days after none of the Authority's bonds are outstanding, the Authority is prohibited from filing a voluntary petition under Chapter 9 of the Bankruptcy Code as it may, from time to time, be in effect.

Pursuant to the Act, the powers of the Authority are vested in and exercised by a board (the "**Board**"), which consists of five members appointed by the Governor. The Governor appoints a Chair, and the Board elects a Treasurer and a Secretary annually. Three members of the Board constitute a quorum. The staff of the Washington State Housing Finance Commission provides administrative and staff support to the Authority.

SECURITY

Sale of Pledged TSRs; Pledge of Collateral

Pursuant to the Act and the Sales Agreement, the State will sell to the Authority the Tobacco Assets, which means the sum of (1) the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, and (2) 29.2% of:

(a) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto);

(b) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003; and

(c) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003.

See "SUMMARY OF THE MSA—Payments Made to Date" for information with respect to Initial Payments and Annual Payments required to be paid under the MSA and the State's share thereof that was received by the State.

Pursuant to the Indenture, the Bonds will be secured by the "**Collateral**," consisting of all of the Authority's right, title and interest in, to and under: (1) the Pledged TSRs and all fees, charges, payments, proceeds, collections, investment earnings and other income and receipts paid or payable to the Authority or the Indenture Trustee for the account of the Bondholders (including, without limitation, amounts paid to the Indenture Trustee for the account of the Authority under any Swap Contract) (the "**Collections**"); (2) all rights to receive the Collections and the proceeds of such rights; (3) the Accounts (except for the Rebate Account) and assets thereof, including money, contract rights, general intangibles or other personal property, held by the Indenture Trustee under the Indenture; (4) subject to certain rights reserved under the Indenture, all rights and interest of the Authority under the Sales Agreement, including the representations, warranties and covenants of the State in the Sales Agreement; (5) any payment received by the Indenture Trustee pursuant to a Swap Contract; (6) 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; (7) all proceeds of the foregoing; and (8) any and all other property of every kind and nature from time to time after the date of the Indenture, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture.

The right of the Authority to receive the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, as Pledged TSRs, is prior to the claim of the State to all other payments received by the State under the MSA on and after the Closing Date and before July 1, 2003. The right of the Authority to receive the other Pledged TSRs on and after July 1, 2003, is valid and enforceable and on a parity with the claim of the State to the Unpledged TSRs.

The Authority has no authority to and does not intend or purport to pledge the faith, credit, or taxing power or any other asset or revenues of the State or any of its political subdivisions in connection

with the issuance of the Series 2002 Bonds. The Authority has no taxing power. The Series 2002 Bonds are limited obligations of the Authority. **The Series 2002 Bonds shall not be obligations of the State and shall be obligations only of the Authority, payable solely from the special fund or funds created by the Authority for their payment. Payment of the principal of, interest on, and redemption premium, if any, on the Series 2002 Bonds shall be a valid claim only as against the special fund or funds relating thereto. Neither the faith and credit nor the taxing power of the State or any municipal corporation, subdivision, or agency of the State, other than the Authority as set forth in the Act, is pledged to the payment of the principal of, interest on, and premium, if any, on the Series 2002 Bonds.**

Payment by MSA Escrow Agent to Indenture Trustee

Upon sale by the State of the Pledged TSRs to the Authority, the State will direct the MSA Escrow Agent to disburse the Pledged TSRs directly to the Indenture Trustee. Under the MSA, the disbursement of Pledged TSRs is required to be made to the Indenture Trustee by the MSA Escrow Agent ten business days after the MSA Escrow Agent receives the related Initial Payments, Annual Payments and Strategic Contribution Payments from the PMs.

Application of Revenues

Promptly upon receipt, the Indenture Trustee will deposit all Collections (excluding investment earnings on amounts on deposit with the Indenture Trustee under the Indenture) in the Collections Account. All Collections consisting of Partial Lump Sum Payments will be promptly transferred to the Partial Lump Sum Payment Account. All Collections consisting of Total Lump Sum Payments will be promptly applied in the manner described in the last paragraph under *"Distribution Date Transfers"* below. In addition, on the Business Day immediately preceding each Distribution Date, the Indenture Trustee will deposit in the Collections Account and apply as described in *"Transfers to Accounts"* (1) all Collections consisting of investment earnings on amounts on deposit with the Indenture Trustee under the Indenture (excluding amounts in the Costs of Issuance Account, the Rebate Account and the Partial Lump Sum Payment Account) and (2) all Collections consisting of gains from investments (other than investment earnings) determined pursuant to the valuation of investments in each Account by the Indenture Trustee as of each Distribution Date (excluding such gains in the Costs of Issuance Account, the Rebate Account and the Partial Lump Sum Payment Account).

Transfers to Accounts. As soon as is possible following each deposit of Collections to the Collections Account, but no later than the earlier of (1) the fifth Business Day following each Deposit Date, or (2) the start of business of the Indenture Trustee on the Distribution Date following each Deposit Date, the Indenture Trustee will withdraw the funds on deposit in the Collections Account and transfer such amounts in the priority set forth below:

(a) to the Operating Account, after June 30, 2004, an amount sufficient to cause the amount therein to equal the amount specified by the Officer's Certificate most recently delivered (or deemed delivered) in order to pay, for the Fiscal Year applicable to such Officer's Certificate, the Operating Expenses to the extent that the aggregate amount thereof does not exceed the Operating Cap in effect as of the date of such deposit;

(b) to the Debt Service Account, until June 1, 2003, all remaining Collections and thereafter an amount sufficient to cause the amount therein to equal the sum of (i) interest on the Outstanding Bonds and Swap Payments that will come due (A) in the next succeeding Bond Year, if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, or (B) in the then current Bond Year, if the Deposit Date is on or after June 1 and on or before

November 30 of any Bond Year, plus (ii) any such unpaid interest on the Bonds from prior Distribution Dates (including interest at the stated rate on such unpaid interest, to the extent legally permissible); *provided,* that the amount to be deposited pursuant to this paragraph (b) shall be calculated assuming that principal on the Bonds will have been paid as described in paragraphs (b), (c) and (d) under *"Distribution Date Transfers"*;

(c) to the Debt Service Account, an amount sufficient to cause the amount therein to equal the amount specified in paragraph (b) above plus the sum of (i) if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, the Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments, if any, due in or scheduled for the next succeeding Bond Year, plus (ii) any such Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments unpaid from prior Distribution Dates; *provided,* that the amount of any Turbo Redemptions or optional redemptions of Turbo Term Bonds will be credited against such Sinking Fund Installments in chronological order;

(d) unless an Event of Default has occurred, to the Liquidity Reserve Account an amount sufficient to cause the amount on deposit therein to equal the Liquidity Reserve Requirement;

(e) to the Operating Contingency Account an amount specified by an Officer's Certificate in order to pay, for the Fiscal Year applicable to such Officer's Certificate, the Operating Expenses in excess of the Operating Cap;

(f) to the Turbo Redemption Account until Turbo Term Bonds are no longer Outstanding, the amount remaining in the Collections Account; and

(g) from and after such time that no Turbo Term Bonds remain Outstanding, retained in the Collections Account.

Distribution Date Transfers. Unless an Event of Default has occurred, on each Distribution Date, the Indenture Trustee will apply amounts in the various Accounts in the following order of priority:

(a) from the Capitalized Interest Subaccount, the Debt Service Account, the Partial Lump Sum Payment Account and the Liquidity Reserve Account, in that order, to pay interest on the Bonds and Swap Payments due on such Distribution Date;

(b) from the Debt Service Account, the Partial Lump Sum Payment Account and the Liquidity Reserve Account, in that order, to pay, in the following order, the Serial Maturities, Turbo Term Bond Maturities and the Sinking Fund Installments, if any, due on or scheduled for such Distribution Date, plus any Sinking Fund Installments unpaid from prior Distribution Dates; *provided,* that the amount of any Turbo Redemptions or optional redemptions of Turbo Term Bonds will be credited against such Sinking Fund Installments in chronological order; and *further provided,* that the Indenture Trustee will not pay a Sinking Fund Installment pursuant to this paragraph unless the Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date;

(c) from the Turbo Redemption Account, to redeem Turbo Term Bonds in chronological order; and

(d) from the Partial Lump Sum Payment Account, but only as directed in an Officer's Certificate delivered by the Authority and accompanied by a Rating Confirmation, to redeem Turbo Term Bonds in chronological order.

Funds deposited in the Operating Account will be transferred, immediately upon such deposit, to or upon the order of the Authority and will be used by the Authority to pay Operating Expenses (other than termination payments on Swap Contracts, on investment contracts or investment agreements for Accounts, or on forward purchase contracts for investments in Accounts).

Funds in the Operating Contingency Account will be applied by the Indenture Trustee at any time, in accordance with directions in an Officer's Certificate, to pay Operating Expenses not otherwise paid from the Operating Account (or to fund an account of the Authority free and clear of the lien of the Indenture for the purpose of paying such Operating Expenses).

Upon the occurrence of any Event of Default and on each succeeding Distribution Date, the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Turbo Redemption Account to pay Pro Rata, *first,* the accrued interest on the Bonds and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, *second,* principal on all Bonds then Outstanding, whether or not such principal is then scheduled to be paid.

Upon the receipt of a Total Lump Sum Payment, the Indenture Trustee will, after making provision for the amounts required to be deposited pursuant to paragraph (a) under *"Transfers to Accounts"* above, use all remaining proceeds of such Total Lump Sum Payment to pay Pro Rata, *first,* the accrued interest on the Bonds and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, *second,* principal on all Bonds then Outstanding, whether or not such principal is then scheduled to be paid.

Additional Bonds

With Rating Confirmation, one or more series of Refunding Bonds may be issued to refund Bonds (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance) but only if upon the issuance of such Refunding Bonds (1) the amount on deposit in the Liquidity Reserve Account will be at least equal to the Liquidity Reserve Requirement; (2) no Event of Default shall have occurred; and (3) the expected base case debt service on the proposed Refunding Bonds shall be less than or equal to the expected base case debt service on the refunded Bonds as of their date of original issuance in all years in which such refunding Bonds debt service is payable.

The Authority may from time to time request the authentication and delivery of a series of Bonds by providing to the Indenture Trustee (at or prior to such authentication and delivery) the following: (1) copies of the applicable Series Supplement, certified by an Authorized Officer of the Authority; (2) in the case of Refunding Bonds, an Officer's Certificate showing compliance with the provisions set forth in the preceding paragraph; (3) an opinion of Counsel (a) as to the due authorization, execution and delivery by the Authority of the Indenture and each relevant Supplemental Indenture, (b) to the effect that the Bonds being issued are valid and binding obligations of the Authority payable from the sources specified in the Indenture, (c) to the effect that the Indenture creates the valid pledge of, and first-priority lien on, the Collateral (including, without limitation, the Pledged TSRs) that it purports to create, and (d) in the case of Refunding Bonds, to the effect that the issuance of such Refunding Bonds will not adversely affect the exclusion from gross income for federal income tax purposes of interest on Tax-Exempt Bonds theretofore issued (as set forth in the opinions delivered with such prior Bonds); (4) such other documents as may be required by the applicable Series Supplement; and (5) an Officer's Certificate to the effect that

the applicable conditions to the issuance of Bonds set forth in the Indenture and in each applicable Series Supplement have been met, and requesting the Indenture Trustee's authentication of the series of Bonds.

No bonds other than the Series 2002 Bonds and Refunding Bonds may be issued under the Indenture. "**Refunding Bonds**" means Bonds, other than the Series 2002 Bonds, issued pursuant to the Indenture for the purposes of refunding any Outstanding Bonds. "**Bonds**" means the Series 2002 Bonds and any Refunding Bonds issued pursuant to the Indenture.

THE SERIES 2002 BONDS

The following summary describes certain terms of the Series 2002 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 2002 Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee.

The Series 2002 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 2002 Bonds. The Series 2002 Bonds will be available for purchase in denominations of $5,000 or any integral multiple thereof in book-entry form only. Except under the limited circumstances described herein, no Beneficial Owner (as defined herein) of the Series 2002 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Series 2002 Bonds. See "THE SERIES 2002 BONDS—Book-Entry Only System."

Payments of Interest

Interest on the Outstanding principal balance of the Series 2002 Bonds will be payable on each June 1 and December 1 or the next succeeding Business Day if such June 1 or December 1 is not a Business Day, commencing June 1, 2003 (each, a "**Distribution Date**"). Interest will accrue from and including the Closing Date. Interest on the Series 2002 Bonds will be computed on the basis of a 360-day year comprised of twelve 30-day months. Failure to pay the full amount of interest payable on any Distribution Date is an Event of Default.

If on any Distribution Date there are insufficient funds to pay all interest then due on the Bonds, available amounts will be allocated Pro Rata among all Bonds based on the respective amounts of interest due thereon.

For each Distribution Date, payments will be made to Bondholders of record as of the Record Date.

"**Record Date**" means the 15th day of the calendar month preceding a Distribution Date. The Authority or the Indenture Trustee may establish special record dates for the determination of the Bondholders for various purposes of the Indenture.

"**Business Day**" means any day other than (1) a Saturday or a Sunday or (2) a day on which banking institutions in New York, New York, or where the Corporate Trust Office of the Indenture Trustee is otherwise located, are required or authorized by law to be closed.

Payments of Principal

Serial Maturities, Turbo Term Bond Maturities, Sinking Fund Installments and Turbo Redemptions will be paid as described below.

The Series 2002 Bonds consist of Serial Bonds and Turbo Term Bonds maturing on June 1, as set forth on the inside cover. The Turbo Term Bonds are subject to redemption in accordance with the schedule of Sinking Fund Installments and, in addition, are subject to Turbo Redemptions to the extent of available Collections.

Payments of Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments will be made from Collections and, if necessary, the Liquidity Reserve Account. Failure to pay interest, Serial Maturities and Turbo Term Bond Maturities when due will constitute an Event of Default under the Indenture. Failure to pay Turbo Redemptions or Sinking Fund Installments will not constitute an Event of Default under the Indenture.

The "**Sinking Fund Installment**" of a Turbo Term Bond represents the amount of principal that the Authority is required to pay as of the specified Distribution Date from Collections and, if necessary, the Liquidity Reserve Account as set forth in the schedules under "Sinking Fund Installments." Failure to pay the Sinking Fund Installment of a Turbo Term Bond will not constitute an Event of Default under the Indenture.

"**Turbo Redemptions**" represent the requirement contained in the Indenture to apply to the redemption of Turbo Term Bonds on each Distribution Date all Collections that are in excess of the requirements in the Indenture for the funding of the Operating Expenses, the deposits to the Debt Service Account for the funding of interest on the Bonds, Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments and maintenance of the Liquidity Reserve Account. Such Collections will be deposited in an account established and maintained by the Indenture Trustee under the Indenture (the "**Turbo Redemption Account**"). Turbo Redemptions are not scheduled amortization payments and are to be made only from Collections as described above, if any, and from amounts on deposit in the Partial Lump Sum Payment Account with confirmation from each Rating Agency that no rating then in effect with respect to the Bonds from such Rating Agency will be withdrawn, reduced or suspended. Failure to pay a Turbo Redemption will not constitute an Event of Default under the Indenture.

Effect of Redemptions on Sinking Fund Installments and Turbo Term Bond Maturities. The amount of any Sinking Fund Installments made will be credited against Turbo Term Bond Maturities in chronological order, and the amount of any Turbo Redemptions or optional redemptions of Turbo Term Bonds made will be credited against both Sinking Fund Installments and Turbo Term Bond Maturities in chronological order.

Partial Redemptions. If less than all the Outstanding Bonds are to be redeemed pursuant to the payment of a Sinking Fund Installment, a Turbo Redemption or optional redemption, the particular Bonds of a Maturity Date and series to be redeemed will be selected by the Indenture Trustee by such method as it may deem fair and appropriate, and the Indenture Trustee may provide for the selection for redemption of portions (equal to any authorized denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination.

Event of Default. Upon the occurrence of any Event of Default and on each succeeding Distribution Date, the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Turbo Redemption Account to pay Pro Rata, *first,* the accrued interest on the Bonds and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, *second,* principal on all Bonds then Outstanding, whether or not such principal is then scheduled to be paid.

Open Market Purchase of Turbo Term Bonds

No moneys in any Account may be used to make open market purchases of Turbo Term Bonds.

Sinking Fund Installments

The Series 2002 Turbo Term Bonds maturing on June 1, 2026 and June 1, 2032 are subject to mandatory redemption from Sinking Fund Installments to the extent of available Collections, and if necessary, the Liquidity Reserve Account, in the amounts set forth below on the dates set forth below, at a redemption price equal to 100% of the principal amount thereof to be redeemed, plus interest accrued thereon to the date fixed for redemption:

Series 2002 Turbo Term Bonds
Maturing June 1, 2026

Sinking Fund Installment Date (June 1)	Principal Amount	Sinking Fund Installment Date (June 1)	Principal Amount
2013	$14,605,000	2020	$18,550,000
2014	16,595,000	2021	19,645,000
2015	17,910,000	2022	20,980,000
2016	19,125,000	2023	22,010,000
2017	20,560,000	2024	23,960,000
2018	16,370,000	2025	25,560,000
2019	17,285,000	2026	26,620,000

Series 2002 Turbo Term Bonds
Maturing June 1, 2032

Sinking Fund Installment Date (June 1)	Principal Amount	Sinking Fund Installment Date (June 1)	Principal Amount
2027	$28,265,000	2030	$35,170,000
2028	30,415,000	2031	37,810,000
2029	32,700,000	2032	15,145,000

Optional Redemption

The Series 2002 Bonds maturing on or prior to June 1, 2012 are not subject to optional redemption. The Series 2002 Bonds maturing on June 1, 2026 and June 1, 2032 are subject to redemption (from sources other than Collections or from the proceeds of Refunding Bonds) at the option of the Authority: (1) with respect to Turbo Term Bonds, in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid but, as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (2) with respect to all Series 2002 Bonds, in whole or in part on or after June 1, 2013, from any maturity selected

by the Authority in its discretion and Pro Rata within a maturity, in each case at a redemption price equal to 100% of the principal amount being redeemed.

All optional redemptions will be credited as described under "Payments of Principal—*Effect of Redemptions on Sinking Fund Installments and Turbo Term Bond Maturities*" above. If less than all of the Series 2002 Bonds are to be redeemed, such partial redemption will be made as described under "Payments of Principal—*Partial Redemptions*" above.

Turbo Redemptions

The Turbo Term Bonds are subject to special mandatory Turbo Redemption in chronological order on each Distribution Date, in whole or in part, to the extent of available Collections, at a redemption price equal to 100% of the principal amount thereof to be redeemed, plus interest accrued thereon to the date fixed for redemption. The Accounts and Collections available for Turbo Redemptions are described under "Payments of Principal" above. The following table sets forth the projected Turbo Redemptions for the Series 2002 Turbo Term Bonds. Certain methodologies and assumptions were used to establish the projected Turbo Redemptions, as described under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION." See also "RISK FACTORS—Uncertainty as to Timing of Amortization."

Projected Turbo Redemptions

Turbo Redemption Date	Series 2002 Turbo Term Bonds Maturing June 1, 2026	Series 2002 Turbo Term Bonds Maturing June 1, 2032
2004	$ 7,150,000	
2005	7,725,000	
2006	9,365,000	
2007	10,730,000	
2008	16,890,000	
2009	20,060,000	
2010	23,155,000	
2011	22,445,000	
2012	24,545,000	
2013	42,190,000	
2014	45,785,000	
2015	49,605,000	
2016	130,000	$53,710,000
2017		58,395,000
2018		52,365,000
2019		15,035,000

The Defeased Turbo Term Bonds are subject to mandatory redemption at a redemption price equal to 100% of the principal amount being redeemed. See "THE INDENTURE—Defeasance—*Defeasance of Turbo Term Bonds*."

Mandatory Clean-up Call

The Series 2002 Bonds are subject to mandatory redemption in whole at a redemption price equal to 100% of the principal amount being redeemed at any time that the available amounts on deposit in the Accounts (other than the Rebate Account, the Operating Account, the Operating Contingency Account and the Costs of Issuance Account) exceed the aggregate principal amount of, and accrued interest on, all Outstanding Bonds.

Notice of Redemption

When a Series 2002 Bond is to be redeemed prior to its stated Maturity Date, the Indenture Trustee will give notice in the name of the Authority, which notice will identify the Series 2002 Bonds to be redeemed, state the date fixed for redemption and state that such Series 2002 Bonds will be redeemed at the Corporate Trust Office of the Indenture Trustee or a Paying Agent. The notice will further state that on such date there will become due and payable upon each Series 2002 Bond to be redeemed the redemption price thereof, together with interest accrued to the redemption date, and that money therefor having been deposited with the Indenture Trustee or Paying Agent, from and after such date, interest thereon will cease to accrue. The Indenture Trustee will give 30 days' notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions of the Indenture, to the registered owners of any Series 2002 Bonds which are to be redeemed, at their addresses shown on the registration books of the Authority. Such notice may be waived by any Bondholders holding Series 2002 Bonds to be redeemed. Failure by a particular Bondholder to receive notice, or any defect in the notice to such Bondholder, will not affect the redemption of any other Series 2002 Bond. The Indenture Trustee will not send notice to Bondholders of any optional redemption of Series 2002 Bonds unless the Indenture Trustee has on deposit a sum sufficient to pay the redemption price of, and accrued interest on, the Series 2002 Bonds to be redeemed on such redemption date. Any notice of redemption given pursuant to the Indenture may be rescinded by written notice to the Indenture Trustee by the Authority no later than 15 days prior to the date specified for redemption. The Indenture 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.

Reports by Indenture Trustee

The Indenture Trustee will deliver to each Bondholder, the State and each Rating Agency at least one Business Day prior to each Distribution Date therefor, a statement prepared by the Indenture Trustee containing the following information in reasonable detail:

- the aggregate principal amount of each maturity of the Bonds Outstanding on such Distribution Date, prior to any payments of principal on such Distribution Date (and indicating the Series 2002 Bonds that are "Working Capital Bonds" as identified in the Authority Tax Certificate);

- the aggregate amount of interest to be paid on the Bonds Outstanding on such Distribution Date;

- each of the Serial Maturities, Turbo Redemptions, Turbo Term Bond Maturities and Sinking Fund Installments due to be paid to Holders of each maturity of the Bonds on such Distribution Date; and

- the amount on deposit in each Account as of such Distribution Date, prior to any payments to Bondholders on such Distribution Date.

Book-Entry Only System

The Series 2002 Bonds are expected to be available only in book-entry form through the facilities of 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 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 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, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., 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, and 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 S&P'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.

Purchases of the Series 2002 Bonds under the DTC system, in denominations of $5,000 or any integral multiple thereof, must be made by or through Direct Participants, which will receive a credit for the Series 2002 Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2002 Bond (the "**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 2002 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 2002 Bonds, except in the event that use of the book entry-entry system for the Series 2002 Bonds is discontinued.

To facilitate subsequent transfers, all Series 2002 Bonds deposited by 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 Series 2002 Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2002 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2002 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.

When notices are given, they shall be sent by the Indenture Trustee to DTC only. 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.

Redemption notices shall be sent to DTC. If less than all of the Series 2002 Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2002 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority 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 Series 2002 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Series 2002 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 Authority or the Indenture 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 Indenture Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or any other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Indenture 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.

DTC may discontinue providing its services as securities depository with respect to the Series 2002 Bonds at any time by giving reasonable notice to the Authority and the Indenture Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, Series 2002 Bond certificates are required to be printed and delivered.

THE ABOVE INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE AUTHORITY BELIEVES TO BE RELIABLE, BUT THE AUTHORITY TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF.

Unless and until Series 2002 Bonds have been issued to Bondholders other than DTC, the Authority and each Fiduciary will be entitled to deal with DTC for all purposes of the Indenture (including the payment of such Series 2002 Bonds and the giving of notices, instructions or directions hereunder) as the sole Bondholder, and the rights of Beneficial Owners will be exercised only through DTC.

BENEFICIAL OWNERS SHOULD MAKE APPROPRIATE ARRANGEMENTS WITH THEIR BROKER OR DEALER TO RECEIVE NOTICES (INCLUDING NOTICES OF REDEMPTION) AND OTHER INFORMATION REGARDING THE SERIES 2002 BONDS THAT MAY BE SO CONVEYED TO DIRECT PARTICIPANTS AND INDIRECT PARTICIPANTS.

None of the Authority, the Indenture Trustee or the Underwriters can give any assurance that DTC or DTC Participants will distribute payments of interest, premium, Serial Maturities, Turbo Term Bond Maturities, Sinking Fund Installments, Turbo Redemptions or other redemptions with respect to the Series 2002 Bonds paid to DTC or its nominee, or send any redemption or other notices, to the Beneficial Owners, or that they will do so in a timely manner or that DTC will act in the manner described in this Offering Circular.

THE SALES AGREEMENT

The following summary describes certain terms of the Sales 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 Sales Agreement. Copies of the Sales Agreement may be obtained upon written request to the Authority, 1000 Second Avenue, Suite 2700, Seattle, Washington 98104.

Authority

Pursuant to the Act, the Governor of the State is authorized to sell and assign to the Authority all of the State's right to receive a portion of the State's annual share of the revenue derived from the MSA. The portion of the State's share sold and assigned is to be determined by the Governor in an amount necessary to generate net proceeds to the State for deposit to the Tobacco Securitization Trust Account of up to $450 million. In the 2001-2003 biennial budget, the State Legislature appropriated $450 million from the Tobacco Securitization Trust Account to the State's general fund.

Conveyance of Tobacco Assets

On the Closing Date, and simultaneously with the Authority's delivery of the consideration in accordance with the provisions of the Sales Agreement summarized below under the caption "Purchase Consideration," the State will sell and convey to the Authority without recourse (subject to certain continuing obligations set forth in the Sales Agreement) in accordance with and subject to the terms of the Sales Agreement, all of its right, title and interest on the Closing Date in and to the Tobacco Assets, being that portion, as determined by the Governor of the State by the Sales Agreement pursuant to the Act, necessary to generate net proceeds to the State of $450 million for deposit to the Tobacco Securitization Trust Account created under Section 13 of the Act. The State has acknowledged and consented to the pledge, assignment and grant of a security interest by the Authority to the Indenture Trustee pursuant to the Indenture for the benefit of the Bondholders of any or all right, title and interest of the Authority in, to and under the Tobacco Assets and the assignment of any or all of the Authority's rights and obligations under the Sales Agreement to the Indenture Trustee.

The right of the Authority to receive the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, as Pledged TSRs, is prior to the claim of the State to all other payments received by the State under the MSA on and after the Closing Date and before July 1, 2003. The right of the Authority to receive 29.2% of (1) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto), (2) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003, and (3) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003, as Pledged TSRs, is valid and enforceable and on a parity with the claim of the State to 70.8% of said revenues. Neither the Authority nor the Indenture Trustee shall have the right to make a claim to make up all or any portion of a perceived deficiency in Pledged TSRs from the Unpledged TSRs and, likewise, the State shall have no right to make a claim to make up all or any portion of a perceived deficiency in the Unsold TSRs from the Pledged TSRs.

Purchase Consideration

On the Closing Date, and simultaneously with the State's sale and conveyance of the Tobacco Assets in accordance with the provisions of the Sales Agreement summarized above under the caption "Conveyance of Tobacco Assets," the Authority promises to pay and otherwise convey to the State, without recourse, the proceeds (net of Financing Costs) of the Series 2002 Bonds and the Residual Certificate.

Representations of State

The State makes the following representations on which the Authority is deemed to have relied in acquiring the Tobacco Assets. The representations speak as of the Closing Date, and survive the sale of the Pledged TSRs and the pledge thereof to the Indenture Trustee pursuant to the Indenture.

Power and Authority. The State is duly authorized through the Act to sell the Tobacco Assets and has full power and authority to execute and deliver the Sales Agreement and to carry out its terms.

Binding Obligation. The Sales Agreement has been duly executed and delivered by the State and, assuming the due authorization, execution and delivery of the Sales Agreement by the Authority, 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 required for the consummation of the transactions contemplated by the Sales Agreement, except for those which have been obtained and are in full force and effect.

No Violation. The consummation by the State 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 of any of the material terms and provisions of, or constitute (with or without notice or lapse of time) a material default under any indenture, agreement or other instrument to which the State is a party (including the MSA) 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, and except as may be described in a written certificate of the Attorney General on the Closing Date or as may be disclosed in this Offering Circular, there are no proceedings or investigations pending against the State, before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the State: (1) asserting the invalidity of any of the Transaction Documents or the Series 2002 Bonds, (2) seeking to prevent the issuance of the Series 2002 Bonds or the consummation of any of the transactions contemplated by any of the Transaction Documents, or (3) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of any of the Act, the Consent Decree, the MSA, the Transaction Documents, or the Series 2002 Bonds.

Title to Tobacco Assets. The State is the sole owner of the Tobacco Assets to be sold to the Authority under the Sales Agreement. On and after the Closing Date, (1) the State shall have no right, title or interest in or to the Tobacco Assets, and (2) the Tobacco Assets shall be property of the Authority, and not of the State, and shall be owned, received, held and disbursed by the Authority or the Indenture Trustee and not by the State. Pursuant to the Act and the Sales Agreement, (1) the Pledged TSRs shall be paid directly to the Indenture Trustee, and (2) the Pledged TSRs shall not be received in the treasury of

the State and shall not be or deemed to be "general state revenues" as that term is used in Article VIII, Section 1 of the State Constitution.

True Sale; Absence of Liens on Tobacco Assets. The State is irrevocably selling the Tobacco Assets free and clear of any and all State Liens, pledges, charges, security interests or any other statutory impediments to transfer or conveyance of any nature encumbering the Tobacco Assets. The sale of the Tobacco Assets is, and shall be treated as, a true sale and absolute transfer and conveyance of the property, and all of the right, title and interest in and to such property, so transferred and conveyed, and not as a pledge or any other security interest granted by the State for any borrowing. The characterization by the State of such sale as an absolute transfer or conveyance will not be negated or adversely affected by (1) the sale and assignment pursuant to the Sales Agreement of less than all of the State's tobacco receipts, (2) the issuance and delivery to the State of the Residual Certificate or any other subordinate interest in the Tobacco Assets, (3) any characterization of the Authority or its bonds for purposes of accounting, taxation or securities regulation, or (4) any other factor whatsoever. Upon receipt of the purchase price as set forth in the Sales Agreement, the State will have received equivalent value for the Tobacco Assets.

Assignment to the Indenture Trustee. The State acknowledges and consents to the pledge, assignment and grant of a security interest by the Authority to the Indenture Trustee pursuant to the Indenture for the benefit of the Bondholders and other Beneficiaries, of any or all right, title and interest of the Authority in, to and under the Pledged TSRs. The State acknowledges that the Authority will assign to the Trustee for the benefit of the Bondholders and, other Beneficiaries, all of its rights and remedies with respect to any breach by the State of any of its obligations, representations and warranties under the Sales Agreement, subject, however, to the limitations and provisions set forth in the following paragraph.

The State's acknowledgments and consents in the foregoing paragraph are subject to the condition that any and all pledges, assignment and grants made or to be made by the Authority pursuant to the foregoing paragraph will be limited solely to the Indenture Trustee for the benefit of Bondholders and other Beneficiaries. The Authority agrees that any pledge, assignment and grant it makes in accordance therewith will be limited and restricted so that the Indenture Trustee may not further assign any such rights, remedies and interest to any other person or entity, including any different or additional assignment thereof to Bondholders or other Beneficiaries.

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 person respecting any matters arising under the Sales Agreement.

Neither the State nor any of the officers or employees or agents of the State shall be under any liability to the Authority, except as provided under the Sales Agreement, for any action taken or for refraining from the taking of any action pursuant to the Sales Agreement or for errors in judgment.

Pledges; Protection of Title; Non-Impairment Covenant

The State covenants and agrees with the Authority, and the Authority is authorized to include such covenant and agreement in the Indenture for the benefit of the Beneficiaries, that the State will (1) irrevocably direct the Escrow Agent and Independent Auditor (as such terms are defined in the MSA) to transfer all Pledged TSRs, pursuant to paragraph 5 of section 7 of the Act, directly to the Indenture Trustee, (2) enforce, at the expense of the State, the Authority's rights to receive the Pledged TSRs to the

full extent permitted by the MSA (it being understood that the State may satisfy its obligation under the Sales Agreement by taking such enforcement action through individual or joint or cooperative efforts with other states and their Attorneys General in a manner that it determines as most appropriate), (3) not agree to any amendment of the MSA in any manner that would materially and adversely affect the ability of the Authority to receive the Pledged TSRs, (4) not limit or alter the rights of the Authority to fulfill the terms of its agreements with Beneficiaries until the 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, (5) enforce the Qualifying Statute, and (6) not amend, supersede or repeal the Qualifying Statute in any way that would materially and adversely affect the ability of the Authority to receive the Pledged TSRs.

The State covenants and agrees with the Authority, and the Authority is authorized to include such covenant and agreement in the Indenture for the benefit of the Beneficiaries, that until the Bonds, together with interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of Bondholders, are fully paid and discharged pursuant to the Indenture (1) the State will promptly pay to the Indenture Trustee any Pledged TSRs received by the State, (2) the State will take all actions as may be required by law and the MSA fully to preserve, maintain, defend, protect and confirm the interest of the Authority in the Pledged TSRs and in the proceeds thereof in all material respects, (3) the State will not take any action that will materially and adversely affect the Authority's legal right to receive the Pledged TSRs, and (4) the State will not (a) release any Participating Manufacturer from any of its covenants or obligations to make payment under the MSA or (b) agree to the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, or waive timely performance or observance by Participating Manufacturers under, the MSA, in each case if the effect thereof would be to materially and adversely affect the Authority's ability to receive the Pledged TSRs, provided, however, that if a Rating Confirmation is received relating to such proposed action then such proposed action will be deemed not to be material or adverse.

In accordance with the Act, prior to the date that is 366 days after which the Authority no longer has any Bonds Outstanding, the Authority is prohibited from filing a voluntary petition under Chapter 9 of the Bankruptcy Code or such corresponding chapter or section as may, from time to time, be in effect, and a public official or organization, entity, or other person shall not authorize the Authority to be or become a debtor under Chapter 9 or any successor or corresponding chapter or sections during such periods. In accordance with the Act, this contractual obligation will be part of the contractual obligation owed to Bondholders and may not subsequently be modified by State law prior to the date that is 366 days after which the Authority no longer has any Bonds Outstanding.

Further Actions

Upon request of the Authority or the Indenture Trustee, the State will execute and deliver such further instruments and do such further acts as the parties reasonably agree are reasonably necessary or proper to carry out more effectively the purposes of the Sales Agreement. The State will enforce the provisions of the Qualifying Statute, MSA and the Consent Decree, and exercise such remedies as it considers necessary and appropriate, to assure receipt of payments required to be made under the MSA that constitute Pledged TSRs. Except (1) to the extent limited by the terms and provisions of the MSA and (2) to the extent disclosure may result in the loss of available attorney-client privilege or attorney work product privilege with respect to any documents, documents produced or received by the State in connection with payments, enforcement of, and exercise of remedies under, the Qualifying Statute, the MSA and the Consent Decree will be made available to the Authority and the Trustee.

Tax Covenants

Pursuant to section 7(3)(c) and section 13 of the Act, the State will take no action that would adversely affect the tax exempt status of the Bonds and will allocate the use of the proceeds of the Bonds to enable the interest thereon to be so excluded; and accordingly, in particular, the State agrees as follows:

The State 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 Authority on the Bonds will 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 Series 2002 Bonds that would cause the Bonds to be "private activity bonds" within the meaning of Section 141(a) of the Tax Code or would cause interest on the Bonds to not be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code.

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 Series 2002 Bonds shall at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Bond to be an "arbitrage bond" as defined in the Tax Code and any applicable Treasury Regulations promulgated thereunder.

The State will execute a tax certificate containing all necessary and appropriate representations, covenants, statements of intention and certifications of fact and reasonable expectations for Co-Bond Counsel to render their opinions that interest on the Series 2002 Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Tax Code.

Residual Certificate and Unsold TSRs

The Authority shall determine the amounts of the residual interests represented by the Residual Certificate, and pay and transfer such residual interests to the registered owner of the Residual Certificate. To the extent that the Indenture Trustee shall receive an amount not constituting Pledged TSRs or any other Unsold TSRs, the Authority shall cause the Indenture Trustee to promptly remit such amount to or upon the order of the State.

Bonds Not Debt of State

The Bonds must be issued in the name of the Authority. The Bonds will not be obligations of the State and will be obligations only of the Authority, payable solely from the special fund or funds created by the Authority for their payment. The Bonds must contain a recital on their face to the effect that payment of the principal of, interest on, and prepayment premium, if any, on the Bonds shall be a valid claim only as against the special fund or funds relating thereto, that neither the faith and credit nor the taxing power of the State or any municipal corporation, subdivision, or agency of the State, other than the Authority as set forth in the Act, is pledged to the payment of the principal of, interest on, and prepayment premium, if any, on the Bonds. Contracts entered into by the Authority must be entered into in the name of the Authority and not in the name of the State. The obligations of the Authority under the contracts will be obligations only of the Authority and are not in any way obligations of the State.

Amendment

Except as otherwise provided in the third paragraph of "Pledges; Protection of Title; Non-Impairment Covenant," after issuance of the Series 2002 Bonds, the Sales Agreement may be amended by agreement of the State and the Authority, with the consent of the Indenture Trustee but without the consent of any of the Bondholders: (1) to cure any ambiguity; (2) to correct or supplement any provisions in the Sales Agreement; (3) to correct or amplify the description of the Tobacco Assets; (4) to add additional covenants for the benefit of the Authority; or (5) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in this Sales Agreement that shall not, as evidenced by a Rating Confirmation delivered to the Indenture Trustee, adversely affect in any material respect the Bonds.

In addition to the provisions in the preceding paragraph, the Sales Agreement may also be amended from time to time by the Authority and the State, with the consent of a majority of the Bondholders for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Sales Agreement or of modifying in any manner the rights of the Bondholders, but no such amendment may reduce the aforesaid portion of the outstanding amount of the Bonds, the holders of which are required to consent to any such amendment, without the consent of all of the Bondholders.

Prior to the execution of any amendment to the Sales Agreement, the Indenture Trustee will be entitled to receive and rely upon an Opinion of Counsel stating that the execution of such amendment is authorized or permitted by the Sales Agreement and will not adversely affect the exclusion of interest on any tax-exempt Bonds from gross income for federal income tax purposes. Without the prior written consent of the Indenture Trustee, no amendment, supplement or other modification of the Sales Agreement may be entered into or be effective.

Definitions

In addition to terms defined elsewhere herein, the following terms have the following meanings in this summary, unless the context otherwise requires:

"**Beneficiaries**" means Bondholders, the Indenture Trustee, and to the extent specified in the Indenture, parties to Swap Contracts.

"**Financing Costs**" means (1) any item of expense directly or indirectly payable or reimbursable by the Authority and related to the authorization, sale or issuance of the Series 2002 Bonds, including, without limitation, rating agency fees, underwriting fees, and fees and expenses of attorneys, consultants and fiduciaries and all costs, fees, expenses incurred by the Authority in connection with the issuance of the Series 2002 Bonds; (2) capitalized operating expenses; (3) capitalized interest on the Series 2002 Bonds; (4) all proceeds of the Series 2002 Bonds deposited in any debt service reserve fund to secure the Series 2002 Bonds; and (5) the cost of any credit or liquidity enhancement for the Series 2002 Bonds.

"**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 Tobacco Assets, whether or not as a result of any act or omission by the State.

"**Tobacco Assets**" means the sum of (1) the first $30,000,000 of payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, and (2) 29.2% of:

(a) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto);

(b) all amounts received by the State under the MSA on and after July 1, 2003, consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003; and

(c) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003.

"**Transaction Documents**" means the Sales Agreement, the Indenture and the Bond Purchase Agreement by and between the Authority and Bear, Stearns & Co. Inc., as representative of the underwriters, relating to the sale of the Series 2002 Bonds.

"**Unsold TSRs**" means the right, title and interest to the revenue (including but not limited to all payments required to be made under the MSA) that the State has a right to receive from time to time after the Closing Date under the MSA, other than the Pledged TSRs.

THE INDENTURE

The following summary describes certain terms of the Indenture pursuant to which the Series 2002 Bonds will be issued. This summary does not purport to be complete and is subject and qualified in its entirety by reference to the provisions of the Indenture and the Series 2002 Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee. See "SECURITY" for further descriptions of certain terms and provisions of the Series 2002 Bonds.

No Liability on Bonds

The Board and any person executing the Bonds are not liable personally on the indebtedness or subject to any personal liability or accountability by reason of the issuance thereof.

The Series 2002 Bonds shall not be obligations of the State and shall be obligations only of the Authority, payable solely from the special fund or funds created by the Authority for their payment. Payment of the principal of, interest on, and redemption premium, if any, on the Series 2002 Bonds shall be a valid claim only as against the special fund or funds relating thereto. Neither the faith and credit nor the taxing power of the State or any municipal corporation, subdivision, or agency of the State, other than the Authority as set forth in the Act, is pledged to the payment of the principal of, interest on, and premium, if any, on the Series 2002 Bonds.

Security Interest and Pledge

The Authority assigns and pledges to the Indenture Trustee and grants a first lien on and a first priority security interest in, in trust upon the terms of the Indenture, the Collateral, consisting of all of the Authority's right, title and interest, whether owned on the Closing Date or thereafter acquired, in, to and under the Collateral, consisting of: (1) the Collections, consisting of the Pledged TSRs and all fees, charges, payments, proceeds, collections, investment earnings and other income and receipts paid or payable to the Authority or the Indenture Trustee for the account of the Bondholders (including, without limitation, amounts paid to the Indenture Trustee for the account of the Authority under any Swap Contract); (2) all rights to receive the Collections and the proceeds of such rights; (3) the Accounts (except for the Rebate Account) and assets thereof, including money, contract rights, general intangibles or other personal property, held by the Indenture Trustee under the Indenture; (4) subject to certain rights reserved under the Indenture, all rights and interest of the Authority under the Sales Agreement, including the representations, warranties and covenants of the State in the Sales Agreement; (5) any payment received by the Indenture Trustee pursuant to a Swap Contract; (6) 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; (7) all proceeds of the foregoing; and (8) any and all other property of every kind and nature from time to time after the date of the Indenture, 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 in the Indenture, the foregoing assignment and pledge does not include: (1) the Unpledged TSRs, (2) the rights of the Authority pursuant to provisions for consent or other similar action by the Authority, notice to the Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Bondholders or parties to Swap Contracts, or (3) any right or power reserved to the Authority pursuant to the Act or other law; nor does the foregoing assignment and pledge preclude the Authority's enforcement of its rights under and pursuant to the Sales Agreement for the benefit of the Bondholders or parties to Swap Contracts as provided in the Indenture.

The Unpledged TSRs, and the proceeds of the Bonds, other than the amounts deposited in one or more of the Accounts, do not constitute any portion of the Pledged TSRs, are not pledged to the Bondholders or parties to Swap Contracts and are not subject to the lien of the Indenture. The right of the Authority to receive 29.2% of (1) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto), (2) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003, and (3) all Litigation Expense Reimbursements, Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003, as Pledged TSRs, is valid and enforceable and on a parity with the claim of the State to 70.8% of said revenues. Neither the Authority nor the Indenture Trustee shall have the right to make a claim to make up all or any portion of a perceived deficiency in Pledged TSRs from the Unpledged TSRs and, likewise, the State shall have no right to make a claim to make up all or any portion of a perceived deficiency in the Unpledged TSRs from the Pledged TSRs.

The Authority covenants and agrees that it will implement, protect, and defend the foregoing assignment and pledge by all appropriate legal action for the benefit of the Bondholders and the counterparties to Swap Contracts.

With the exception of Series 2002 Bond proceeds deposited into the Liquidity Reserve Account and the Capitalized Interest Subaccount of the Debt Service Account, the Bondholders have no pledge or lien on the proceeds of the Series 2002 Bonds. Such amounts will not be part of the Collateral.

Defeasance

Total Defeasance. When (1) 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, including any applicable redemption premiums as will provide sufficient funds to pay or redeem all obligations to Bondholders in full (to be verified by a nationally recognized firm of defeasance escrow verification agents) and the Indenture Trustee shall have received an opinion of nationally recognized bond counsel to the effect that such defeasance (a) is authorized or permitted by the Indenture and (b) will not adversely affect the exclusion of interest on the Bonds from gross income for federal income tax purposes, (2) any required notice of redemption has been duly given in accordance with the

Indenture or irrevocable instructions to give notice has been given to the Indenture Trustee, (3) all Swap Payments have been made, (4) all Operating Expenses due and payable constituting termination payments on Swap Contracts, on investment contracts or investment agreements for Accounts, or on forward purchase contracts for investments in Accounts, shall have been paid, (5) the Residual Certificate shall have been surrendered to the Indenture Trustee for cancellation in exchange for a transfer of the Collateral, and (6) all the rights under the Indenture of the Fiduciaries have been provided for, then upon written notice from the Authority to the Indenture Trustee, the Bondholders and counterparties to Swap Contracts 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 of the Indenture, the security interests created by the Indenture (except in such funds and investments) will terminate, and the Authority 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 under the Indenture and to make the Pledged TSRs and other Collateral payable to the order of the Authority. Upon such defeasance, the funds and investments required to pay or redeem the Bonds and other obligations to such Bondholders will be irrevocably set aside for that purpose, and money held for defeasance will be invested only as provided above and applied by the Indenture Trustee and other Paying Agents, if any, to the retirement of the Bonds and such other obligations. Upon the discharge of the Indenture Trustee's lien and security interests created under the Indenture, the Indenture Trustee will execute and deliver such instruments as may be necessary to discharge the Indenture Trustee's lien and security interests created under the Indenture.

Partial Defeasance. Subject to the provisions of the Indenture relating to the tax covenants of the Authority, the Authority may create a defeasance escrow for the retirement and defeasance of any Bonds, and for Swap Payments under Swap Contracts related to such Bonds to be defeased, in accordance with clauses (1) and (2) of *"Defeasance"* above. Thereafter, the Holders of such Defeased Bonds and counterparties to such related Swap Contracts shall cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds held in such defeasance escrow and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien of the Indenture.

Defeasance of Turbo Term Bonds. When the Authority has determined to create a defeasance escrow for the retirement and defeasance of Turbo Term Bonds, the Authority will determine for each such Turbo Term Bond (the "**Defeased Turbo Term Bonds**") of the same Maturity Date and series the optional redemption date or Maturity Date to which amounts in such defeasance escrow will be applied for the payment of principal of, premium (if any) and interest on such Defeased Turbo Term Bond. In addition to payment of interest on each such Defeased Turbo Term Bond on each Distribution Date prior to such redemption date or Maturity Date, as applicable, the Authority will redeem Defeased Turbo Term Bonds of such Maturity Date and series by:

(a) determining the pro rata portion of each Bond principal balance shown in the schedule set forth in the Indenture for such series of Bonds (and with respect to the Series 2002 Bonds, set forth under "THE SERIES 2002 BONDS—Turbo Redemptions—Projected Turbo Redemptions") (the "**Projected Turbo Schedule**") that is allocable to the Defeased Turbo Term Bonds having such Maturity Date (such pro rata portion to be determined using the ratio of (i) the principal amount of the Defeased Turbo Term Bonds of that series and Maturity Date at the time such defeasance escrow is created to (ii) the original principal amount of all Turbo Term Bonds of that series and Maturity Date as of the date of original issuance of such Turbo Term Bonds) (the "**Pro Rata Defeasance Redemption Schedule**");

(b) for the purpose of adjusting the Projected Turbo Schedule for any subsequent defeasances of Turbo Term Bonds of such series having such Maturity Date, permanently

subtracting from each of the amounts set forth in the Projected Turbo Schedule for such Turbo Term Bonds the related amounts set forth in the Pro Rata Defeasance Redemption Schedule;

(c) determining on such date of defeasance the earliest future Distribution Date (or the date of defeasance, if applicable) from and after which the Outstanding principal amount of the Defeased Turbo Term Bonds of such series and Maturity Date is or will be greater than the Bond principal balance set forth in the Pro Rata Defeasance Redemption Schedule for such Distribution Date or date of defeasance, if applicable (such earliest date, or date of defeasance, if applicable, herein called the "**First Defeasance Redemption Date**"); and

(d) reducing the principal amount of such Defeased Turbo Term Bonds to equal, but not be lower than, the related Bond principal balance set forth in the Pro Rata Defeasance Redemption Schedule by redeeming such Defeased Turbo Term Bonds on the First Defeasance Redemption Date (unless such date is the date of defeasance, in which case within 31 days after such date of defeasance), at a redemption price equal to 100% of the Outstanding principal amount thereof, plus interest accrued to the date fixed for redemption, such redemption to be applied Pro Rata to all Defeased Turbo Term Bonds of such Maturity Date.

Establishment of Accounts

The Indenture Trustee will establish and maintain the following segregated trust accounts in the Indenture Trustee's name:

(1) the Collections Account;

(2) the Operating Account;

(3) the Debt Service Account, and therein the Capitalized Interest Subaccount;

(4) the Liquidity Reserve Account;

(5) the Partial Lump Sum Payment Account;

(6) the Operating Contingency Account;

(7) the Turbo Redemption Account; and

(8) the Costs of Issuance Account.

Investments

Generally. Pending its use under the Indenture, money in the Accounts may be invested by the Indenture Trustee in Eligible Investments and will be so invested pursuant to written direction of the Authority if there is not then an Event of Default actually known to an Authorized Officer of the Indenture Trustee. Eligible Investments will mature or be redeemable at the option of the Authority 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 in respect of interest, Serial Maturities, Turbo Term Bond Maturities and Sinking Fund Installments pursuant to the terms of the Indenture on each such next succeeding Distribution Date. Investments will be held by the Indenture Trustee in the respective Accounts and will be sold or redeemed to the extent necessary to make payments or transfers from each Account. The Indenture Trustee will be entitled to

assume, absent receipt by the Indenture Trustee of written notice to the contrary, that any investment that, at the time of purchase, is an Eligible Investment remains an Eligible Investment thereafter.

Valuation. In computing the amount in any Account, the value of Eligible Investments will be determined as of each Deposit Date and will be calculated as follows:

(1) Except as otherwise specifically provided in the Indenture, all Eligible Investments will be valued at fair market value based on accepted industry standards by accepted industry providers, which shall include, but are not limited to, pricing services provided by Bear, Stearns & Co. Inc., Goldman, Sachs & Co. or Financial Times Interactive Data Corporation;

(2) 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;

(3) 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;

(4) as to certificates of deposit and bankers acceptances: the face amount thereof, plus accrued interest; and

(5) as to any investment not specified above: the value thereof established by agreement (prior to the making of such investment) between the Authority and the Indenture Trustee (with written notice to each Rating Agency of such agreement).

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 above will be effective only to the extent they are consistent with other applicable provisions of the Indenture or any separate escrow agreement.

Contract; Obligations to Bondholders

In consideration of the purchase and acceptance by those who hold any or all of the Bonds from time to time, the provisions of the Indenture will be a part of the contract of the Authority with the Bondholders. The pledge and grant of a security interest made in the Indenture and the covenants therein set forth to be performed by the Authority will be for the equal benefit, protection, and security of the Bondholders. All of the Bonds, regardless of the time or times of their Maturity Date, will be of equal rank without preference, priority or distinction of any thereof over any other except as expressly provided pursuant to the Indenture.

The Authority covenants to pay when due all sums payable on the Bonds, but only from the Collections and money designated in the Indenture, subject only to the Indenture. The obligation of the Authority to pay principal, interest, and premium, if any, to the Bondholders from the Collections and other money designated in the Indenture, subject only to the Indenture, 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 Authority represents in the Indenture that it is duly authorized pursuant to law to issue, sell and deliver the Bonds, to enter into the Indenture and to pledge and grant a security interest in the Collections and other Collateral as provided in the Indenture. The Collections and other Collateral are and will be free and clear of any pledge, lien, security interest, 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 Authority to that end has been duly and validly taken. The Bonds and the provisions of the Indenture are and will be the valid and binding obligations of the Authority, enforceable 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.

The State has covenanted and agreed with the Authority in the Sales Agreement, and the Authority is authorized to include such covenant and agreement in the Indenture for the benefit of the Bondholders, any party who has entered into a Swap Contract with the Authority or other parties receiving the express benefit of the security for the Bonds ("**Beneficiaries**"), that the State will (1) irrevocably direct the Escrow Agent and Independent Auditor (as such terms are defined in the MSA) to transfer all Pledged TSRs, pursuant to paragraph 5 of section 7 of the Act, directly to the Indenture Trustee, (2) enforce, at the expense of the State, the Authority's rights to receive the Pledged TSRs to the full extent permitted by the MSA (it being understood that the State may satisfy its obligation thereunder by taking such enforcement action through individual or joint or cooperative efforts with other states and their Attorneys General in a manner that it determines as most appropriate), (3) not agree to any amendment of the MSA in any manner that would materially and adversely affect the ability of the Authority to receive the Pledged TSRs, (4) not limit or alter the rights of the Authority to fulfill the terms of its agreements with Beneficiaries until the 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, (5) to enforce the Qualifying Statute, and (6) not amend, supersede or repeal the Qualifying Statute in any way that would materially and adversely affect the ability of the Authority to receive the Pledged TSRs.

The State has covenanted and agreed with the Authority in the Sales Agreement, and the Authority is authorized to include such covenant and agreement in the Indenture for the benefit of the Beneficiaries, that until the Bonds, together with interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of Bondholders, are fully paid and discharged pursuant to the Indenture (1) the State will promptly pay to the Indenture Trustee any Pledged TSRs received by the State; (2) the State will take all actions as may be required by law and the MSA fully to preserve, maintain, defend, protect and confirm the interest of the Authority in the Pledged TSRs and in the proceeds thereof in all material respects; (3) the State will not take any action that will materially and adversely affect the Authority's legal right to receive the Pledged TSRs; and (4) the State will not (a) release any PM from any of its covenants or obligations to make payment under the MSA or (b) agree to the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, or waive timely performance or observance by PMs under, the MSA, in each case if the effect thereof would be to materially and adversely affect the Authority's ability to receive the Pledged TSRs; *provided,* that if a Rating Confirmation is received relating to such proposed action, then such proposed action will be deemed not to be material or adverse.

The State has provided through the MSA, the Consent Decree and the Sales Agreement for the (1) Authority's ownership and receipt of the Pledged TSRs, (2) the receipt or other application of the net proceeds of the Bonds and (3) the resulting benefits to the people of the State. The Authority acknowledges that the MSA, the Consent Decree and the Sales 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 Sales Agreement constitute important security provisions of the Bonds, the Authority 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 Sales Agreement, the Bondholders 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 Authority thereby 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.

Operating Expenses

The Authority may deliver an Officer's Certificate to the Indenture Trustee on or before April 15 of each year during which Bonds are Outstanding, commencing with the Fiscal Year commencing July 1, 2003, (1) certifying the amount of the Operating Cap for the upcoming Fiscal Year, and (2) specifying the amount of Operating Expenses estimated to be incurred or paid by the Authority during the upcoming Fiscal Year. Such Officer's Certificate may also set forth Operating Expenses that have already been incurred by the Authority but that have not yet been paid or repaid; *provided,* that the Operating Cap will nonetheless continue to apply to all such amounts. In the event that the Authority does not deliver an Officer's Certificate on or prior to any April 15 as described above, the Authority will be deemed to have delivered an Officer's Certificate on such April 15 certifying and specifying that both the amount of the Operating Cap for the upcoming Fiscal Year and the amount of the Operating Expenses estimated to be incurred or paid by the Authority during the upcoming Fiscal Year will be equal to the Inflated Operating Cap Component in effect as of such April 15.

The Authority covenants, for the benefit of the Bondholders, to pay its Operating Expenses, but only to the extent that funds are available for such purpose as provided in the Indenture.

Tax Covenants

The Authority will at all times do and perform all acts and things permitted by law and the Indenture which are necessary or desirable in order to assure that interest paid on the Tax-Exempt Bonds (or any of them) will be excluded from gross income for federal income tax purposes and will take no action that would result in such interest not being excluded from gross income for federal income tax purposes. Without limiting the generality of the foregoing, the Authority agrees that it will comply with the provisions of the Authority Tax Certificate. This covenant will survive defeasance or redemption of the Bonds.

Pursuant to the Act, the State 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 Authority on the Series 2002 Bonds will be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code.

Pursuant to the Act, the State will not directly or indirectly use or permit the use of any of the proceeds of the Series 2002 Bonds that would cause the Series 2002 Bonds to be "private activity bonds" within the meaning of Section 141(a) of the Tax Code or would cause interest on the Series 2002 Bonds to not be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code.

Pursuant to the Act, 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 Series 2002 Bonds will at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Series 2002 Bond to be an "arbitrage bond" as defined in the Tax Code or any applicable Treasury Regulations promulgated thereunder.

Non-Petition Covenant

Prior to the date which is 366 days after the date on which the Authority no longer has any Bonds Outstanding, the Authority will not file a voluntary petition under Chapter 9 of the 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 may authorize the Authority to be or become a debtor under the Bankruptcy Code or any corresponding law during such periods. Pursuant to the Act, the State agrees with the Bondholders that it will not modify or delete these provisions prior to the date which is 366 days after the date on which the Authority no longer has any Bonds Outstanding.

Accounts and Reports

The Authority 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 Bondholders 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.

Ratings

The Authority will pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect ratings on all the Outstanding Bonds from at least two nationally recognized statistical rating organizations.

Affirmative Covenants

Punctual Payment. The Authority will duly and punctually pay debt service on the Bonds in accordance with the terms of the Bonds and the Indenture.

Maintenance of Existence. Unless the Special Conditions are met, the Authority will keep in full effect its existence, rights and franchises as a public entity under the laws of the State.

Protection of Collateral. The Authority will from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to (1) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (2) perfect or protect the validity of any grant made or to be made by the Indenture; (3) preserve and defend title to the Collections and the other Collateral and the rights of the Indenture Trustee, on behalf of 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 MSA, the Indenture, the Sales Agreement or the Authority Tax Certificate or the performance by any party thereunder; (4) enforce the Sales Agreement; (5) pay any and all taxes levied or assessed upon all or any part of the Collateral; or (6) carry out more effectively the purposes of the Indenture.

Performance of Obligations. The Authority (1) will diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the Collateral; (2) 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 Sales Agreement or the Authority Tax Certificate; and (3) with respect to Pledged TSRs, the Authority will direct the Attorney General to enforce, in the name of the State and, if permissible, to enforce directly through the Authority's own attorneys in the name of the State, with notice to the Attorney General, the MSA.

Notice of Events of Default. The Authority will give the Indenture Trustee and Rating Agencies prompt Written Notice of each Event of Default under the Indenture.

Other. The Authority will:

(1) 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;

(2) maintain or contract for a sufficient number of employees and compensate all employees, consultants and agents directly, from the Authority's bank accounts, for services provided to the Authority by such employees, consultants and agents and, to the extent any employee, consultant or agent of the Authority is also an employee, consultant or agent of another Person, allocate the compensation of such employee, consultant or agent between the Authority and such Person on a basis that reflects the services rendered to the Authority and such Person;

(3) 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 Authority 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;

(4) observe all formalities as a distinct entity, and ensure that all actions relating to (a) the dissolution or liquidation of the Authority or (b) the initiation of, participation in, acquiescence in or consent to any bankruptcy, insolvency, reorganization or similar proceeding involving the Authority, are duly authorized by unanimous vote of its members;

(5) 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;

(6) 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;

(7) maintain only those bank accounts or other depository accounts to which the Authority alone is the account party, and from which only the Authority has the power to make withdrawals;

(8) pay all of the Authority's operating expenses from the Authority's own assets (except for expenses incurred prior to the date of issuance of the Series 2002 Bonds);

(9) 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 (a) as a result of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business, (b) the incurrence of obligations under the Indenture, the Sales Agreement or the Authority Tax Certificate, (c) the incurrence of operating expenses in the ordinary course of business of the type otherwise contemplated by the Indenture, the Sales Agreement or the Authority Tax Certificate, and (d) the incurrence of obligations payable solely from specified assets of the Authority not subject to the lien of the Indenture and the holders of which expressly have no recourse to any other assets of the Authority in the event of non-payment;

(10) maintain its organization in conformity with the Indenture; and

(11) object in any relevant bankruptcy case to the consolidation of the assets of the Authority with those of the State.

Negative Covenants

Sale of Assets. Except as expressly permitted by the Indenture, the Authority will not sell, transfer, exchange or otherwise dispose of any of its properties or assets that are subject to the lien of the Indenture.

No Setoff. The Authority will 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. Unless the Special Conditions are met, the Authority will not terminate its existence or dissolve or liquidate in whole or in part.

Limitation of Liens. The Authority will not (1) permit the validity or 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 thereby, (2) 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 on a parity with or senior to the lien of the Indenture or (3) permit the lien of the Indenture not to constitute a valid first priority security interest in the Collateral.

Limitations on Consolidation, Merger, Sales of Assets, etc. Except as otherwise provided in the Indenture, the Authority will not consolidate or merge with or into any other Person, or convey or transfer all or substantially all of its properties or assets, unless the following conditions (the "**Special Conditions**" are met:

(1) an entity survives such event, and such entity is organized and existing under the laws of the United States, the State 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 Authority in the Indenture;

(2) immediately after giving effect to such transaction, no Event of Default has occurred under the Indenture;

(3) the Authority has received a Rating Confirmation;

(4) the Authority has received an opinion of Counsel to the effect that such transaction will not have a material adverse tax consequence to the Authority and will not adversely affect the exclusion of interest on any of the Tax-Exempt Bonds from gross income for federal income tax purposes;

(5) any action as is necessary to maintain the lien and security interest created by the Indenture has been taken; and

(6) the Authority has delivered to the Indenture 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.

Restricted Payments. The Authority will not, directly or indirectly, make distributions from the Collections Account except in accordance with the Indenture.

Swap Contracts. The Authority will not enter into any Swap Contract until it has first obtained a Rating Confirmation with respect to such Swap Contract; nor will the Authority enter into any Swap Contract unless such Swap Contract provides that any payments to be made to or for the benefit of the Authority will be made to the Indenture Trustee for deposit into the Collections Account.

Prior Notice

The Indenture Trustee will give each Rating Agency 15 days' prior written notice of any amendment to the Indenture or the defeasance or redemption of Bonds. The Indenture Trustee will give each Rating Agency 15 days' prior written notice of any amendment (of which the Indenture Trustee has knowledge) to the Sales Agreement.

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 Indenture Trustee will maintain on file with the Authority a written certificate specifying the name, address, telephone number, email address and telefacsimile number of every Authorized Officer of the Indenture Trustee (1) having direct responsibility for the administration of the Indenture or (2) to whom a particular matter is referred because of such officer's knowledge of and familiarity with the particular subject.

The duties and responsibilities of the Indenture Trustee will be as set forth in the Indenture. Notwithstanding the foregoing, no provision of the Indenture will 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 reasonably satisfactory to it against any loss, liability, or expense; *provided,* that the Indenture Trustee will 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.

As Indenture Trustee under the Indenture:

(1) the Indenture Trustee may conclusively rely and will 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 reasonably believed by it to be genuine and to have been signed or presented by the proper person or persons. The Indenture Trustee need not investigate any fact or matter stated in the document, but the Indenture Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit;

(2) before the Indenture Trustee acts or refrains from acting, it may require an Officer's Certificate and/or an opinion of Counsel. The Indenture Trustee will not be liable for any action it takes or omits to take in good faith in reliance on such certificate or opinion. Whenever in the administration of the trusts of the Indenture the Indenture Trustee deems 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 is specifically prescribed in the Indenture) may, in the absence of negligence or bad faith on the part of the Indenture Trustee, be deemed to be conclusively proved and established by an Officer's Certificate delivered to the Indenture Trustee, and such certificate, in the absence of negligence or bad faith on the part of the Indenture Trustee, will be full warrant to the Indenture Trustee for any action taken, suffered or omitted to be taken by it under the provisions of the Indenture upon the faith thereof;

(3) any request, direction, order, or demand of the Authority mentioned in the Indenture will be sufficiently evidenced by an Officer's Certificate (unless other evidence in respect thereof is specifically prescribed in the Indenture); and any Authority resolution may be evidenced to the Indenture Trustee by a copy thereof certified by the secretary or an assistant secretary of the Authority;

(4) prior to the occurrence of an Event of Default under the Indenture and after the curing or waiving of all Events of Default, the Indenture Trustee will not be bound to make any investigation into the facts or matters stated in any resolution, certificate, Officer's Certificate, opinion of Counsel, Authority 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 the Holders of a majority of the principal amount of the Bonds affected and then Outstanding; and if the payment within a reasonable time to the Indenture 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 Indenture Trustee, not reasonably assured to the Indenture Trustee by the security afforded to it by the terms of the Indenture, the Indenture Trustee may require indemnity reasonably satisfactory to it against such expenses or liabilities as a condition to proceeding;

(5) the Indenture Trustee will be under no obligation to exercise any of the rights or powers vested in it by the Indenture at the request or direction of the Authority or Bondholders, unless the Authority or Bondholders have offered to the Indenture Trustee reasonable security or indemnity against the costs, expenses and liabilities which might be incurred by it in compliance

with such request or direction; *provided,* that the Indenture Trustee will make the payments and distributions required by the Indenture without requiring any indemnity be provided to it;

(6) the Indenture Trustee 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 or attorneys;

(7) the recitals contained in the Indenture and in the Bonds, except any such recitals relating to the Indenture Trustee, will be taken as the statements of the Authority, and the Indenture Trustee assumes no responsibility for their correctness. The Indenture Trustee makes no representation as to the validity or sufficiency of the Indenture or of the Bonds. The Indenture Trustee will not be accountable for the use or application by the Authority of the Bonds or the proceeds thereof or of any moneys paid to the Authority pursuant to the terms of the Indenture. The Indenture Trustee will have no responsibility with respect to any information, statement or recital in any offering circular or other disclosure material prepared or distributed with respect to the Bonds. The Indenture Trustee will be responsible, however, for its representations contained in its certificate of authentication pertaining to each Bond;

(8) the Indenture Trustee (a) undertakes to perform such duties and only such duties as are specifically set forth in the Indenture, and no implied covenants or obligations may be read into the Indenture against the Indenture Trustee and (b) in the absence of negligence, bad faith or willful misconduct on its part, may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished pursuant to and conforming to the requirements of the Indenture; but in the case of any such certificates or opinions which by any provision of the Indenture are specifically required to be furnished to the Indenture Trustee, will be under a duty to examine the same to determine whether or not they conform to the requirements of the Indenture; and

(9) the Indenture Trustee will exercise such of the rights and powers vested in it by the Indenture, and following the occurrence of an Event of Default, or a written allegation to the Indenture Trustee that an Event of Default has occurred, use the same degree of care and skill in its exercise as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

Rights and Duties of the Fiduciaries

All money and investments received by the Fiduciaries under the Indenture will 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 of the Indenture.

The Fiduciaries will keep proper accounts of their transactions under the Indenture (separate from its other accounts), which will be open to inspection on reasonable notice by the Authority and its representatives duly authorized in writing.

The Fiduciaries will not be required to monitor the financial condition of the Authority and, unless otherwise expressly provided, will not have any responsibility with respect to reports, notices, certificates or other documents filed with them under the Indenture, except to make them promptly available for inspection by Bondholders.

Each Fiduciary will be entitled to the advice of counsel (who may be counsel for any party) and will not be liable for any action taken 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 will 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; except that the Indenture Trustee and any Paying Agent will make the payments and distributions required by the Indenture without requiring that any further evidence be provided to it. A permissive right or power to act will not be construed as a requirement to act.

The Fiduciaries will 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 will be had for any claim based on the Indenture or the Bonds against any director, officer, agent or employee of any Fiduciary unless such claim is based upon the bad faith, negligence, willful misconduct, fraud or deceit of such person.

Nothing in the Indenture will obligate any Fiduciary to pay any debt or meet any financial obligations to any Person in relation to the Bonds except from money received for such purposes under the provisions of the Indenture or from the exercise of the Indenture Trustee's rights under the Indenture.

The Fiduciaries may be or become the owner of or trade in the Bonds with the same rights as if they were not the Fiduciaries.

Unless otherwise specified by a Supplemental Indenture, the Fiduciaries will not be required to furnish any bond or surety.

The Authority will, as and only as an Operating Expense, indemnify and save each Fiduciary harmless against any expenses and liabilities (including reasonable legal fees and expenses) that it may reasonably incur in the exercise of its duties under the Indenture and that are not due to such Fiduciary's negligence, willful misconduct or bad faith. This paragraph will survive the discharge of the Indenture or the earlier resignation or removal of such Fiduciary.

Nothing in the Indenture will relieve any Fiduciary of responsibility for its negligence, bad faith or willful misconduct.

Paying Agents

The Authority in the Indenture designates the Indenture Trustee as Paying Agent. The Authority may appoint additional Paying Agents, generally or for specific purposes, may discharge a Paying Agent from time to time and may appoint a successor, in each case with written notice to each Rating Agency. The Authority will designate a successor if the Indenture Trustee ceases to serve as Paying Agent. Each Paying Agent will be a bank or trust company eligible under the laws of the State, and will have (together with its corporate parent, if applicable) a capital and surplus of not less than $50,000,000 and be registered as a transfer agent with the Securities and Exchange Commission. The Authority will give notice of the appointment of a successor to the Indenture Trustee as Paying Agent in writing to each Bondholder shown on the books of the Indenture Trustee. A Paying Agent may but need not be the same Person as the Indenture Trustee. Unless otherwise provided by the Authority, the Indenture Trustee as Paying Agent will act as registrar and transfer agent.

Resignation or Removal of the Indenture Trustee

The Indenture Trustee may resign on not less than 30 days' written notice to the Authority, the Bondholders and each Rating Agency. The Indenture Trustee will promptly certify to the Authority that it has given written notice to all Bondholders and such certificate will be conclusive evidence that such notice was given as required by the Indenture. The Indenture Trustee will be removed if rated below investment grade by each Rating Agency and each successor Indenture Trustee must have an investment grade rating from each Rating Agency. The Indenture Trustee may be removed by written notice from the Authority (if an Event of Default has not occurred) or the Holders of a majority of the principal amount of the Outstanding Bonds to the Indenture Trustee, the Authority and each Rating Agency. Such resignation or removal will not take effect until a successor has been appointed and has accepted the duties of Indenture Trustee.

Successor Fiduciaries

In case a Fiduciary resigns or is removed or becomes incapable of acting, or is merged or converted into (or consolidated with) another corporation or association, or sells, assigns or otherwise transfers all or substantially all of its corporate trust business, 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 Authority. If the Indenture Trustee is merged or converted into (or consolidated with) another corporation or association, or if the Indenture Trustee sells, assigns or otherwise transfers all or substantially all of its corporate trust business, then such appointed successor trustee may, but need not, be the corporation or association resulting from such merger, conversion or consolidation. The Authority will notify the Bondholders and each Rating Agency of the appointment of a successor Indenture Trustee in writing within 20 days after the appointment. The Authority will promptly certify to the successor Indenture Trustee that it has given such notice to all Bondholders and such certificate will be conclusive evidence that such notice was given as required by the Indenture. If no appointment of a successor Indenture Trustee is made within 45 days after the giving of written notice in accordance with the provisions of the Indenture relating to the resignation or removal of the Indenture Trustee or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Indenture Trustee or any Bondholder 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 must be a trust company or a bank having trust powers and having a capital and surplus of not less than $50,000,000. Any such successor Indenture Trustee will notify the Authority of its acceptance of the appointment and, upon giving such notice, will 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 the incumbent Indenture Trustee may reasonably require to confirm or perfect any succession under the Indenture.

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, will be sufficient for any purpose of the Indenture (except as otherwise expressly provided) if made in the following manner, but the Authority 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 acknowledgements 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 will be irrevocable and bind all future record and beneficial owners thereof.

Registered Holders

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 Authority 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 of the Indenture, any payment to the registered owner of a Bond will satisfy the Authority's obligations thereon to the extent of such payment.

Events of Default

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

(1) failure to pay, when due, interest on any Bond;

(2) failure to pay, when due, any Serial Maturity, Turbo Term Bond Maturity or Swap Payment;

(3) failure of the Authority 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 Authority by the Indenture Trustee or to the Authority and the Indenture Trustee by the Holders of at least 25% in principal amount of the Bonds then Outstanding. In the case of a default specified in this paragraph, if the default is such that it cannot be corrected within the said 60-day period, it will not constitute an Event of Default if corrective action is instituted by the Authority within said 60-day period and diligently pursued until the default is corrected; or

(4) a material breach by the State of its covenants contained or referred to in "Contract; Obligations to Bondholders," "Tax Covenants" or "Non-Petition Covenant," which breach is not remedied within 60 days after written notice, specifying such default and requiring the same to be remedied, has been given to the Authority and the State by the Indenture Trustee or to the Indenture Trustee, the Authority and the State by the Holders of at least 25% in principal amount of the Bonds then Outstanding. In the case of a default specified in this paragraph, if the default is such that it cannot be corrected within the said 60-day period, it will 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 paragraphs (1) and (2) above, failure to make any payment or to make provision therefor, including any Turbo Redemption or any Sinking Fund Installment, 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.

Remedies

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 will, in its own name by action or proceeding in accordance with law:

(a) enforce all rights of the Bondholders and require the Authority and the State to carry out their respective agreements with the Bondholders;

(b) sue upon the Bonds;

(c) require the Authority to account as if it were the trustee of an express trust for the Bondholders; and

(d) enjoin any acts or things which may be unlawful or in violation of the rights of the Bondholders.

(2) The Indenture Trustee will, 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.

(3) Upon an Event of Default under (1) or (2) under "Events of Default," or a failure actually known to an Authorized Officer of the Indenture Trustee to make any other payment required by the Indenture within 7 days after the same becomes due and payable, the Indenture Trustee will give written notice thereof to the Authority. The Indenture Trustee will give default notices under (3) or (4) under "Events of Default" 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 this section for the benefit of the Bondholders in accordance with the written direction of the Holders of a majority 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 shall 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.

(4) The Holders of a majority in aggregate principal amount of the Outstanding Bonds may direct the time, method and place of conducting any proceeding for any remedy available to the Indenture Trustee with respect to the Indenture; *provided,* that (a) such direction is not in conflict with any rule of law or with the Indenture, (b) the Indenture Trustee has been provided with indemnity reasonably satisfactory to it, and (c) the Indenture Trustee may take any other action deemed proper by it that is not inconsistent with such direction.

Payment of Bonds Upon Event of Default. Upon the occurrence of any Event of Default and on each succeeding Distribution Date, the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Turbo Redemption Account to pay Pro Rata, *first,* the accrued interest on the Bonds and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, *second,* principal on all Bonds then Outstanding, whether or not such principal is then scheduled to be paid.

Individual Remedies. No one or more Bondholders may 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 therein provided; and all proceedings at law or in equity to enforce any provision of the Indenture will be instituted, had and maintained in the manner provided therein 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 on each of such Holder's Bonds at and after the same comes due pursuant to the Indenture, or the obligation of the Authority to pay the principal, premium, if any, and interest on each of the Bonds to the respective Holders thereof at the time, place, from the source and in the manner expressed in the Indenture and in the Bonds.

Venue. The venue of every action, suit, or special proceeding against the Authority will be laid in the Superior Court of the State of Washington for King County.

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 Authority, and will do so upon written instruction of the Holders of at least 25% in principal amount of the Outstanding Bonds.

Supplements and Amendments to the Indenture

(1) The Indenture may be:

(a) supplemented in writing by the Authority and the Indenture Trustee to (i) provide for earlier or greater deposits into the Debt Service Account, (ii) subject any additional property to the lien of the Indenture, (iii) add to the covenants and agreements of the Authority or surrender or limit any right or power of the Authority, (iv) identify particular Bonds for purposes not inconsistent with the Indenture, including remarketing and defeasance, (v) cure any ambiguity or defect, or (vi) 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, and (vii) to provide any other things relative to the Bonds that are not materially adverse to the Holders of Outstanding Bonds as evidenced by a Rating Confirmation; or

(b) amended in writing by the Authority and the Indenture Trustee, (i) to add provisions that are not materially adverse to the Bondholders, (ii) to adopt amendments that do not take effect unless and until (A) no Bonds Outstanding prior to the adoption of such amendment remain Outstanding or (B) such amendment is consented to by such Bondholders in accordance with the further provisions of the Indenture, or (iii) pursuant to the following paragraph (2).

(2) Except as provided in the foregoing paragraph (1), the Indenture may be amended in writing by the Authority and the Indenture Trustee:

(a) only with written notice to the Rating Agencies and the written consent of the Holders of a majority of the principal amount of the Bonds to be Outstanding at the effective date thereof and affected thereby; but

(b) only with the unanimous written consent of the affected Bondholders for any of the following purposes: (i) to extend the stated Maturity Date of any Bond, (ii) to reduce the principal amount, applicable premium or interest rate of any Bond, (iii) to make any Bond redeemable other than in accordance with its terms, or (iv) 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 must 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 Tax-Exempt Bonds in gross income for federal income tax purposes.

When the Authority determines that the requisite number of consents have been obtained for an amendment to the Indenture or to the agreement which requires consents, it will 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 Authority 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 by the Indenture. It will not be necessary for the consent of Bondholders pursuant to the Indenture amendment provisions of the Indenture to approve the particular form of any proposed amendment, but it will be sufficient if such consent approves the substance thereof.

Supplements and Amendments to the Sales Agreement

Except as otherwise provided in the third paragraph of "THE SALES AGREEMENT—Pledges; Protection of Title; Non-Impairment Covenant" and "THE INDENTURE—Non-Petition Covenant," after issuance of the Series 2002 Bonds, the Sales Agreement may be amended by agreement of the State and the Authority, with the consent of the Indenture Trustee but without the consent of any of the Bondholders, for any purpose that will not adversely affect the Bonds in any material respect, as evidenced by (1) a Rating Confirmation and (2) an Opinion of Counsel that the amendment is permitted under the Sales Agreement and will not adversely affect the tax exemption of interest on the Tax-Exempt Bonds. The Sales Agreement may also be amended for any purpose, other than as provided in the third paragraph of "THE SALES AGREEMENT—Pledges; Protection of Title; Non-Impairment Covenant" and "THE INDENTURE—Non-Petition Covenant," or other than to reduce the number of Bondholders specified in the Indenture required to consent to an amendment of the Sales Agreement, by satisfying the conditions in the previous sentence and by obtaining the consent of the Holders of a majority in aggregate principal amount of Outstanding Bonds.

It will not be necessary for the consent of Bondholders pursuant to the Sales Agreement amendment provisions of the Indenture to approve the particular form of any proposed amendment or consent, but it will be sufficient if such consent approves the substance thereof.

Definitions

In addition to terms defined elsewhere in the Indenture, the following words and terms as used in the Indenture will have the following meanings unless the context or use clearly indicates another or different meaning or intent:

"**Authority Tax Certificate**" means the Issuer Tax Certificate executed by the Authority at the time of issuance of the Series 2002 Bonds, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"**Authorized Officer**" means, (1) in the case of the Authority, the Chairperson, the Secretary, and any other person authorized to act by the Board members under the Indenture by appropriate Written Notice to the Indenture Trustee, and (2) 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.

"**Bondholders**" means the registered owners of the Bonds from time to time as shown on the books of the Indenture Trustee.

"**Corporate Trust Office**" means (1) the office of the Indenture Trustee at which the corporate trust business of the Indenture Trustee related to the Indenture will, at any particular time, be principally administered, which office is, at the date of the Indenture, located at 1420 Fifth Avenue, 7th Floor, Seattle, Washington 98101, and (2) with respect to payments on the Bonds and any exchange, transfer or surrender of the Bonds, means 180 East Fifth Street, St. Paul, Minnesota 55101 or such other location designated by the Indenture Trustee in writing to the Authority, DTC and each Rating Agency.

"**Counsel**" means nationally recognized bond counsel or such other counsel as may be selected by the Authority for a specific purpose under the Indenture.

"**Default**" means an Event of Default without regard to any declaration, notice or lapse of time.

"**Defeasance Collateral**" means money and any of the following:

(1) 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 Authority 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 excludes investments in mutual funds and unit investment trusts;

(2) 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);

(3) certificates evidencing ownership of the right to the payment of the principal of and interest on obligations described in clause (2); *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;

(4) 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 (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 (1), (2) or (3) which fund may be applied only to the payment when due of such bonds or other obligations; and

(5) investment arrangements that are rated, or with providers whose senior unsecured debt obligations are rated, in the highest long-term and short-term rating categories by each Rating Agency.

"**Defeased Bonds**" means Bonds that remain in the hands of their Holders but are no longer deemed Outstanding.

"**Eligible Investments**" means (in each case to the extent that such is a legal investment for moneys of the Authority):

(1) Defeasance Collateral;

(2) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, the Federal Home Loan Mortgage Corporation, Fannie Mae, the Federal Home Loan Bank, the Federal Farm Credit System, the Export-Import Bank of the United States, the Federal Financing Bank, the Government National Mortgage Association, the Farmers' Home Administration, the Federal Housing Administration, the Private Export Funding Corporation, the Resolution Trust Company or the Student Loan Marketing Association;

(3) 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 "A-1+" by S&P, "P-1" by Moody's and "F1" by Fitch;

(4) certificates, notes, warrants, bonds, obligations, or other evidences of indebtedness of a state or a political subdivision thereof rated by each Rating Agency rating such bonds in one of its three highest rating categories;

(5) commercial or finance company paper (including both non-interest-bearing discount obligations and interest bearing obligations) having short-term ratings of "A-1+" by S&P, "P-1" by Moody's and "F1" by Fitch and that are either (a) payable at par on demand or on a specified date at least 191 days, but not more than 270 days, after the date of issuance thereof and that have long-term ratings of "AA" by S&P, "Aa1" by Moody's and "AA" by Fitch, (b) payable at par on demand or on a specified date at least 100 days, but not more than 190 days, after the date of issuance thereof and that have long-term ratings of "A" by S&P, "A1" by Moody's and "A" by Fitch, or (c) payable at par on demand or on a specified date not more than 99 days, after the date of issuance thereof;

(6) repurchase obligations with respect to any security described in clauses (1), (2), or (3) above entered into with a primary dealer, depository institution, or trust company (acting as principal) rated "A-1+" by S&P, "P-1" by Moody's, and "F1" by Fitch (if payable on demand or on a specified date no more than three months after the date of issuance thereof), or rated by each Rating Agency rating such bonds in one of its three highest long-term rating categories, or

collateralized by securities described in clauses (1), (2), or (3) 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 (a) a specific written agreement governs the transaction, (b) 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 (i) a Federal Reserve Bank, or (ii) 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, (c) 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 (d) 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% or, if greater, the amount then required by S&P in order that the ratings then assigned by S&P to the Bonds will not be lowered or suspended;

(7) 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 "P-1" by Moody's, "A-1+" by S&P, and "F1" 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;

(8) units of taxable or tax-exempt money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated by each Rating Agency rating such bonds in one of its three highest rating categories, 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 (a) 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, (b) the Indenture 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;

(9) 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, by each Rating Agency rating such agreements, contracts, or obligations, as the case may be, in one of its three highest rating categories, if the Authority has an option to terminate such agreement in the event that such rating is downgraded below the rating on the Bonds, or if not so rated, then collateralized by securities described in clauses (1), (2), or (3) 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 (a) a specific written agreement governs the transaction, (b) 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 (i) a Federal Reserve Bank, or (ii) 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 has received written confirmation

from such third party that it holds such securities, free and clear of any lien, as agent for the Indenture Trustee, (c) the agreement has a term of 30 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 (d) 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% or, if greater, the amount then required by S&P in order that the ratings then assigned by S&P to the Bonds will not be lowered or suspended; the investment agreements described in this paragraph include investment agreements to be entered into by the Authority on the Closing Date; and

(10) 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 redeemed at a price less than its purchase price prior to its stated maturity. Any references to Fitch in this definition apply only if and to the extent that the obligations described are then rated by Fitch.

"**Fiduciary**" means the Indenture Trustee and each Paying Agent, if any.

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

"**Fitch**" means Fitch Ratings or its successor.

"**Holders**" means the registered owners of the Bonds from time to time as shown on the books of the Indenture Trustee.

"**Inflated Operating Cap Component**" means the amount determined from time to time pursuant to clause (1) of the definition of the term "Operating Cap."

"**Officer's Certificate**" means a certificate signed by an Authorized Officer of the Authority.

"**Outstanding**" when used as to Bonds, or a series thereof, as the context requires, means Bonds issued under the Indenture, excluding: (1) Bonds that have been exchanged or replaced, or delivered to the Indenture Trustee for credit against a principal payment; (2) Bonds that have been paid in full; (3) 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; (4) Bonds the payment of which has been provided for pursuant to the defeasance provisions of the Indenture; and (5) 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 Authority, or any Person controlling, controlled by or under common control with the Authority. 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.

"**Rating Confirmation**" means, with respect to the Bonds, written confirmation from each Rating Agency which, at the request of the Authority, assigned a rating and continues to have a rating assigned to the Bonds, to the effect that the then-current rating assigned by such Rating Agency to the Bonds, without regard to any bond insurance or any other form of credit enhancement, will not be withdrawn, reduced or suspended solely as a result of the proposed action for which such written confirmation is sought.

"**Residual Certificate**" means an instrument in the form of Appendix B to the Indenture, evidencing the right to receive any amounts remaining in any Account after all deposits and payments set forth in the Indenture have been made and there are no Bonds Outstanding.

"**Serial Maturity**" means the principal amount required to be made on a Serial Bond on its Maturity Date.

"**Swap Contract**" means an interest rate exchange, cap, collar, hedge or similar agreement entered into by the Authority.

"**Swap Payment**" means any payment from Collateral with respect to a Swap Contract, except that such payments shall not include any payment to be made by the Authority to a counterparty with respect to the termination of the Swap Contract.

"**Tax-Exempt Bonds**" means all Bonds so identified in any Series Supplement, including the Series 2002 Bonds.

"**Turbo Term Bond Maturity**" means the principal amount required to be made on a Turbo Term Bond on its Maturity Date.

"**Unpledged TSRs**" means the payments received by the State under the MSA on and after the Closing Date and before July 1, 2003, other than the first $30,000,000 of such payments, (2) all Litigation Expense Reimbursements received by the State under the MSA on and after July 1, 2003, and (3) 70.8% of:

(a) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto);

(b) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003; and

(c) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003.

"**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.

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal problems that could affect the Series 2002 Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the Pledged TSRs to be reduced or eliminated. References in the discussion to various opinions of Hawkins, Delafield & Wood are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions.

Bankruptcy of a PM May Delay or Reduce Payments

Because the only source of payment for the Series 2002 Bonds (other than amounts in the Liquidity Reserve Account and the Capitalized Interest Subaccount) is the 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 payments on the Series 2002 Bonds, and the Bondholders and Beneficial Owners could incur losses on their investments.

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 Authority, the Indenture Trustee, the Bondholders or the Beneficial Owners 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. Hawkins, Delafield & Wood will render an opinion, subject to all the facts, assumptions and qualifications stated therein, that in a properly presented and argued case, there being no precedent directly on point, a court of competent jurisdiction should hold that the MSA constitutes an executory contract under the Bankruptcy Code. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Hawkins, Delafield & Wood 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, regulations, rulings 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 payments on the Series 2002 Bonds. With respect to matters of State law, Hawkins, Delafield & Wood will rely on an opinion of Preston Gates & Ellis LLP.

On the other hand, even 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 payments to the Bondholders and Beneficial Owners.

Furthermore, in a bankruptcy proceeding, payments previously made to the Bondholders might be avoidable as preferential payments, so that the Bondholders and 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 Authority, the Indenture 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 payments to the Bondholders and Beneficial Owners.

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.

Certain smokers, consumer groups, cigarette manufacturers, cigarette importers, cigarette distributors, native American tribes, taxpayers, taxpayers' groups and other parties have instituted lawsuits against various tobacco manufacturers, including the PMs, as well as certain of the Settling States and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, certain of 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 moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. By way of example, and not by limitation, in *A.D. Bedell Wholesale Co. v. Philip Morris, Inc.,* certain tobacco wholesalers brought an action against Philip Morris, Reynolds Tobacco and B&W alleging that certain sections of the MSA violated the Sherman Antitrust Act. The District Court dismissed the case holding that the defendant OPMs were immune from antitrust liability under both the Noerr-Pennington ("NP") and Parker immunity doctrines. The Court of Appeals on June 19, 2001, affirmed the District Court's dismissal of the case. The Court of Appeals held that defendants were immune from antitrust liability under the NP doctrine but not under the Parker immunity doctrine. The Court of Appeals had earlier explained that in reviewing the District Court's decision, it would have to affirm the dismissal if the defendant OPMs were immune under either the NP doctrine or the Parker immunity doctrine. In July 2001, the plaintiffs filed a request for an en banc hearing before the Third Circuit, which request was denied. Attorneys for Bedell filed a petition for a writ of certiorari in the U.S. Supreme Court on October 19, 2001. On January 7, 2002, the U.S. Supreme Court denied the petition.

On October 31, 2001, the same attorneys representing Bedell filed a lawsuit in a Pennsylvania federal district court against two state officials (*Mariana v. Fisher*) seeking to enjoin the State of Pennsylvania from receiving moneys payable to it under the MSA, alleging that the MSA violates federal antitrust laws and certain provisions of the United States Constitution. On June 17, 2002, the court dismissed plaintiffs' claims, holding that the defendant state officials were immune from the antitrust laws under the NP doctrine and that plaintiffs could prove no set of facts to establish that the MSA violates the Commerce or Compact clauses of the U.S. Constitution.

Legal enforcement of the terms of the MSA may continue to be challenged in the future. To date, no such lawsuits have been successful. 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, the Bondholders could incur a complete loss of their investment. See "RISK FACTORS—Limited Remedies."

In rendering the opinion described below, Hawkins, Delafield & Wood considered the claims asserted in the above-referenced federal and state actions, which Hawkins, Delafield & Wood believe 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, Hawkins, Delafield & Wood will render an opinion to the Authority that under federal and State law, the MSA is a valid,

binding and enforceable obligation of the signatories thereto and that the MSA has been duly authorized, executed and delivered by the State, acting through its Attorney General. The opinions of Hawkins, Delafield & Wood as to the enforceability of the MSA and the obligations of the aforementioned signatories is also subject to the effect of bankruptcy, insolvency, and other laws affecting creditors' rights or remedies and general principles of equity, regardless of whether such enforceability is considered in a proceeding in equity or at law.

In rendering their enforceability opinion with respect to the MSA, Hawkins, Delafield & Wood has assumed (1) the due organization and valid existence of each signatory to the MSA, (2) the due authorization, execution and delivery of the MSA by each such signatory, other than the State (acting through its Attorney General), and each signatory's full power, authority and legal right to execute and to deliver, and to perform and observe the provisions of, the MSA, (3) that the execution, delivery and performance by each such signatory (other than the State acting through its Attorney General), does not (a) violate the provisions of the organizational documents of such signatory, (b) violate any judgment, decree, writ, injunction, award, determination or order applicable to any such signatory, or (c) conflict with, or result in a breach of, or constitute a default under, any of the provisions of any indenture, mortgage, deed of trust, contract or other instrument to which such signatory is a party, and (4) the absence of the need for any consent, approval, order or authorization of, or filing with or notice to, any court or other governmental authority in respect of each such signatory that was not obtained. With respect to matters of State law, Hawkins, Delafield & Wood will rely on an opinion of the Attorney General of the State.

Qualifying Statute Constitutionality

Certain cases which challenged the enforceability of the MSA also challenged the Model Statute. Other cases have also challenged the Model Statute as part of an antitrust theory or as violative of certain provisions of the U.S. Constitution. 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 Model Statute, as enacted by the respective states (collectively, the "**State Defendants**"). The plaintiffs challenged the MSA and sought to enjoin the passage or enforcement, as the case may be, of the Model Statute (termed by the plaintiffs and the district court, the "**Qualifying Statute**"). The complaint alleged, among other things, that the passage, implementation and/or enforcement of the Model Statute would violate federal and state antitrust laws and 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. The district court found that jurisdiction did not exist over the non-California State Defendants, but dismissed with prejudice all federal antitrust and constitutional claims against the PMs and the California State Defendants based on the merits.

In *Star Scientific, Inc. v. Beales*, a cigarette manufacturer brought suit against the attorney general of the State of Virginia challenging the MSA and seeking to have Virginia's Model Statute declared unconstitutional and enjoined. The plaintiff tobacco manufacturer made similar claims as the plaintiffs in PTI, alleging that the MSA and Model Statute violated the Due Process, Equal Protection, Commerce, Compact and Takings Clauses of the U.S. Constitution. The district court dismissed plaintiff's claims, and on January 22, 2002, the Fourth Circuit Court of Appeals affirmed the district court's order dismissing the case. On October 7, 2002, the U.S. Supreme Court denied the plaintiff's petition for a writ of certiorari. On June 24, 2001, in *North American Trading Company and International Tobacco Partners, LLC v. NAAG*, plaintiffs filed an action against various parties, including the Attorney General of the State, in the United States District Court for the District of Columbia alleging certain constitutional

and antitrust claims and that the Model Statute is unenforceable as to importers of foreign-made cigarettes intended for resale in the United States. Plaintiffs requested an injunction to prevent the enforcement of the Model Statute as it applies to such importers. On September 18, 2001 the District Court dismissed the case. On July 1, 2002, a civil complaint was filed as *Grand River Enterprises Six Nations, Ltd. v. Pryor* in the United States District Court for the Southern District of New York by six cigarette manufacturers, importers and distributors against 31 parties in their official capacity as Attorneys General of various states, including the Attorney General of the State. The suit alleges that the provisions of the Model Statute and the enforcement thereof by the defendants violate various provisions of the U.S. Constitution and federal laws.

Although a determination that the Model 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. See "RISK FACTORS—Risks Related to Enforceability or Modification of the Master Settlement Agreement and Constitutionality of the Model Statute—*Model Statute*."

In rendering the opinion described below, Hawkins, Delafield & Wood considered the claims asserted in the above-referenced federal actions as well as other federal and State constitutional and statutory claims, which they believe are representative of the legal theories that an opponent of the Model Statute would advance in an attempt to invalidate the Model Statute. Subject to the assumptions and qualifications set forth below, Hawkins, Delafield & Wood will render an opinion that the State's Model Statute is valid and enforceable under both federal and State law, and as such, is enforceable against the NPMs. The opinion of Hawkins, Delafield & Wood as to the enforceability of the State's Model Statute is limited to the extent that enforceability may be affected by bankruptcy, insolvency and other laws affecting creditors' rights or remedies heretofore or hereafter enacted, and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

In rendering their enforceability opinion with respect to the Model Statute, Hawkins, Delafield & Wood has relied upon a letter agreement dated February 7, 2001, from counsel to the OPMs confirming that the OPMs would not dispute that the State's Model Statute constitutes a Model Statute under the MSA. With respect to matters of State law, Hawkins, Delafield & Wood will rely on an opinion of Preston Gates & Ellis LLP.

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

The opinions of Hawkins, Delafield & Wood described above expressly note that a court's decision regarding the matters upon which Hawkins, Delafield & Wood and are 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 such opinions, such as that the MSA or Model Statute is void or voidable, it would not necessarily constitute reversible error. Consequently, an opinion of Hawkins, Delafield & Wood 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 Hawkins, Delafield & Wood 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 Hawkins, Delafield & Wood as to specific questions of law. Such opinions 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 entirety by the opinions themselves.

Enforcement of Rights to Pledged TSRs

It is possible that the State could in the future attempt to claim some or all of the Pledged TSRs for itself, or otherwise interfere with the security for the Series 2002 Bonds. In that event, the Series 2002 Bondholders, the Indenture Trustee or the Authority could assert claims based on contractual or constitutional rights.

Contractual Remedies. The Sales Agreement obligates the State to take all necessary action to protect the Authority's interest in the Pledged TSRs in all material respects. Thus, if the State violates the provisions of the MSA so as to impair the Authority's right to the Pledged TSRs, the Indenture Trustee, as assignee of the Authority's rights under the Sales Agreement, could seek to compel the State to enforce its payment rights under the MSA.

Constitutional Claims. The Bondholders are further entitled to the benefit of the prohibitions in the Contract Clause of the United States Constitution against any state's impairment of the obligation of contracts. This prohibition, although not absolute, is particularly strong when applied to a state's attempt to evade its own obligations.

Based on the U.S. Supreme Court's standard of review for Contract Clause challenges in *Energy Reserves Group, Inc. v. Kansas Power & Light Co.,* 459 U.S. 400 (1983), the State must justify the exercise of its inherent police power to safeguard the vital interests of its people before the State may alter the MSA, the Consent Decree or the financing arrangements in a manner that would substantially impair the rights of the Bondholders to be paid from the Pledged TSRs. However, to justify the enactment by the State of legislation that substantially impairs the contractual rights of the Bondholders to be paid from the Pledged TSRs, the State must demonstrate a significant and legitimate public purpose, such as the remedying of a broad and general social or economic problem. In the event that the State demonstrates a significant and legitimate public purpose for such legislation, the State must also show that the impairment of the Bondholders' rights are based upon reasonable conditions and are of a character appropriate to the public purpose justifying the legislation's adoption.

Finally, the Bondholders may also have constitutional claims under the Due Process Clauses of the United States and Washington Constitutions.

CONTINUING DISCLOSURE UNDERTAKING

The Authority covenants in the Indenture (and any obligations of the Authority to disseminate reports as described herein will be undertaken by the Indenture Trustee on behalf of the Authority) for the sole benefit of the Holders of the Series 2002 Bonds (and, to the extent specified herein, the beneficial owners) and subject (except to the extent otherwise expressly provided herein) to the remedial provisions of the Indenture, that the Authority will provide:

(1) within 210 days after the end of each Fiscal Year, to each nationally recognized municipal securities information repository and to any State information depository, (a) its audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, (b) material historical quantitative data on the Authority's revenues, expenditures, financial operations and indebtedness, generally of the types discussed in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" under the last column in the table captioned "Projection of Total Payments to be Received by the Authority" in this Offering Circular, and (c) the debt service coverage for the most recent Fiscal Year for the Outstanding Bonds, after giving credit for any Turbo Redemptions that have been paid; and

(2) in a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to any State information depository, notice of any of a failure to comply with clause (1) above and, if material, notice of any of the following events with respect to the Outstanding Bonds, if material: (a) principal, scheduled mandatory redemption and interest payment delinquencies; (b) non-payment related Defaults; (c) unscheduled draws on debt service reserves reflecting financial difficulties; (d) unscheduled draws on credit enhancements reflecting financial difficulties; (e) substitution of credit or liquidity providers, or their failure to perform; (f) adverse tax opinions or events affecting the tax-exempt status of the Series 2002 Bonds; (g) modifications to rights of Bondholders; (h) bond calls; (i) defeasances; (j) release, substitution, or sale of property securing repayment of the Bonds; and (k) rating changes.

The Authority does not undertake to provide such notice with respect to:

(1) credit enhancement if: (a) the enhancement is added after the primary offering of the Bonds, (b) the Authority does not apply for or participate in obtaining the enhancement and (c) the enhancement is not described in this Offering Circular;

(2) a mandatory, scheduled redemption not otherwise contingent upon the occurrence of an event, if: (a) the terms, dates and amounts of redemption are set forth in detail in this Offering Circular, (b) the only open issue is which Bonds will be redeemed in the case of a partial redemption, (c) notice of redemption is given to the Holders as required under the terms of the Indenture and (d) public notice of the redemption is given pursuant to Release No. 23856 of the Securities and Exchange Commission (the "**SEC**") under the Securities Exchange Act of 1934, as amended, even if the originally scheduled amounts may be reduced by prior optional redemptions or purchases; or

(3) tax exemption other than pursuant to Section 103 of the Tax Code;

(4) the amount of each receipt of Pledged TSRs; or

(5) failure to comply with clause (1) as set forth in the second paragraph of this section.

No Bondholder may institute any suit, action or proceeding at law or in equity ("**Proceedings**") 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 Authority evidence of ownership and a written notice of a request to cure such breach, and the Authority has refused to comply within a reasonable time. All Proceedings must be instituted only as specified in the Indenture, and for the equal benefit of all Holders of the Outstanding Bonds, and no remedy may be sought or granted other than specific performance of the covenant at issue. Any beneficial owner of Bonds of a Series described herein may bring a Proceeding to enforce the Undertaking set forth herein without acting in concert if: (1) such beneficial owner has filed with the Authority evidence of beneficial ownership and written notice of, and request to cure, the alleged breach, (2) the Authority has failed to comply within a reasonable time and (3) such beneficial owner stipulates that no remedy is sought other than substantial performance of the Undertaking. To the extent permitted by law, each beneficial owner agrees that all Proceedings will be instituted only for the equal benefit of all beneficial owners of the Outstanding Bonds benefited by the same or a substantially similar undertaking.

No default under the Undertaking will constitute an Event of Default under the Indenture.

Any amendment to the Undertaking may only be entered into if all or any part of the Rule, as interpreted by the staff of the SEC at the time of sale of the Series 2002 Bonds, ceases to be in effect for

any reason and the Authority elects that the Undertaking will be deemed terminated or amended (as the case may be) accordingly, or if

> (1) 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 Authority, or type of business conducted;
>
> (2) the Undertaking, as amended, would have complied with the requirements of the Rule at the time of sale of the Series 2002 Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances;
>
> (3) the amendment does not materially impair the interests of Bondholders or beneficial owners of the Series 2002 Bonds, as determined by parties unaffiliated with the Authority (such as, but without limitation, the Authority's financial advisor or bond counsel) or by Bondholder consent pursuant to the Indenture; and
>
> (4) 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.

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.

TAX MATTERS

Opinions of Co-Bond Counsel

In the opinions of Hawkins, Delafield & Wood and Preston Gates & Ellis LLP, as Co-Bond Counsel, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (1) interest on the Series 2002 Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Tax Code, and (ii) interest on the Series 2002 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Tax 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 their opinions, Co-Bond Counsel have relied on certain representations, certifications of fact, and statements of reasonable expectations made by the Authority and the State in connection with the Series 2002 Bonds, and Co-Bond Counsel have assumed compliance by the Authority and the State with certain ongoing covenants to comply with applicable requirements of the Tax Code to assure the exclusion of interest on the Series 2002 Bonds from gross income under Section 103 of the Tax Code.

Co-Bond Counsel express no opinion regarding any other Federal or state tax consequences with respect to the Series 2002 Bonds. Co-Bond Counsel render their opinions under existing statutes and court decisions as of the issue date, and assume no obligation to update their opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. Co-Bond Counsel express 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 2002 Bonds, or under state and local tax law.

Certain Ongoing Federal Tax Requirements and Covenants

The Tax Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Series 2002 Bonds in order that interest on the Series 2002 Bonds be and remain excluded from gross income under Section 103 of the Tax Code. These requirements include, but are not limited to, requirements relating to use and expenditure of gross proceeds of the Series 2002 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 2002 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 Authority and the State have covenanted to comply with certain applicable requirements of the Tax Code to assure the exclusion of interest on the Series 2002 Bonds from gross income under Section 103 of the Tax Code.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral Federal income tax matters with respect to the Series 2002 Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of a Series 2002 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 2002 Bonds.

Prospective owners of the Series 2002 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 not included in gross income for Federal income tax purposes. Interest on the Series 2002 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 Tax 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 2002 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 2002 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 2002 Bonds is expected to be the initial public offering price set forth on the inside cover of this Offering Circular. Co-Bond Counsel further are of the opinion that, for any Series 2002 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 Tax Code is excludable from gross income for federal income tax purposes to the same extent as other interest on the Series 2002 Bonds.

In general, under Section 1288 of the Tax 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 Discount 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.

Bond Premium

In general, if an owner acquires a Series 2002 Bond for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on the Series 2002 Bond after the acquisition date (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates), that premium constitutes "bond premium" on that Series 2002 Bond (a "**Premium Bond**"). In general, under Section 171 of the Tax Code, an owner of a Premium Bond must amortize the bond premium over the remaining term of the Premium Bond, based on the owner's yield over the remaining term of the Premium Bond, determined based on constant yield principles. An owner of a Premium Bond must amortize the bond premium by offsetting the qualified stated interest allocable to each interest accrual period under the owner's regular method of accounting against the bond premium allocable to that period. In the case of a tax-exempt Premium Bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost. Owners of any Premium Bonds should consult their own tax advisors regarding the treatment of bond premium for Federal income tax purposes, including various special rules relating thereto, and state and local tax consequences, in connection with the acquisition, ownership, amortization of bond premium on, sale, exchange, or other disposition of Premium Bonds.

Possible Government Action

Legislation affecting municipal bonds is regularly under consideration by the United States Congress. In addition, the IRS has established an expanded audit program for tax-exempt bonds. There can be no assurance that legislation enacted or proposed or an audit initiated or concluded by the IRS after the issue date of the Series 2002 Bonds involving either the Series 2002 Bonds or other tax-exempt bonds will not have an adverse effect on the tax-exempt status or market price of the Series 2002 Bonds.

IRS Audits

The IRS examined several outstanding tax-exempt bond issues secured by tobacco settlement revenues. The IRS closed its examinations of the three earliest tax-exempt bond issues of this type on behalf of New York City, Westchester County, New York, and Nassau County, New York, with no change in the tax-exempt status of the interest on such bonds under Section 103 of the Tax Code. Other pending IRS audits of tax-exempt bonds of this type, if any, or future IRS audits of tax-exempt bonds of this type or others, however, could adversely affect the tax-exempt status of the interest on the Series 2002 Bonds under Section 103 of the Tax Code, depending on all the facts and circumstances. The pendency or outcome of any such IRS audit also could have an adverse effect on the market for or the market price of the Series 2002 Bonds.

RATINGS

It is expected that the Series 2002 Bonds will be assigned a rating of "A" by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("**S&P**") and a rating of "A1" by Moody's Investors Service, Inc. ("**Moody's**" and together with S&P, the "**Rating Agencies**").

The ratings address each Rating Agency's assessment of the payment of interest on the Series 2002 Bonds when due and the payment of Serial Maturities and Turbo Term Bond Maturities when due. The ratings do not address the payment of Sinking Fund Installments or Turbo Redemptions.

The ratings by S&P and Moody's of the Series 2002 Bonds reflect only the views of such organizations and any desired explanation of the significance of such ratings and any outlooks or other statements given by such Rating Agencies with respect thereto should be obtained from the Rating Agency furnishing the same, at the following addresses: Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., 55 Water Street, New York, New York 10004; Moody's Investors Service, Inc., 99 Church Street, New York, New York 10007.

There is no assurance that the initial ratings assigned to the Series 2002 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 any of the Rating Agencies. 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 the Series 2002 Bonds.

UNDERWRITING

The underwriters set forth on the cover (the "**Underwriters**") have jointly and severally agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2002 Bonds from the Authority at an underwriters' discount of $3,473,644.66. The Underwriters will be obligated to purchase all of the Series 2002 Bonds if any are purchased. The initial public offering prices of the Series 2002 Bonds may be changed from time to time by the Underwriters.

Bear, Stearns & Co. Inc. is acting as representative on behalf of the Underwriters.

The Series 2002 Bonds may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Series 2002 Bonds into investment trusts) at prices lower than such public offering prices.

LEGAL MATTERS

The Authority has not been served with and is not aware of any litigation pending in any court (either State or federal) to restrain or enjoin the issuance or delivery of the Series 2002 Bonds, or questioning the creation, organization or existence of the Authority, the validity or enforceability of the Indenture, the transfer of the Pledged TSRs by the State to the Authority, the proceedings for the authorization, execution, authentication and delivery of the Series 2002 Bonds or the validity of the Series 2002 Bonds. For a discussion of other legal matters, including certain pending litigation involving the MSA and the PMs, see "RISK FACTORS," "TOBACCO INDUSTRY" and "LEGAL CONSIDERATIONS."

Hawkins, Delafield & Wood and Preston Gates & Ellis LLP, as Co-Bond Counsel to the Authority, will render opinions with respect to the validity of the Series 2002 Bonds in substantially the form set forth in Appendix C. Certain legal matters will be passed upon for the State by the Attorney General of the State and for the Underwriters by Orrick, Herrington & Sutcliffe LLP, as Underwriters' Counsel.

OTHER PARTIES

DRI•WEFA

DRI•WEFA, Inc. ("**DRI•WEFA**") has been retained on behalf of the Authority as an independent econometric consultant. DRI•WEFA has announced that it intends to change its name to Global Insight (USA), Inc. The DRI•WEFA Report attached as Appendix A hereto is included herein in reliance on DRI•WEFA as experts in such matters. DRI•WEFA's fees for acting as independent economic consultant are not contingent upon the issuance of the Series 2002 Bonds. The DRI•WEFA Report should be read in its entirety before purchasing any Series 2002 Bonds.

Financial Advisors

Public Financial Management Inc. and CSG Advisors Inc. (collectively, the "**Financial Advisors**") have been retained to act as financial advisors to the Authority in connection with certain aspects of the issuance of the Series 2002 Bonds. Although the Financial Advisors assisted in the preparation of this Offering Circular, the Financial Advisors are not obligated, and have not undertaken, to make an independent verification or assume responsibility for the accuracy, completeness or fairness of the information contained in this Offering Circular.

TOBACCO SETTLEMENT AUTHORITY

By /s/ Richard S. Swanson
Chair

INDEX OF DEFINED TERMS

PAGE

Accounts S-2
Act S-6
Actual Operating Income 21
Actual Volume 20
Annual Payments S-3
Authority 1
Authority Tax Certificate 113
Authorized Officer 113
B&W S-3
Bankruptcy Code 13
Base Aggregate Participating Manufacturer Market Share 21
Base Case Forecast 52
Base Operating Income 21
Base Share 23
Base Volume 20
Beneficial Owner 86
Beneficiaries 93
Board 76
Bond Structuring Methodology 61
Bond Year S-11
Bondholders 113
Bonds S-12
Broin I 39
Broin II cases 8
Business Day 81
Cash Flow Assumptions 61
CDC 55
cigarette 18
Closing Date S-6
Co-Bond Counsel S-14
Collateral S-2, 77
Collections S-2, 77
Consent Decree S-5, 30
Corporate Trust Office 113
Counsel 113
CPC S-6
CPI 20
debt service coverage ratio 69
Default 113
Defeasance Collateral 113
Defeased Bonds 114
Defeased Turbo Term Bonds 96
Deposit Date S-10
Direct Participants 86
Discount Bond 125

PAGE

Distribution Date S-7, 2
DRI•WEFA S-5, 128
DRI•WEFA High Forecast 74
DRI•WEFA Low Case 1 75
DRI•WEFA Low Case 2 75
DRI•WEFA Low Case 3 75
DRI•WEFA Report S-6, 51
DTC S-6, 81
DTCC 86
EC 12, 49
Eligible Investments 114
EPA 36
ETS 35
Event of Default S-12, 109
FDA 3
Federal Tobacco Legislation Offset 22
Fiduciary 116
Final Approval S-4, 25
Financial Advisors 128
Financing Costs 93
First Defeasance Redemption Date 97
Fiscal Year 116
Fitch 116
Foundation 26
Guaranteed Amount 11, 44
Holders 116
incidence 55
Income Adjustment 21
Indenture 1
Indenture Trustee 1
Indirect Participants 86
Inflated Operating Cap Component 116
Inflation Adjustment 20
Initial Payments S-3
IRS 15
Liggett 10
Liquidity Reserve Account S-8
Liquidity Reserve Requirement S-8
Litigating Releasing Parties Offset 23
Litigation Expense Reimbursements 1
Loews S-5
Lorillard S-3
Lump Sum Payment S-9
Market Share 23
Maturity Date S-7
Model Statute 27

Moody's 127
MSA Auditor.... 4
MSA Escrow Agent 18
MSA Escrow Agreement 18
NAAG 5
Non-Participating Manufacturers.... S-3
Non-Released Parties 23
notice in writing 117
NPM Adjustment.... 21
NPMs.... S-3
Officer's Certificate.... 116
Offset for Claims-Over.... 23
Offset for Miscalculated or Disputed Payments.... 22
OID.... 125
Operating Cap S-10
Operating Expenses.... S-10
OPMs.... S-3
Original Participating Manufacturers.... S-3
OSHA.... 36
Outstanding 116
Partial Lump Sum Payment.... S-9
Participating Manufacturers S-3
Paying Agent.... 116
Person.... 117
Philip Morris S-3
Pledged TSRs.... 1
PMs S-3, 15
Premium Bond.... 126
Previously Settled States 15
Previously Settled States Reduction.... 21
Pro Rata.... S-7
Pro Rata Defeasance Redemption Schedule ... 96
Proceedings 123
Projected Turbo Redemption.... S-8
Projected Turbo Schedule 96
Qualifying Statute 27, 120
Rating Agencies 127
Rating Confirmation.... 117
Record Date.... 81
Refunding Bonds.... S-12, 81
Relative Market Share.... 18
Released Parties.... 17
Released Party.... 17
Releasing Parties 17
Residual Certificate.... 117
Reynolds Tobacco.... S-3
RICO.... 11
S&P.... 127
Sales Agreement S-5
SEC 123
Serial Maturity 117
Series 2002 Bonds.... 1
Settling States.... S-3
Sinking Fund Installment.... S-7, 82
Special Conditions 103
SPMs.... S-3, 15
State.... 1
State Defendants 120
State Lien 93
State-Specific Finality.... 25
Stipulating Defendants.... 10, 44
Stipulation.... 10, 44
Strategic Contribution Payments S-4
Subsequent Participating Manufacturers.... S-3
Swap Contract.... 117
Swap Payment.... 117
Tax Code.... S-14
Tax-Exempt Bonds 117
Tobacco Assets 93
Tobacco Products.... 26
Tobacco Settlement Revenues S-4
Total Lump Sum Payment S-9
Transaction Documents.... 94
TSRs.... S-4
Turbo Redemption Account.... S-7, 82
Turbo Redemptions.... S-7, 82
Turbo Term Bond Maturity.... 117
Undertaking.... 123
Underwriters 127
United States 18
Unpledged TSRs S-1, 117
Unsold TSRs.... 94
USDA.... 34
USDA-ERS 34
Vector.... 32
Volume Adjustment.... 20
written notice 117
Written Notice.... 117

APPENDIX A

DRI•WEFA REPORT

A Forecast of U.S. Cigarette Consumption (2001-2032) for the Tobacco Settlement Authority

Submitted to:

Tobacco Settlement Authority

Prepared by:

DRI•WEFA, Inc.

October 10, 2002

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Group Managing Director

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Executive Summary

DRI•WEFA has developed a cigarette consumption model based on historical U.S. data between 1965 and 2000. 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 2001 through 2032. Our Base Case Forecast indicates that total consumption in 2032 will be 247 billion cigarettes (approximately 12.4 billion packs), a 43% decline from the 2000 level. We also present alternative forecasts that project higher and lower paths of cigarette consumption. Under these, less likely, scenarios we forecast that by 2032 US cigarette consumption could be as low as 230 billion and as high as 260 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 DRI•WEFA'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.

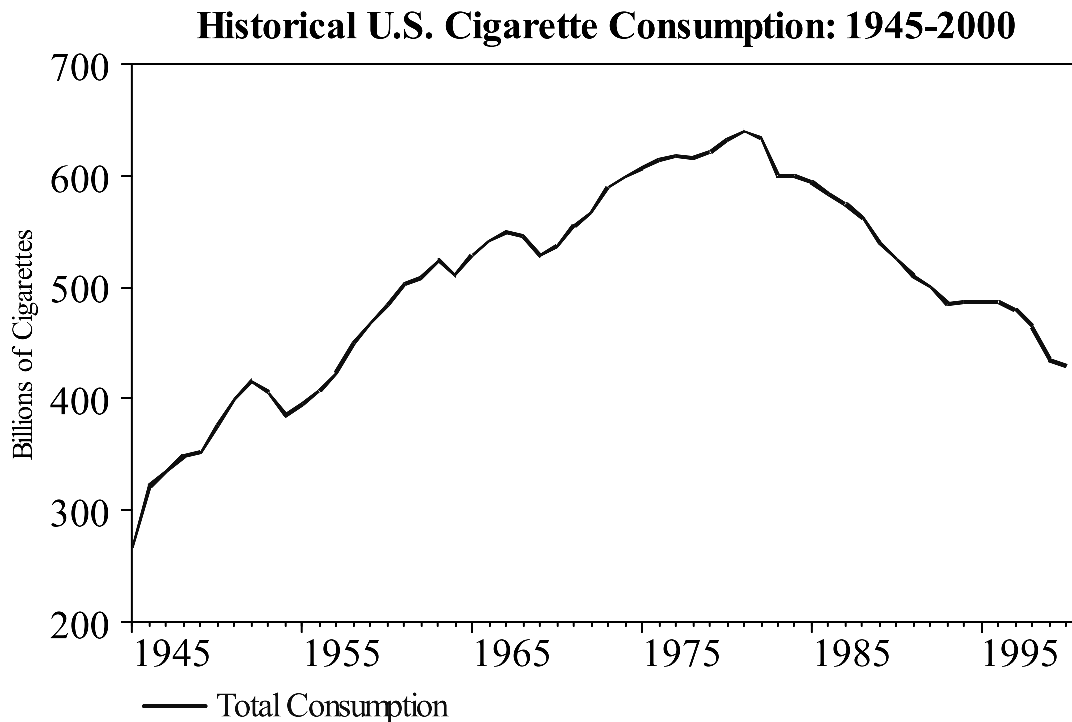
This forecast differs slightly from the one presented by DRI•WEFA in 2001 ("DRI•WEFA's 2001 Forecast"). In the year 2000, lower than expected prices, resulted in higher than expected consumption. The United States Department of Agriculture ("USDA"**),** now estimates a consumption level for year 2000 of 430 billion, 7 billion more than DRI•WEFA's forecast in 2001. DRI•WEFA has also revised its year 2001 consumption estimate upwards, to 419 billion from 408 billion. This forecast also differs somewhat from one presented to other issuers earlier in 2002. While that forecast had anticipated some state excise tax increases in response to state budget difficulties, a slightly greater number of states than expected have raised taxes on cigarette purchases, and as a result, consumption is projected to be lower in the near term. Cigarette consumption is now expected to fall to 403 billion in 2002, 2 billion fewer than the forecast of early 2002, and to 394 billion in 2003, 4 billion fewer than the earlier forecast.

Disclaimer

The projections and forecasts regarding future cigarette consumption included in this 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. 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, 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[1]. 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[2] as reported by the Bureau of Alcohol Tobacco and Firearms. The United States Department of Agriculture ("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[3]. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998 and 430 billion cigarettes in 2000[4].



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

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

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

[4] *Source*: USDA-ERS, September 2001.

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, exceeding previous levels by 1934. Following the release of the Surgeon General's 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 then the decline for 1999 accelerated to 6.45%. These sharp recent declines are correlated with large price increases in 1998 and 1999.

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 recent declines are correlated with large price increases in 1998 and 1999. All percentages are based upon compound annual growth rates.

The following table sets forth United States domestic cigarette consumption for the six years ended December 31, 2000[5]. 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 Master Settlement Agreement dated November 23, 1998 (MSA) 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.

U.S. Cigarette Consumption

Year Ended December 31,	Consumption (Billions of Cigarettes)	Percentage Change
2000	430	-1.15
1999	435	-6.45

[5] *Source*: USDA-ERS.

1998	465	-3.13
1997	480	-1.44
1996	487	0.00
1995	487	0.21

The US Cigarette Industry

The cigarette market is an oligopoly in which, according to reports of the manufacturers, the four leading manufacturers accounted for almost 94% of the market in 2001. These top four companies in shipments were Philip Morris, RJ Reynolds, Brown & Williamson, and Lorillard, who occupied 50.9 percent, 22.3 percent, 10.9 percent, and 9.5 percent of the market respectively, as reported by each individual manufacturer.

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 percent in 1950 to approximately 0.5 percent today. In 2000, the federal government received $7.5 billion in excise tax revenue from tobacco sales. In addition, state and local governments also raise significant revenues, $8.7 billion in 2000, from excise and sales taxes. Cigarettes constitute the majority of these sales, which include cigars and other tobacco products.

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 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 46.5 million American adults were current smokers in 2000, representing approximately 23.3% of the population age 18 and older, according to a Centers for Disease Control and Prevention ("CDC") study[6] released in July 2002. 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,[7] the incidence rate declined relatively slowly through the next decade. The National Center for Health Statistics also presents a preliminary estimate of adult incidence for 2000 of 23.3%.[8]

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 2001, however, the incidence had fallen to 28.5%, just 3.6% above the 1991 level.[9]

The Youth Tobacco Surveillance (YTS) report, issued in November 2001 by the CDC, is a supplement to the Youth Risk Behavior Survey.[10] The YTS covers calendar year 2000 and provides more comprehensive data on tobacco use among both middle and high school students as well as data on secondhand smoke exposure, ability to obtain tobacco products, and knowledge of, and attitudes about, tobacco and tobacco advertising (both pro- and anti-tobacco). Some of the results pertaining to cigarette use can be found in the table below.

Youth Risk Behavior Survey

	Middle School Students Grades 6-8	High School Students Grades 9 -12
Ever Used Tobacco	36.3%	64.0%

[6] *Source*: CDC. Morbidity and Mortality Weekly Report, "Cigarette Smoking Among Adults – United States, 2000," July 26, 2001.
[7] *Source*: CDC, Office on Smoking and Health.

[8] *Source*: National Center for Health Statistics, National Health Interview Survey. September 20, 2001

[9] *Source*: CDC, Morbidity and Mortality Weekly Report, "Trends in Cigarette Smoking Among High School Students ---United States, 1991-2001," May 17, 2002.
[10] CDC, CDC Surveillance Summaries, November 2, 2001, MMWR 2001:50(No.SS-4).

Current Cigarette Users	11.0%	28.0%
Ever Smoked Cigarettes Daily	5.5%	20.6%
First Smoked Before Age 11	8.4%	6.7%

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 among eighth, tenth and twelfth graders was lower in June 2001 than in June 2000, the fourth consecutive annual decline. However, incidence levels for 10th and 12th graders continue to remain higher than in June 1991.[11] Smoking incidence for 8th graders has fallen below its level in 1991.

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

Grade	June 1991	June 2000	June 2001	'00-'01 Change (%)	'91-'01 Change (%)
8th	14.3	14.6	12.2	-16.4	-14.7
10th	20.8	23.9	21.3	-10.9	2.40
12th	28.3	31.4	29.5	-6.1	4.24

The 2000 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 55.7 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 25.8% in 1999. The same survey found that an estimated 13.4% of youths age 12 to 17 were current cigarette smokers in 2000, a decrease from 14.9% in 1999.

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

[11] *Source*: University of Michigan , Monitoring the Future Study, December 2001.

generally fallen between an interval of -0.3 to -0.5.[12] (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 recently 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 1997.[13] 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.[14] 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.

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 10% increase in cigarette prices, will reduce smoking participation among college students by 2.6% and will reduce the level of smoking among current college students by 6.2%."[15]

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[12] Chalpouka FJ,Warner KE:P.5.

[13] *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.

[14] 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.

[15] 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.

Tauras et al. 2001) conducted a study that looked at the effects of price on teenage smoking initiation.[16] 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 1-5 cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticites of initiation are –0.27 for any smoking, -0.81 for smoking at least 1-5 cigarettes, and –0.96 for smoking at least one-half pack of cigarettes. These results above indicate that a 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.

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.[17] 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."

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.[18] Their results suggest that workplace smoking bans reduce smoking prevalence by 5 percentage points and reduce consumption by smokers nearly 10 percent. 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.

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[16] Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press, Copyright 2001.

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

[18] *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.

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 be incorporated into current levels of consumption.

General Population Growth. DRI•WEFA forecasts that the United States population will increase from approximately 272 million in 1999 to approximately 365 million in 2032. This forecast is consistent with the Bureau of the Census forecast based on the 1990 Census. On December 28, 2000 the Bureau reported results from the 2000 Census that estimate the US population on April 1, 2000 to be 281 million. We have not yet incorporated this data into our analysis because it has yet to be reconciled, by the Bureau, to its 1990 estimate. That 1990 Census estimate likely suffered from a significant undercount of population. As the USDA, in its estimate of per capita consumption, also uses the estimates based on the 1990 Census, our forecast is consistent with its history. When the correct population data from 1990 to 2000 is released, it is expected to show that per capita consumption of cigarettes was slightly lower than originally thought, but that its growth trend is the same. We do not expect the revised population and per capita consumption levels to affect our forecast of total cigarette consumption.

Price Elasticity of Demand & Price Increases. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5. Based on DRI•WEFA's multivariate regression analysis using data from 1965 to 1999, the long run price elasticity of consumption for the entire population is -0.31; a 1.0% increase in the price of cigarettes decreases consumption by 0.31%.

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 intended to offset the costs of the MSA and agreements with previously settled states. The cigarette manufacturers have since increased wholesale prices on seven occasions: in August 1999 by $0.18 per pack, in January 2000 by $0.13 per pack, in July 2000 by $0.06 per pack, in December 2000 by $0.14 per pack, on April 25, 2001 by $0.14 per pack, on October 29, 2001 by $0.05 per pack, and most recently on April 1, 2002 by $0.12 per pack. For the year 2000, we estimate that the average price per pack was $3.20, representing a nominal growth in the price of cigarettes of 11.0% from 1999. For 2001, we estimate that the average price was $3.45.

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, Maine, Rhode Island, Washington, West Virginia, and Wisconsin all increased their tax on cigarettes. They were followed, in January 2002, by a scheduled increase in the federal excise tax of $0.05 per pack, and in April 2002, by excise tax increases in New York and Connecticut. As a result of these increases, we estimate that average retail prices across the U.S. had risen, in May 2002, to $3.64 per pack.

On July 1, 2002 excise tax increases went into effect in Illinois, Indiana, Kansas, Louisiana, Maryland, New Jersey, New York City, Ohio, Pennsylvania, Rhode Island, Utah, and Vermont. Also, Hawaii, Massachusetts, Michigan, Nebraska, Oregon, and Tennessee have scheduled tax increases later in 2002. These increases range from $0.07 per pack in Tennessee to $1.42 per pack in New York City. They average $0.47 per pack, and will boost the nationwide average retail price by $0.18. The average state excise tax is now over $0.60 per pack. These states are among at least thirty states which have considered increases in excise taxes as a response to budget shortfalls following the 2001 recession. This will result in an average price per pack that increases from $3.50 at the start of 2002 to $3.80 in July, and to over $4.00 in 2003. Over the longer term our forecast expects price increases to continue to exceed the general rate of inflation due to costs related to the MSA and further increases in excise taxes, among other reasons.

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. Under the MSA, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped.

***Changes in Disposable Incom*e**. 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.[19] However, a few studies found cigarette consumption decreases as disposable income increases.[20] Based on our multivariate regression analysis using data from 1965 to 1999, 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,[21] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[22] One study examines the effects of

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[19] Ippolito, et al.; Fuji.

[20] Wasserman, et al.; Townsend et al.

[21] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.

[22] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."

youth smoking on future adult smoking.[23] 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. Our 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.

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, 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.

Smoking Bans in Public Places. Beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. As of 1999, 48 states and the District of Columbia required smoke-free indoor air to some degree or in some public places.[24] Based on the regression analysis using data from 1965 to 1999, the restrictions on public smoking appear to have an independent effect on per capita

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[23] *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.

[24] *Source*: American Lung Association, "State Legislated Actions on Tobacco Issues", 1999.

cigarette consumption. We estimate that the restriction instituted beginning in the late 1970's has reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. 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.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[25] and the American Medical Association[26] (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

[25] *Source:* Surgeon General's 1988 Report, "The Health Consequences of Smoking – Nicotine Addiction".

[26] *Source*: Council on Scientific Affairs, "Reducing the Addictiveness of Cigarettes, "Report to the AMA House of Delegates, June 1998.

by Farrelly, Pechacek, and Chaloupka.[27] They estimate that tobacco control program expenditures between 1988 and 1998 resulted in a decline in cigarette sales of 3%.

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.[28] 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 growers 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 calls 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.

Our research has indicated, and our model incorporates, a negative impact on cigarette consumption of 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. 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 percent of cigarette packs. In addition, it would prohibit in-store promotions and require that all advertising and packaging be black-and-white. 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, by 2003, only cigarettes that self-extinguish. We expect that an agreement will be reached by then on a nationwide standard. We do not believe that either the New York statute or a nationwide agreement will affect consumption noticeably. It will probably raise the cost of

[27] "The Impact of Tobacco Control Program Expenditures on Aggregate Cigarette Sales: 1981-1998." Working Paper No. 8691, :. National Bureau of Economic Research, 2001.

[28] "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.

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.

Similarly, on January 16, 2001, Vector Group Ltd. announced plans to introduce a virtually nicotine-free cigarette. 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.

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 DRI•WEFA's standard adult population growth, and adjustment for non-adult smoking, we projected actual cigarette consumption (in billions of cigarettes) out to 2032. 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 1999 on the variables described above, we developed the following regression equation. All of the data sources are detailed in Appendix 1 of this Report.

$$\log(cpc) = 53.3410 - 0.02316 * trend - 0.21193 * \log(cigprice) - 0.09367 * \log(cigprice)(-1) + 0.26979 * \log(ydp96pc) - 0.01901 * smokeban$$

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 per cent of the variation in US adult per capita cigarette consumption over the 1965 to 1999 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. We estimate youth consumption in 1999 at 5.92 billion cigarettes. Youth incidence is expected to gradually decline, and our estimated consumption levels will fall to 3.4 billion in 2032.

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 per cent 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 –0.21 measures the short-run elasticity of cigarette demand. That is, a 1% increase in price reduces consumption by 0.21% in the current year. The second coefficient, -0.09 relates to prices in the previous year. It indicates that, following a 1% increase, an additional decrease in cigarette consumption of 0.09% will occur. Thus, according to the data, a one per cent increase in price decreases cigarette consumption by 0.31 (.3055) per cent 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 -0.24 and -0.38. 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 percent. 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 2.32 per cent 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 (53.34) 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 DRI•WEFA 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 brought prices to an average of $2.88 per pack in 1999 and $3.20 in 2000. The most recent increase of $0.12 on April 1, 2002, coupled with excise tax increases, brings the current retail price to approximately $3.85. Our consumption model anticipates that for the year 2002 the average price per pack will be $3.71, and that this will increase further to $3.98 in 2003. Much of this increase will be due to state excise tax increases. These increases will result in retail price growth in excess of 7% per year in 2002 and 2003. Price increases will then moderate for a few years as state tax increases that would have been expected over the 2004 to 2006 period were accelerated into 2002. The cigarette manufacturers will be less aggressive in raising prices in the short term as well, in order to compensate for the state actions which reduce cigarette demand. At the same time, coincidentally, payments due under the MSA will fall after the last initial payment in January 2003.

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 manufacture is dominated by a few firms, price changes will typically be discrete events, with jumps such as occurred on August 31, 1999 and December 18, 2000, 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.

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 over $15 by 2032, which is $6.55 in 2000 dollars, more than double the actual price on $3.20 in 2000. Relative to other goods, cigarette prices will rise by an average of 2.26% 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 not taper off until 2003, despite recent administrative initiatives to curb underage smoking. This is due to the momentum provided by current youth smokers. We then assume that youth smoking declines following the longer term trend of the 1970's and 1980's. By 2032 we assume that youth smoking will have declined at an average annual rate of 1.7% since 2000, or by 43% overall.

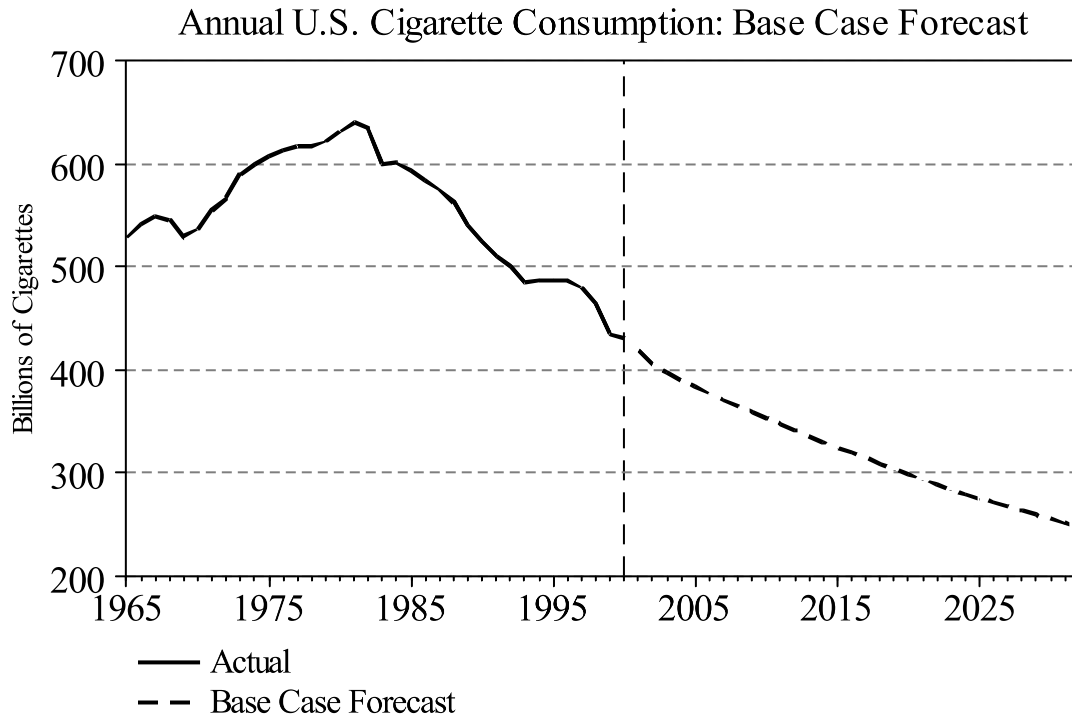
We believe the assumptions on which the Base Case Forecast are based to be reasonable.

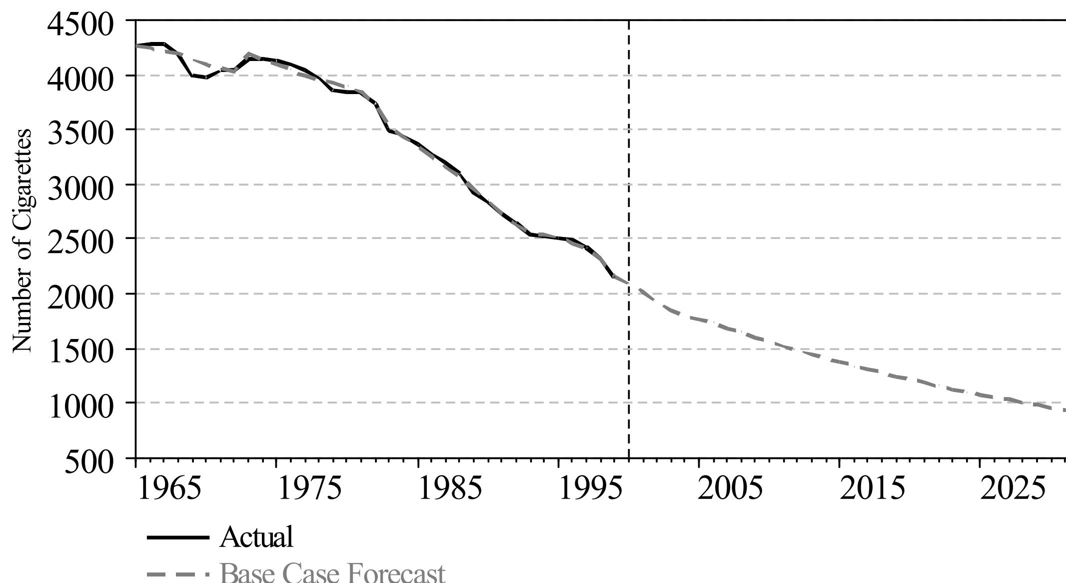
Forecast of Cigarette Consumption

After developing the regression equation specified above, we used it to project CPC for the period 2001 through 2032. Then using the standard adult population projections of DRI•WEFA'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 1999 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.

While consumption declined by an estimated 6.45% in 1999, industry shipments declined by almost 9%. The relative performance of shipments was expected to be better in 2000. Considerable inventory building occurred in late 1998 as wholesalers ordered ahead of the November 1998 price increase. This increase in inventories was followed by a fall in shipments in early 1999 as the stockpiled cigarettes were distributed to retail outlets. Thus total 1999 shipments showed a particularly sharp fall from 1998 levels. Also the shipments of the four "Original Participating Manufacturers" declined relative to the overall market as their market share declined. On January 25, 2001, RJ Reynolds reported that domestic industry shipments in 2000 increased by 0.1% over 1999. For the reasons given above, shipment volumes in the first half of the year exceeded the depressed 1999 levels, while volume decreased in the second half by 2.58% from the second half of 1999. Industry shipments for 2001 were, at 406.3 billion, 3.2% below 2000.

Cigarette consumption is projected to decline by 3.7% in 2002, and 2.4% in 2003. After 2003, the rate of decline is projected to moderate and average less than 2% per year. From 2000 through 2032 the average annual rate of decline is projected to be 1.72%. On a per capita basis consumption is projected to fall at an average rate of 2.55% per year. Total consumption of cigarettes in the U.S. is projected to fall from an estimated 430 billion in 2000 to under 400 billion by 2003, under 300 billion by 2020, and to reach 247 billion in 2032.

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

On October 25, 1999 DRI•WEFA presented a similar study, "A Forecast of US Cigarette Consumption (1999-2042)". Its long run conclusions were quite similar to this study. By the final year of this forecast, 2032, the current forecast is 4% greater than the 1999 forecast, 247 billion vs. 237 billion. In the 1999 study our projected level of 1999 consumption was 432 billion; the estimated number from the USDA was slightly higher, 435 billion.

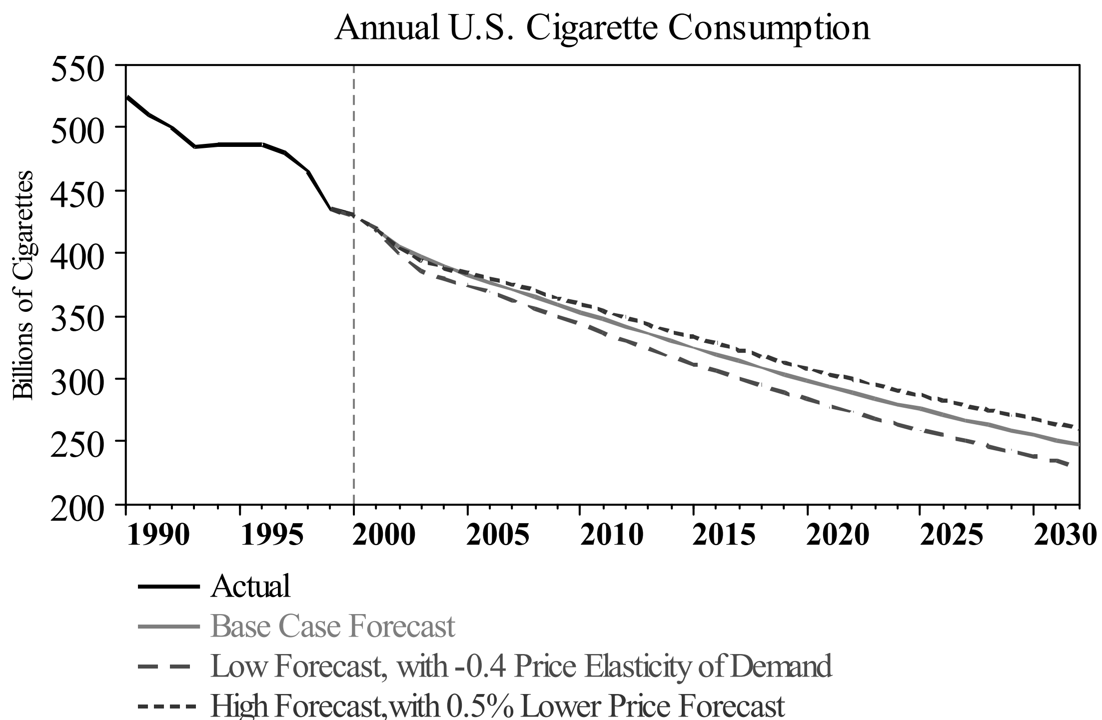
We incorporated this and other new data in 2000. At that time we realized that price increases had been greater than anticipated in our 1999 study. We increased our retail price assumption for 2000 from $3.03 to $3.39, and correspondingly decreased our consumption forecast for the year to 411 billion. However, aggressive discounting at the retail level resulted in a lower average price for the year, $3.20 per pack. Similarly, in 2001 retail prices averaged $3.44 per pack, 4.4% lower than the $3.60 our forecast had assumed. Increased consumption due to lower than anticipated prices explains most of the revision to our 2000 and 2001 consumption forecasts. We now estimate a consumption level of 419 billion for 2001, 11 billion more than we projected in our 2001 forecast. This forecast also differs somewhat from one presented to other issuers earlier in 2002. While that forecast had anticipated some state excise tax increases in response to state budget difficulties, a slightly greater number of states than expected have raised taxes on cigarette purchases, and as a result, consumption is projected to be lower in the near term. Cigarette consumption is now expected to fall to 403 billion in 2002, 2 billion fewer than the previous forecast, and to 394 billion in 2003, 4 billion fewer than the earlier forecast.

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 1.72 to 1.56%, resulting in consumption of 260 billion in 2032.

In the low forecast, Low Case 1, we posit a sharper price elasticity of demand. Our estimate of the price elasticity, -0.31, 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 1.93% and results in cigarette consumption of 230 billion in 2032.



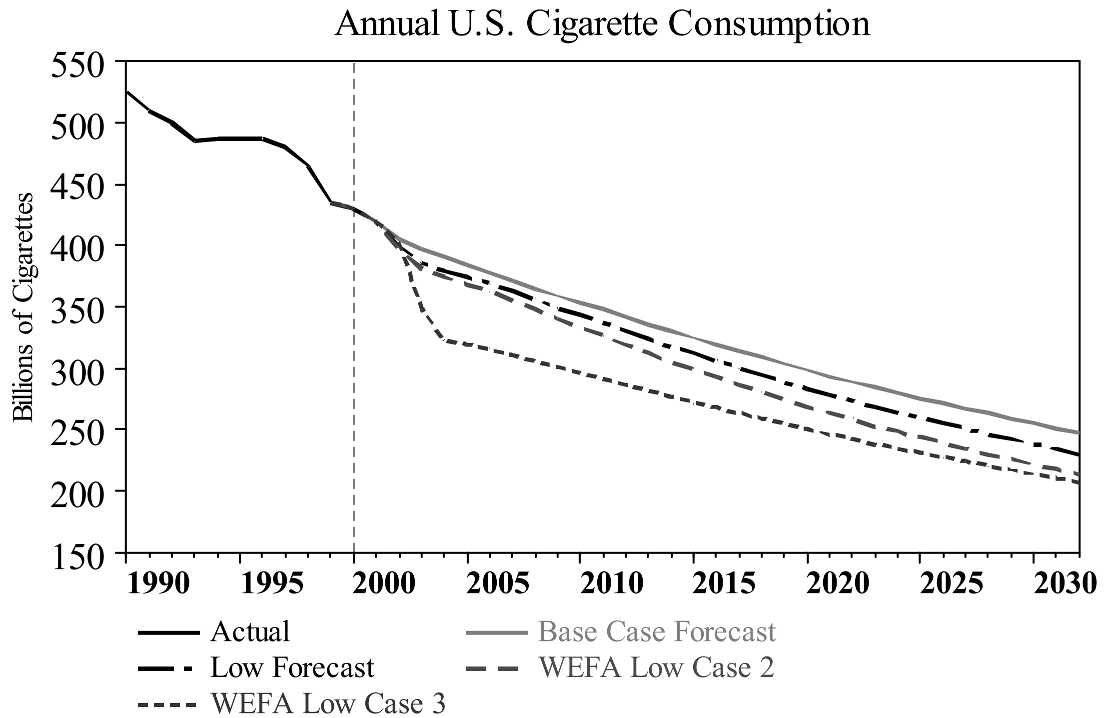
Hypothetical Stress Scenarios

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 2.17%, and results in demand of 213 billion cigarettes in 2032 (DRI•WEFA 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 2.54% per year, accelerated to a pace of 4.37% annually, demand would also fall to 213 billion in 2032.

A second large negative stress is placed by postulating, in 2003, 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, -17.7% over two years, in consumption. By 2032, consumption will have fallen to 207 billion cigarettes, an average annual rate of decline of 2.25% (DRI•WEFA Low Case 3). The estimated price elasticity of –0.31 is used in this case.

Alternative Forecasts

	2032 Consumption Level (Bil.)	Average Annual Decline (%)
Base Case Forecast	247	1.72
Low Case 1	230	1.93
High Alternative	260	1.56
Low Case 2	213	2.17
Low Case 3	207	2.25



Finally, for comparative purposes we have calculated the volume of total cigarette consumption under two alternative annual rates of decline, 3.5% and 4%. At 3.5% per year consumption falls to 138 billion by 2032 and at 4% it falls to 116 billion.

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	4.11	0.92	1.28	0.04		
1967	3.13	0.72	1.39	0.05		
1968	3.55	1.89	1.56	0.05		
1969	2.21	0.00	1.69	0.06		
1970	2.97	2.24	2.00	0.05		
1971	2.81	0.12	2.27	0.06		
1972	3.43	2.08	2.85	0.06		
1973	5.76	-3.29	2.03	0.07		
1974	-1.19	-5.49	2.05	0.07		
1975	0.97	-1.87	2.12	0.05		
1976	2.93	-1.40	2.07	0.05		
1977	2.44	-1.60	1.91	0.07		
1978	4.10	-2.05	1.91	0.06		
1979	2.02	-4.73	2.00	0.05		
1980	0.01	-5.03	1.96	0.05		
1981	1.56	-2.11	1.73	0.06		
1982	0.59	4.80	1.64	0.05		
1983	1.93	15.84	1.46	0.04		
1984	6.79	2.10	1.48	0.05		
1985	2.45	2.31	1.16	0.05		
1986	2.28	4.84	1.38	0.06		
1987	1.37	3.36	1.23	0.05		
1988	3.50	4.83	1.26	0.05		
1989	1.53	7.64	1.35	0.05		
1990	1.10	4.71	0.89	0.06	7.96	
1991	-0.38	7.16	0.96	0.06	7.72	
1992	2.29	5.24	0.99	0.06	7.62	
1993	-0.04	0.91	1.02	0.06	7.12	
1994	1.56	-6.11	0.95	0.07	7.21	
1995	1.72	-0.21	0.85	0.07	7.76	
1996	1.57	0.18	0.89	0.08	7.54	
1997	2.20	2.31	1.27	0.08	6.58	
1998	4.45	11.03	1.15	0.08	6.30	2.20
1999	1.58	26.72	1.13	0.08	5.92	2.88
2000	2.61	7.47	1.14	0.08	5.92	3.20
2001	2.60	4.36	1.10	0.08	5.92	3.45
2002	0.63	5.76	1.02	0.08	5.91	3.71
2003	2.26	4.20	0.96	0.08	5.87	3.98
2004	2.14	1.67	0.87	0.08	5.84	4.16
2005	2.23	1.87	0.98	0.08	5.82	4.36

2006	2.66	2.59	0.89	0.08	5.80	4.58
2007	2.56	2.63	1.00	0.08	5.78	4.82
2008	2.15	2.71	1.00	0.08	5.77	5.08
2009	2.00	3.10	1.02	0.07	5.77	5.37

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 Price Per Pack of Cigarettes
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*%*	*Billions*	*$ (Current)*
2010	2.21	2.61	1.00	0.07	5.62	5.65
2011	2.23	2.57	0.93	0.07	5.47	5.94
2012	2.02	2.52	0.88	0.07	5.32	6.24
2013	2.02	2.48	0.81	0.07	5.18	6.55
2014	2.02	2.84	0.80	0.07	5.18	6.90
2015	2.04	2.02	0.84	0.07	5.18	7.22
2016	2.04	2.37	0.82	0.07	5.18	7.58
2017	2.05	2.34	0.77	0.07	5.18	7.94
2018	2.05	2.31	0.76	0.07	5.18	8.33
2019	2.06	2.27	0.74	0.06	5.03	8.73
2020	2.08	1.89	0.76	0.06	4.88	9.12
2021	2.09	2.22	0.77	0.06	4.73	9.55
2022	2.10	1.85	0.77	0.06	4.59	9.97
2023	2.11	2.17	0.78	0.06	4.44	10.45
2024	2.11	1.81	0.78	0.06	4.44	10.90
2025	2.11	1.79	0.79	0.05	4.29	11.38
2026	2.11	1.78	0.79	0.05	4.14	11.86
2027	2.11	1.76	0.79	0.05	3.99	12.37
2028	2.11	1.75	0.80	0.05	3.85	12.91
2029	2.11	1.73	0.80	0.05	3.70	13.46
2030	2.11	2.02	0.80	0.05	3.70	14.07
2031	2.11	1.70	0.79	0.04	3.55	14.67
2032	2.11	1.68	0.77	0.04	3.40	15.29

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2032)

	Per Capita Consumption	Growth Rate (%)	Total Consumption (billions)	Total Consumption (billions of packs)	Growth Rate (%)
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	2326	-4.00	465.00	23.25	-3.13
1999	2136	-8.17	435.00	21.75	-6.45
2000	2092	-2.06	430.00	21.50	-1.15
FORECAST					
2001	2017	-3.59	419.00	20.95	-2.56
2002	1922	-4.72	403.38	20.17	-3.73
2003	1857	-3.36	393.62	19.68	-2.42

2004	1809	-2.58	386.96	19.35	-1.69
	Per Capita Consumption	**Growth Rate (%)**	**Total Consumption (billions)**	**Total Consumption (billions of packs)**	**Growth Rate (%)**
2005	1767	-2.31	381.69	19.08	-1.36
2006	1727	-2.31	376.09	18.80	-1.47
2007	1684	-2.44	370.57	18.53	-1.47
2008	1642	-2.51	365.00	18.25	-1.50
2009	1598	-2.65	358.90	17.95	-1.67
2010	1558	-2.54	353.27	17.66	-1.57
2011	1519	-2.48	347.65	17.38	-1.59
2012	1481	-2.52	341.81	17.09	-1.68
2013	1444	-2.51	335.90	16.79	-1.73
2014	1406	-2.58	329.95	16.50	-1.77
2015	1372	-2.44	324.71	16.24	-1.59
2016	1339	-2.44	319.48	15.97	-1.61
2017	1306	-2.46	314.11	15.71	-1.68
2018	1274	-2.45	308.83	15.44	-1.68
2019	1243	-2.44	303.49	15.17	-1.73
2020	1213	-2.36	298.55	14.93	-1.63
2021	1184	-2.39	293.59	14.68	-1.66
2022	1157	-2.34	288.83	14.44	-1.62
2023	1129	-2.37	284.10	14.20	-1.64
2024	1103	-2.32	279.72	13.99	-1.54
2025	1078	-2.29	275.39	13.77	-1.55
2026	1053	-2.28	271.14	13.56	-1.54
2027	1029	-2.28	267.00	13.35	-1.53
2028	1006	-2.27	262.94	13.15	-1.52
2029	983	-2.27	258.94	12.95	-1.52
2030	960	-2.33	255.01	12.75	-1.52
2031	938	-2.29	251.03	12.55	-1.56
2032	917	-2.26	247.16	12.36	-1.54

Base Case and Alternative Forecasts of Total U.S. Cigarette Consumption

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 (%)*
1999	435.00	21.75	-6.45	435.00	21.75	-6.45	435.00	21.75	-6.45
2000	430.00	21.50	-1.15	430.00	21.50	-1.15	430.00	21.50	-1.15
2001	419.00	20.95	-2.56	419.00	20.95	-2.56	419.00	20.95	-2.56
2002	403.38	20.17	-3.73	400.18	20.01	-4.49	405.19	20.26	-3.30
2003	393.62	19.68	-2.42	388.48	19.42	-2.92	396.07	19.80	-2.25
2004	386.96	19.35	-1.69	381.34	19.07	-1.84	389.99	19.50	-1.54
2005	381.69	19.08	-1.36	375.48	18.77	-1.54	385.33	19.27	-1.19
2006	376.09	18.80	-1.47	369.13	18.46	-1.69	380.31	19.02	-1.30
2007	370.57	18.53	-1.47	362.80	18.14	-1.72	375.33	18.77	-1.31
2008	365.00	18.25	-1.50	356.29	17.81	-1.79	370.11	18.51	-1.39
2009	358.90	17.95	-1.67	349.35	17.47	-1.95	364.48	18.22	-1.52
2010	353.27	17.66	-1.57	343.02	17.15	-1.81	359.31	17.97	-1.42
2011	347.65	17.38	-1.59	336.78	16.84	-1.82	354.17	17.71	-1.43
2012	341.81	17.09	-1.68	330.35	16.52	-1.91	348.75	17.44	-1.53
2013	335.90	16.79	-1.73	323.87	16.19	-1.96	343.24	17.16	-1.58
2014	329.95	16.50	-1.77	317.33	15.87	-2.02	337.71	16.89	-1.61
2015	324.71	16.24	-1.59	311.71	15.59	-1.77	332.85	16.64	-1.44
2016	319.48	15.97	-1.61	306.04	15.30	-1.82	327.99	16.40	-1.46
2017	314.11	15.71	-1.68	300.26	15.01	-1.89	323.00	16.15	-1.52
2018	308.83	15.44	-1.68	294.61	14.73	-1.88	318.09	15.90	-1.52
2019	303.49	15.17	-1.73	288.90	14.44	-1.94	313.07	15.65	-1.58
2020	298.55	14.93	-1.63	283.67	14.18	-1.81	308.44	15.42	-1.48
2021	293.59	14.68	-1.66	278.39	13.92	-1.86	303.78	15.19	-1.51
2022	288.83	14.44	-1.62	273.44	13.67	-1.78	299.34	14.97	-1.46
2023	284.10	14.20	-1.64	268.43	13.42	-1.83	294.91	14.75	-1.48
2024	279.72	13.99	-1.54	263.87	13.19	-1.70	290.84	14.54	-1.38
2025	275.39	13.77	-1.55	259.36	12.97	-1.71	286.80	14.34	-1.39
2026	271.14	13.56	-1.54	254.95	12.75	-1.70	282.84	14.14	-1.38
2027	267.00	13.35	-1.53	250.64	12.53	-1.69	278.94	13.95	-1.38
2028	262.94	13.15	-1.52	246.43	12.32	-1.68	275.12	13.76	-1.37
2029	258.94	12.95	-1.52	242.31	12.12	-1.67	271.38	13.57	-1.36
2030	255.01	12.75	-1.52	238.17	11.91	-1.71	267.66	13.38	-1.37
2031	251.03	12.55	-1.56	234.10	11.70	-1.71	263.91	13.20	-1.40
2032	247.16	12.36	-1.54	230.14	11.51	-1.69	260.27	13.01	-1.38

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 2003		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
1999	435.00	21.75	-6.45	435.00	21.75	-6.45	435.00	21.75	-6.45
2000	430.00	21.50	-1.15	430.00	21.50	-1.15	430.00	21.50	-1.15
2001	419.00	20.95	-2.56	419.00	20.95	-2.56	419.00	20.95	-2.56
2002	403.38	20.17	-3.73	397.97	19.90	-5.02	403.39	20.17	-3.72
2003	393.62	19.68	-2.42	384.20	19.21	-3.46	349.75	17.49	-13.30
2004	386.96	19.35	-1.69	376.47	18.82	-2.01	324.63	16.23	-7.18
2005	381.69	19.08	-1.36	369.90	18.49	-1.75	320.22	16.01	-1.36
2006	376.09	18.80	-1.47	362.68	18.13	-1.95	315.54	15.78	-1.46
2007	370.57	18.53	-1.47	355.44	17.77	-2.00	310.93	15.55	-1.46
2008	365.00	18.25	-1.50	348.12	17.41	-2.06	306.14	15.31	-1.54
2009	358.90	17.95	-1.67	340.25	17.01	-2.26	301.03	15.05	-1.67
2010	353.27	17.66	-1.57	333.21	16.66	-2.07	296.30	14.82	-1.57
2011	347.65	17.38	-1.59	326.27	16.31	-2.08	291.59	14.58	-1.59
2012	341.81	17.09	-1.68	319.23	15.96	-2.16	286.69	14.33	-1.68
2013	335.90	16.79	-1.73	312.20	15.61	-2.2	281.73	14.09	-1.73
2014	329.95	16.50	-1.77	304.99	15.25	-2.31	276.74	13.84	-1.77
2015	324.71	16.24	-1.59	298.98	14.95	-1.97	272.34	13.62	-1.59
2016	319.48	15.97	-1.61	292.83	14.64	-2.06	267.96	13.40	-1.61
2017	314.11	15.71	-1.68	286.62	14.33	-2.12	263.46	13.17	-1.68
2018	308.83	15.44	-1.68	280.57	14.03	-2.11	259.06	12.95	-1.67
2019	303.49	15.17	-1.73	274.48	13.72	-2.17	254.58	12.73	-1.73
2020	298.55	14.93	-1.63	269.02	13.45	-1.99	250.43	12.52	-1.63
2021	293.59	14.68	-1.66	263.42	13.17	-2.08	246.27	12.31	-1.66
2022	288.83	14.44	-1.62	258.23	12.91	-1.97	242.28	12.11	-1.62
2023	284.10	14.20	-1.64	252.94	12.65	-2.05	238.31	11.92	-1.64
2024	279.72	13.99	-1.54	248.18	12.41	-1.88	234.64	11.73	-1.54
2025	275.39	13.77	-1.55	243.49	12.17	-1.89	231.00	11.55	-1.55
2026	271.14	13.56	-1.54	238.92	11.95	-1.88	227.44	11.37	-1.54
2027	267.00	13.35	-1.53	234.45	11.72	-1.87	223.96	11.20	-1.53
2028	262.94	13.15	-1.52	230.11	11.51	-1.85	220.56	11.03	-1.52
2029	258.94	12.95	-1.52	225.85	11.29	-1.85	217.21	10.86	-1.52
2030	255.01	12.75	-1.52	221.54	11.08	-1.91	213.90	10.70	-1.52
2031	251.03	12.55	-1.56	217.38	10.87	-1.88	210.57	10.53	-1.56
2032	247.16	12.36	-1.54	213.33	10.67	-1.86	207.32	10.37	-1.54

Alternative Constant Rate Decline Projections of Total U.S. Cigarette Consumption

YEAR	3.5% Decline Per Year			4.0% Decline Per Year		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
1999	435.00	21.75		435.00	21.75	
2000	430.00	21.50	-1.15	430.00	21.50	-1.15
2001	414.95	20.75	-3.50	412.80	20.64	-4.00
2002	400.43	20.02	-3.50	396.29	19.81	-4.00
2003	386.41	19.32	-3.50	380.44	19.02	-4.00
2004	372.89	18.64	-3.50	365.22	18.26	-4.00
2005	359.84	17.99	-3.50	350.61	17.53	-4.00
2006	347.24	17.36	-3.50	336.59	16.83	-4.00
2007	335.09	16.75	-3.50	323.12	16.16	-4.00
2008	323.36	16.17	-3.50	310.20	15.51	-4.00
2009	312.04	15.60	-3.50	297.79	14.89	-4.00
2010	301.12	15.06	-3.50	285.88	14.29	-4.00
2011	290.58	14.53	-3.50	274.44	13.72	-4.00
2012	280.41	14.02	-3.50	263.47	13.17	-4.00
2013	270.60	13.53	-3.50	252.93	12.65	-4.00
2014	261.13	13.06	-3.50	242.81	12.14	-4.00
2015	251.99	12.60	-3.50	233.10	11.65	-4.00
2016	243.17	12.16	-3.50	223.77	11.19	-4.00
2017	234.66	11.73	-3.50	214.82	10.74	-4.00
2018	226.44	11.32	-3.50	206.23	10.31	-4.00
2019	218.52	10.93	-3.50	197.98	9.90	-4.00
2020	210.87	10.54	-3.50	190.06	9.50	-4.00
2021	203.49	10.17	-3.50	182.46	9.12	-4.00
2022	196.37	9.82	-3.50	175.16	8.76	-4.00
2023	189.49	9.47	-3.50	168.15	8.41	-4.00
2024	182.86	9.14	-3.50	161.43	8.07	-4.00
2025	176.46	8.82	-3.50	154.97	7.75	-4.00
2026	170.29	8.51	-3.50	148.77	7.44	-4.00
2027	164.33	8.22	-3.50	142.82	7.14	-4.00
2028	158.57	7.93	-3.50	137.11	6.86	-4.00
2029	153.02	7.65	-3.50	131.62	6.58	-4.00
2030	147.67	7.38	-3.50	126.36	6.32	-4.00
2031	142.50	7.13	-3.50	121.30	6.07	-4.00
2032	137.51	6.88	-3.50	116.45	5.82	-4.00

Appendix 1: Raw Data Reference

Mnemonic	Label	Time Frame	Source
ADV	Advertising and Promotional Expenditures, Millions of Dollars	1963-1999	Federal Trade Commission Report to Congress for '90, '91, '92, '93, '96, 97, '98, '99
CIGPRICE	Real Tobacco Consumer Price Index	1947-1999	DRI•WEFA Calculation: CPITOB/CPIU = CIGPRICE
CPC	Adult Per Capita Consumption, Cigarettes	1945-1999	Tobacco Situation and Outlook Report, USDA's Economic Research Service, various issues
CPITOB	Consumer Price Index, Tobacco 1982/1984 = 100	1947-1999	Bureau of Labor Statistics
CPIU	Consumer Price Index, All Items	1947-1999	Bureau of Labor Statistics
NP	Total Population, Millions	1946-1999	BEA, NIPA
NP16A	Total Population, Above 16, Millions	1946-1999	BUREAU OF THE CENSUS
NPTF1617	Total Population, Female 16-17, Millions	1946-1999	BUREAU OF THE CENSUS
NPTM1617	Total Population, Male 16-17, Millions	1946-1999	BUREAU OF THE CENSUS
NP18A	Total Population, Above 18, Millions	1946-1999	DRI•WEFA Calculation: NP16A - (NPTF1617 + NPTM1617)
SMOKEBAN	Dummy Variable that Captures the Effect of the Bans on Smoking in Public Places from the 1980's to the 1990's	1965-1998	DRI•WEFA
RADVPC	Real Per Capita Advertising Expenditures	1960-1997	DRI•WEFA Calculation: [(YDP96 x 100) / CPIU] / NP = RADVPC
TEENPER	Incidence of First Daily Use of Cigarettes, Ages 12-17, Percentage	1965-1997	Center for Disease Control and Prevention, Substance Abuse and Mental Health Services Admin., National Household Survey on Drug Abuse for 1998
TOTALCIGC	Total Consumption, Billions of Cigarettes	1945-1999	Publications and reports of the U.S. Department of Treasury's Bureau of Alcohol, Tobacco, and Firearms, and the Internal Revenue

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APPENDIX B

MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

(AS AMENDED BY THE ADDENDUM OF CLARIFICATIONS)

TABLE OF CONTENTS

Page

I. RECITALS 1
II. DEFINITIONS 1
(a) "Account" 1
(b) "Adult" 1
(c) "Adult-Only Facility" 1
(d) "Affiliate" 1
(e) "Agreement" 2
(f) "Allocable Share" 2
(g) "Allocated Payment" 2
(h) "Bankruptcy" 2
(i) "Brand Name" 2
(j) "Brand Name Sponsorship" 2
(k) "Business Day" 2
(l) "Cartoon" 2
(m) "Cigarette" 3
(n) "Claims" 3
(o) "Consent Decree" 3
(p) "Court" 3
(q) "Escrow" 3
(r) "Escrow Agent" 3
(s) "Escrow Agreement" 3
(t) "Federal Tobacco Legislation Offset" 3
(u) "Final Approval" 3
(v) "Foundation" 3
(w) "Independent Auditor" 3
(x) "Inflation Adjustment" 3
(y) "Litigating Releasing Parties Offset" 3
(z) "Market Share" 3
(aa) "MSA Execution Date" 4
(bb) "NAAG" 4
(cc) "Non-Participating Manufacturer" 4
(dd) "Non-Settling States Reduction" 4
(ee) "Notice Parties" 4
(ff) "NPM Adjustment" 4

TABLE OF CONTENTS
(continued)

Page

(gg) "NPM Adjustment Percentage" ... 4
(hh) "Original Participating Manufacturers" ... 4
(ii) "Outdoor Advertising" ... 4
(jj) "Participating Manufacturer" ... 4
(kk) "Previously Settled States Reduction" ... 5
(ll) "Prime Rate" ... 5
(mm) "Relative Market Share" ... 5
(nn) "Released Claims" ... 5
(oo) "Released Parties" ... 5
(pp) "Releasing Parties" ... 5
(qq) "Settling State" ... 6
(rr) "State" ... 6
(ss) "State-Specific Finality" ... 6
(tt) "Subsequent Participating Manufacturer" ... 6
(uu) "Tobacco Product Manufacturer" ... 6
(vv) "Tobacco Products" ... 6
(ww) "Tobacco-Related Organizations" ... 6
(xx) "Transit Advertisements" ... 6
(yy) "Underage" ... 7
(zz) "Video Game Arcade" ... 7
(aaa) "Volume Adjustment" ... 7
(bbb) "Youth" ... 7

III. PERMANENT RELIEF ... 7
(a) Prohibition on Youth Targeting ... 7
(b) Ban on Use of Cartoons ... 7
(c) Limitation of Tobacco Brand Name Sponsorships ... 7
(d) Elimination of Outdoor Advertising and Transit Advertisements ... 8
(e) Prohibition on Payments Related to Tobacco Products and Media ... 9
(f) Ban on Tobacco Brand Name Merchandise ... 9
(g) Ban on Youth Access to Free Samples ... 9
(h) Ban on Gifts to Underage Persons Based on Proofs of Purchase ... 9
(i) Limitation on Third-Party Use of Brand Names ... 9
(j) Ban on Non-Tobacco Brand Names ... 10
(k) Minimum Pack Size of Twenty Cigarettes ... 10

TABLE OF CONTENTS
(continued)

Page

(l) Corporate Culture Commitments Related to Youth Access and Consumption ... 10
(m) Limitations on Lobbying ... 10
(n) Restriction on Advocacy Concerning Settlement Proceeds ... 11
(o) Dissolution of The Tobacco Institute, Inc., the Council for Tobacco Research-U.S.A., Inc. and the Center for Indoor Air Research, Inc. ... 11
(p) Regulation and Oversight of New Tobacco-Related Trade Associations ... 11
(q) Prohibition on Agreements to Suppress Research ... 12
(r) Prohibition on Material Misrepresentations ... 12

IV. PUBLIC ACCESS TO DOCUMENTS ... 12

V. TOBACCO CONTROL AND UNDERAGE USE LAWS ... 14

VI. ESTABLISHMENT OF A NATIONAL FOUNDATION ... 14
(a) Foundation Purposes ... 14
(b) Base Foundation Payments ... 14
(c) National Public Education Fund Payments ... 14
(d) Creation and Organization of the Foundation ... 15
(e) Foundation Affiliation ... 15
(f) Foundation Functions ... 15
(g) Foundation Grant-Making ... 16
(h) Foundation Activities ... 16
(i) Severance of this Section ... 16

VII. ENFORCEMENT ... 16
(a) Jurisdiction ... 16
(b) Enforcement of Consent Decree ... 17
(c) Enforcement of this Agreement ... 17
(d) Right of Review ... 17
(e) Applicability ... 17
(f) Coordination of Enforcement ... 17
(g) Inspection and Discovery Rights ... 18

VIII. CERTAIN ONGOING RESPONSIBILITIES OF THE SETTLING STATES ... 18

IX. PAYMENTS ... 18
(a) All Payments Into Escrow ... 18
(b) Initial Payments ... 19
(c) Annual Payments and Strategic Contribution Payments ... 19
(d) Non-Participating Manufacturer Adjustment ... 20
(e) Supplemental Payments ... 24

TABLE OF CONTENTS
(continued)

Page

(f) Payment Responsibility 25
(g) Corporate Structures 25
(h) Accrual of Interest 25
(i) Payments by Subsequent Participating Manufacturers 25
(j) Order of Application of Allocations, Offsets, Reductions and Adjustments 26
X. EFFECT OF FEDERAL TOBACCO-RELATED LEGISLATION 27
XI. CALCULATION AND DISBURSEMENT OF PAYMENTS 28
(a) Independent Auditor to Make All Calculations 28
(b) Identity of Independent Auditor 28
(c) Resolution of Disputes 28
(d) General Provisions as to Calculation of Payments 28
(e) General Treatment of Payments 30
(f) Disbursements and Charges Not Contingent on Final Approval 30
(g) Payments to be Made Only After Final Approval 32
(h) Applicability to Section XVII Payments 33
(i) Miscalculated or Disputed Payments 33
(j) Payments After Applicable Condition 34
XII. SETTLING STATES' RELEASE, DISCHARGE AND COVENANT 34
(a) Release 34
(b) Released Claims Against Released Parties 36
XIII. CONSENT DECREES AND DISMISSAL OF CLAIMS 37
XIV. PARTICIPATING MANUFACTURERS' DISMISSAL OF RELATED LAWSUITS 38
XV. VOLUNTARY ACT OF THE PARTIES 38
XVI. CONSTRUCTION 38
XVII. RECOVERY OF COSTS AND ATTORNEYS' FEES 38
XVIII. MISCELLANEOUS 39
(a) Effect of Current or Future Law 39
(b) Limited Most-Favored Nation Provision 39
(c) Transfer of Tobacco Brands 40
(d) Payments in Settlement 41
(e) No Determination or Admission 41
(f) Non-Admissibility 41
(g) Representations of Parties 41
(h) Obligations Several, Not Joint 41

TABLE OF CONTENTS
(continued)

Page

(i) Headings 41
(j) Amendment and Waiver 41
(k) Notices 41
(l) Cooperation 41
(m) Designees to Discuss Disputes 42
(n) Governing Law 42
(o) Severability 42
(p) Intended Beneficiaries 42
(q) Counterparts 42
(r) Applicability 42
(s) Preservation of Privilege 43
(t) Non-Release 43
(u) Termination 43
(v) Freedom of Information Requests 43
(w) Bankruptcy 43
(x) Notice of Material Transfers 45
(y) Entire Agreement 45
(z) Business Days 45
(aa) Subsequent Signatories 45
(bb) Decimal Places 45
(cc) Regulatory Authority 45
(dd) Successors 45
(ee) Export Packaging 45
(ff) Actions Within Geographic Boundaries of Settling States 45
(gg) Notice to Affiliates 45
EXHIBIT A STATE ALLOCATION PERCENTAGES A-1
EXHIBIT B FORM OF ESCROW AGREEMENT B-1
EXHIBIT C FORMULA FOR CALCULATING INFLATION ADJUSTMENTS C-1
EXHIBIT D LIST OF LAWSUITS D-1
EXHIBIT E FORMULA FOR CALCULATING VOLUME ADJUSTMENTS E-1
EXHIBIT F POTENTIAL LEGISLATION NOT TO BE OPPOSED F-1
EXHIBIT G OBLIGATIONS OF THE TOBACCO INSTITUTE UNDER THE MASTER SETTLEMENT AGREEMENT G-1
EXHIBIT H DOCUMENT PRODUCTION H-1
EXHIBIT I INDEX AND SEARCH FEATURES FOR DOCUMENT WEBSITE I-1

TABLE OF CONTENTS
(continued)

		Page
EXHIBIT J	TOBACCO ENFORCEMENT FUND PROTOCOL	J-1
EXHIBIT K	MARKET CAPITALIZATION PERCENTAGES	K-1
EXHIBIT L	MODEL CONSENT DECREE	L-1
EXHIBIT M	LIST OF PARTICIPATING MANUFACTURERS' LAWSUITS AGAINST THE SETTLING STATES	M-1
EXHIBIT N	LITIGATING POLITICAL SUBDIVISIONS	N-1
EXHIBIT O	MODEL STATE FEE PAYMENT AGREEMENT	O-1
EXHIBIT P	NOTICES	P-1
EXHIBIT Q	1996 AND 1997 DATA	Q-1
EXHIBIT R	EXCLUSION OF CERTAIN BRAND NAMES	R-1
EXHIBIT S	DESIGNATION OF OUTSIDE COUNSEL	S-1
EXHIBIT T	MODEL STATUTE	T-1
EXHIBIT U	STRATEGIC CONTRIBUTION FUND PROTOCOL	U-1

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) All Payments Into Escrow. 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) Initial Payments. 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) Annual Payments and Strategic Contribution Payments.

(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) Non-Participating Manufacturer Adjustment.

(1) Calculation of NPM Adjustment for Original Participating Manufacturers. 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) <u>Allocation of NPM Adjustment among Original Participating Manufacturers</u>. 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) NPM Adjustment for Subsequent Participating Manufacturers. 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) Supplemental Payments. 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) Payment Responsibility. 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) Corporate Structures. 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) Accrual of Interest. 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) Payments by Subsequent Participating Manufacturers.

(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. IJU-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 CV 96-0148414S (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. Incorporate, 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 (ICJ.)
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. 96-2-1505608SEA (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.   CONSENT DECREE AND FINAL JUDGMENT
[XXXXXX XXXXX XXXX], et al., Defendants.

____________________________ 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-ev-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."

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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 particularlized state procedural or technical requirements) will mean that the statute will no longer conform to this model.]

(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.

(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.

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[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.]

(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 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]

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[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.

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APPENDIX C

PROPOSED FORM OF OPINIONS OF CO-BOND COUNSEL

_____________, 2002

Tobacco Settlement Authority
Seattle, Washington

Ladies and Gentlemen:

We have examined the Constitution and laws of The State of Washington (the "State") and a record of proceedings relating to the issuance of $517,905,000 aggregate principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2002 (the "Series 2002 Bonds"), of the Tobacco Settlement Authority (the "Authority"), a public instrumentality and agency of the State, separate and distinct from the State, exercising public and essential governmental functions, and created by and existing under the Laws of 2002, Chapter 365, of the State, as amended (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 Series 2002 Bonds are authorized and issued pursuant to the Act and a resolution of the Authority adopted October 8, 2002, and are issued pursuant to an indenture and series supplement thereto, each by and between the Authority and U.S. Bank, N.A., as trustee (the "Indenture Trustee"), and each dated as of October 1, 2002 (together, the "Indenture"). The Authority is authorized and has reserved the right to issue one or more series of Refunding Bonds, secured on a parity with the Series 2002 Bonds, only on the terms and conditions set forth in 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 have deemed such reliance proper, on certain representations, certifications of fact, and statements of reasonable expectation made by the Authority and the State in connection with the issuance of the Series 2002 Bonds, and certain opinions provided to us, and we have assumed compliance by the Authority 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 the interest on the Series 2002 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 Indenture Trustee. We also have assumed the enforceability of the Purchase and Sale Agreement against the State and the enforceability of the Indenture against the Indenture Trustee, each in accordance with its respective terms. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Offering Circular or other offering material relating to the Series 2002 Bonds and 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 Authority is duly created and established and validly exists under the Act as a public instrumentality and agency of the State, separate and distinct from the State, exercising public and essential governmental functions, with the 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 Authority under the Indenture and the Purchase and Sale Agreement, and to issue the Series 2002 Bonds.

3. Each of the Purchase and Sale Agreement and the Indenture has been duly and lawfully authorized, executed and delivered by the Authority, is in full force and effect and is the legal, valid and binding agreement of the Authority, enforceable against the Authority in accordance with its terms.

4. The Indenture creates the valid pledge of, and first-priority lien on, the Collateral (including, without limitation, the 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 Authority, irrespective of whether such parties have notice thereof.

5. The claim of the Indenture Trustee (as assignee and pledgee of the Authority) upon the right, title and interest to the first thirty million dollars of payments received by the State under the MSA on and after the date hereof and before July 1, 2003, as Pledged TSRs, is valid and enforceable and prior to the claim of the State to all other payments received by the State under the MSA on and after the date hereof and before July 1, 2003. The claim of the Indenture Trustee (as assignee and pledgee of the Authority) upon the right, title and interest to twenty-nine and two-tenths percent (29.2%) of (i) the payments (other than Litigation Expense Reimbursements) received by the State under the MSA on and after July 1, 2003 (and all adjustments thereto), (ii) all amounts received by the State under the MSA on and after July 1, 2003 consisting of adjustments to payments made to the State under the MSA prior to July 1, 2003, and (iii) all Lump Sum Payments, Partial Lump Sum Payments and Total Lump Sum Payments, including those received prior to July 1, 2003, as Pledged TSRs, is valid and enforceable and on a parity with the claim of the State to seventy and eight-tenths percent (70.8%) of said revenues.

6. The Series 2002 Bonds have been duly and validly authorized and issued by the Authority in accordance with provisions of the Act and the Indenture and are valid and binding special revenue obligations of the Authority, payable only out of the Collateral pledged by the Authority under the Indenture in Section 201 thereof.

7. In accordance with the Act, the Series 2002 Bonds are not obligations of the State and are obligations only of the Authority, payable solely from the special fund or funds created by the Authority for their payment. Payment of the principal of, interest on, and redemption or prepayment premium, if any, on the Series 2002 Bonds shall be a valid claim only as against the special fund or funds relating thereto. Neither the faith and credit nor the taxing power of the State or any municipal corporation, subdivision, or agency of the State, other than the Authority as set forth in the Act, is pledged to the payment of the principal of, interest on, and redemption or prepayment premium, if any, on the Series 2002 Bonds.

8. Under existing statutes and court decisions, interest on the Series 2002 Bonds (i) is excluded from gross income 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; such interest, however, is included in adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

We express no opinion regarding any other tax consequences with respect to the Series 2002 Bonds. We render our opinions under existing statutes and court decisions as of the date hereof, and we assume no obligation to update our opinions after such date to reflect any future action, fact or circumstances, or change in law or interpretation, or otherwise. 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 Series 2002 Bonds.

In rendering this opinion, we are advising you that the enforceability of rights and remedies with respect to the Series 2002 Bonds, the Indenture and the Purchase and Sale Agreement may be limited by bankruptcy, insolvency and other laws affecting creditors' rights or remedies heretofore or hereafter enacted, and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

Very truly yours,