NEW ISSUE **BOOK-ENTRY ONLY**

*In the opinions of Hawkins Delafield & Wood LLP and Pacifica Law Group LLP, as Co-Bond Counsel to the Authority, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (1) interest on the Series 2013 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 2013 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."*

$334,700,000
TOBACCO SETTLEMENT AUTHORITY
Tobacco Settlement Revenue Refunding Bonds, Series 2013

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

The Tobacco Settlement Authority (the "**Authority**") is issuing $334,700,000 aggregate principal amount of Tobacco Settlement Revenue Refunding Bonds, Series 2013 (**the "Series 2013 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 2013 Bonds are to be issued by the Authority pursuant to an Indenture between the Authority and U.S. Bank National Association, Seattle, Washington, as trustee (the "**Indenture Trustee**"), dated as of October 1, 2002, as amended and restated on the date of delivery of the Series 2013 Bonds and the Series 2013 Supplement between the Authority and the Indenture Trustee, dated as of the date of delivery of the Series 2013 Bonds (collectively, the "**Indenture**"). The Series 2013 Bonds are being issued to (i) refund on a current basis all of the Authority's outstanding Tobacco Settlement Asset-Backed Bonds, Series 2002 (the "**Series 2002 Bonds**"), and (ii) to pay the costs of issuance of the Series 2013 Bonds.

The Series 2002 Bonds were issued by the Authority to finance the Authority's purchase of the "**Pledged TSRs**" from the State, which consist of 29.2% of (a) the payments received by the State under the MSA (as hereinafter defined) 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 (each as defined herein). The Master Settlement Agreement (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 Pledged TSRs is valid and enforceable and on a parity with the claim of the State to the Unpledged TSRs (defined herein).

The Series 2013 Bonds are limited obligations of the Authority. The Authority has pledged the Pledged TSRs as security and in trust for the benefit of the Holders of the Bonds. Payment of the Series 2013 Bonds depends on receipt by the Indenture Trustee, as collateral assignee of the Authority, of the Pledged TSRs. The amount of Pledged TSRs actually collected depends on many factors, including domestic cigarette consumption, the financial capability of the PMs and the tobacco industry, litigation generally, including litigation challenging the MSA and related state statutes, and federal, state and local regulations affecting the tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, including the NPM Adjustment (defined herein), some of which have occurred and may continue to occur and may be material. The State was a contested state in arbitration proceedings with the PMs regarding the NPM Adjustment related to the 2003 sales year. A decision released by the Arbitration Panel (as defined herein) on September 11, 2013 determined that nine states, including the State, diligently enforced their respective Qualifying Statutes during sales year 2003, and, along with 15 other jurisdictions that were either not contested or were not subject to the arbitration proceedings, are not subject to the NPM Adjustment under the MSA for sales year 2003. No assurance can be given as to whether the State will be subject to NPM Adjustments for sales years subsequent to 2003. See "BONDHOLDERS' RISKS" and "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS" herein for a discussion of certain factors that should be considered in connection with an investment in the Series 2013 Bonds.

The Series 2013 Bonds will be dated their date of delivery and mature on June 1 in the years as set forth on the inside cover page (each such date, a "**Maturity Date**"). Interest on the Series 2013 Bonds will be payable on each June 1 and December 1, commencing June 1, 2014. The Series 2013 Bonds are also subject to optional and mandatory redemption as described herein.

See the inside cover for Maturity Schedule, Interest Rates and Prices or Yields with respect to the Series 2013 Bonds.

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

THE SERIES 2013 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 2013 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 2013 BONDS.

The Series 2013 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 LLP, New York, New York, and Pacifica Law Group LLP, Seattle, Washington, Co-Bond Counsel. Certain legal matters will be passed upon for the Authority by Pacifica Law Group LLP, Seattle, Washington, general counsel to the Authority and by Nixon Peabody LLP, New York, New York, as Disclosure Counsel to the Authority; for the State by the Attorney General of the State; and for the Underwriters by Orrick, Herrington & Sutcliffe LLP, New York, New York, counsel to the Underwriters. It is expected that the Series 2013 Bonds will be available for delivery on or about October 17, 2013, in book-entry form through The Depository Trust Company, New York, New York.

Barclays **Citigroup**

BofA Merrill Lynch **KeyBanc Capital Markets** **RBC Capital Markets**

Raymond James

Dated: October 2, 2013

MATURITY SCHEDULE

$334,700,000
Tobacco Settlement Authority
Tobacco Settlement Revenue Refunding Bonds, Series 2013

Maturity Date (June 1)	Principal Maturity	Interest Rate	Yield	First Optional Redemption Date (June 1)	CUSIP* (Base# 88880M)
2014	$24,515,000	4.000%	0.380%	NA	AK7
2015	20,495,000	5.000	0.710	NA	AL5
2016	19,730,000	5.000	1.100	NA	AM3
2017	19,025,000	5.000	1.500	NA	AN1
2018	13,215,000	5.000	1.970	NA	AP6
2019	13,665,000	5.000	2.390	NA	AQ4
2020	13,970,000	5.000	2.710	NA	AR2
2021	13,880,000	5.000	3.040	NA	AS0
2022	14,510,000	5.000	3.290	NA	AT8
2023	15,235,000	5.000	3.460	NA	AU5
2024	15,815,000	5.000	1.300†	2014	AV3
2025	16,485,000	5.000	2.110†	2015	AW1
2026	17,240,000	5.000	2.780†	2016	AX9
2027	17,550,000	5.000	3.420†	2017	AY7
2028	17,670,000	5.250	3.800†	2018	AZ4
2029	18,125,000	5.250	4.180†	2018	BA8
2030	18,125,000	5.250	4.490†	2019	BB6
2031	18,940,000	5.250	4.820†	2020	BC4
2032	19,060,000	5.250	4.890†	2021	BD2
2033	7,450,000	5.250	4.950†	2022	BE0

* Copyright 2010, American Bankers Association. CUSIP data herein are provided by Standard & Poor's CUSIP Service Bureau, a Division of the McGraw-Hill Companies, Inc. The CUSIP numbers listed above are being provided solely for the convenience of Bondholders only at the time of issuance of the Series 2013 Bonds. Neither the Authority nor the Underwriters make any representation with respect to such numbers or undertake any responsibility for their accuracy now or at any time in the future. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2013 Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part of such maturity or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Series 2013 Bonds.

† Priced at the stated yield to the first optional redemption date for each respective maturity at a redemption price of 100%. See "THE SERIES 2013 BONDS-Redemption Provisions" herein.

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 OFFICIAL STATEMENT 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 2013 BONDS PAYABLE FROM TOBACCO SETTLEMENT PAYMENTS MADE UNDER THE MSA. THERE CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES 2013 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 2013 BONDS.

This Official Statement has been prepared by the Authority and contains information furnished by IHS Global 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 "CERTAIN INFORMATION RELATING TO THE DOMESTIC 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 contained under the caption "CERTAIN INFORMATION RELATING TO THE DOMESTIC 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 caption "IHS GLOBAL REPORT" and in the IHS Global Report attached as Appendix D to this Official Statement has been included in reliance upon IHS Global 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 Official Statement 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 IHS Global Report attached as Appendix D, or under the caption "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" in this Official Statement 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 Official Statement 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 "BONDHOLDERS' RISKS" and "SUMMARY OF THE MASTER SETTLEMENT

AGREEMENT"), the inclusion in this Official Statement of such forecasts, projections and estimates should not be regarded as a representation by the Authority, the State, IHS Global 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.

References in this Official Statement to the Indenture, the Sale Agreement and the Continuing Disclosure Agreement do not purport to be complete. Refer to the Indenture, the Sale Agreement and the Continuing Disclosure Agreement for full and complete details of their provisions. Copies of the Indenture, the Sale Agreement and the Continuing Disclosure Agreement are on file with the Authority and the Indenture Trustee.

The order and placement of material in this Official Statement, including its appendices are not to be deemed a determination of relevance, materiality or importance, and all materials in this Official Statement, including its appendices, must be considered in its entirety.

If and when included in this Official Statement, 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 Official Statement. 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 Official Statement. The Underwriters have reviewed the information in this Official Statement 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 PROVIDED IN THE SECURITIES ACT OF 1933, AS AMENDED.

THE SERIES 2013 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 OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Official Statement and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Series 2013 Bonds to potential investors is made only by means of the entire Official Statement. Terms used herein and not previously defined have the meanings ascribed to them in "APPENDIX E – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS — Definitions." For locations of definitions of certain terms used herein, see the "Index of Defined Terms."

Overview..................................... The Tobacco Settlement Authority (the "**Authority**") is issuing $334,700,000 aggregate principal amount of its Tobacco Settlement Revenue Refunding Bonds, Series 2013 (the "**Series 2013 Bonds**").

The Series 2013 Bonds are to be issued by the Authority pursuant to an Indenture between the Authority and U.S. Bank National Association, Seattle, Washington, as trustee (the "**Indenture Trustee**"), dated as of October 1, 2002, as amended and restated on the date of delivery of the Series 2013 Bonds and the Series 2013 Supplement between the Authority and the Indenture Trustee, dated as of the date of delivery of the Series 2013 Bonds (collectively, the "**Indenture**''). The Series 2013 Bonds are being issued to (i) refund on a current basis all of the Authority's outstanding Tobacco Settlement Asset-Backed Bonds, Series 2002 (the "**Series 2002 Bonds**") and (ii) to pay the costs of issuance of the Series 2013 Bonds.

The Series 2002 Bonds were issued by the Authority to finance the Authority's purchase of the "**Pledged TSRs**" from the State of Washington (the "**State**") pursuant to the Sale Agreement described below.

"**Pledged TSRs**" means 29.2% of:

(a) the payments received by the State under the MSA (as defined below) 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.

The Master Settlement Agreement (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.

Pledged TSRs do not include "**Unpledged TSRs**", which are 70.8% of:

(a) the payments 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.

The right of the Authority to receive the Pledged TSRs is valid and enforceable and on a parity with the claim of the State to the Unpledged TSRs.

The Series 2013 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 2013 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 2013 Bonds.

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 2013 Bonds are being issued, pursuant to Chapter 365, Laws of Washington, 2002, codified at RCW §43.340.005 et seq., as amended (the "**Act**"). Under authority of the Act, the State sold the Pledged TSRs to the Authority.

Pursuant to the Act, 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, prior to 366 days after the Authority's bonds are no longer outstanding.

Sale of Tobacco Settlement Revenues .... Pursuant to a Purchase and Sale Agreement, dated as of October 1, 2002 (the "**Sale Agreement**"), between the State and the Authority, the State sold the Pledged TSRs to the Authority. The Authority has assigned and pledged the 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 SALE AGREEMENT."

Securities Offered .... The Series 2013 Bonds will be issued pursuant to the Indenture. It is expected that the Series 2013 Bonds will be delivered in book-entry form on or about October 17, 2013 (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 2013 Bonds will not receive physical delivery of bond certificates. See "THE SERIES 2013 BONDS—Book-Entry Only System."

Security for the Bonds .... The Series 2013 Bonds, together with any Refunding Bonds (as defined below) to be issued under the Indenture (collectively, the "**Bonds**"), are limited obligations of the Authority secured by and payable from the "**Collateral**," consisting of all of the Authority's right, title and interest, whether now owned or later acquired, 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 (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 described in the following paragraph, all rights and interest of the Authority under the Sale Agreement, including the representations, warranties and covenants of the State in the Sale Agreement; (5) 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; (6) all proceeds of the foregoing; and (7) 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 Collateral does not include: (i) the Unpledged TSRs, (ii) 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 (iii) any right or power reserved to the Authority pursuant to the Act or other law. The assignment and pledge of the Collateral does not preclude the Authority's enforcement of its rights under and pursuant to the Sale Agreement for the benefit of the Bondholders.

Covenants. .... The Authority and the State have made certain covenants for the benefit of the Bondholders. The Authority has covenanted in the Sale Agreement and the Indenture not to impair the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes. The State has covenanted in the Sale Agreement, and 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 under the Sale 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 Bondholders or the Indenture Trustee 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 State's Qualifying Statute, and (6) not amend, supersede or repeal the State's 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 Appendix E—"DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS—The Indenture" for a summary of the covenants made by the Authority and "—The Sale Agreement" for a summary of the covenants made by the State to the Authority in the Sale Agreement.

Master Settlement Agreement...... The MSA was entered into on November 23, 1998, among the attorneys general of 46 states (including the State), 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**"). On January 5, 2004, Reynolds American Inc. ("**Reynolds American**") was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities and operations of B&W with those of Reynolds Tobacco, which occurred on June 30, 2004. References herein to the "Original Participating Manufacturers" or "OPMs" mean, for the period prior to June 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard and for the period on and after June 30, 2004, collectively Philip Morris, Reynolds American and Lorillard.

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 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 MASTER SETTLEMENT AGREEMENT."

"**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.

MSA Payments. .... Under the MSA, the OPMs are required to pay to the Settling States (1) five initial payments, all of which have been paid (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 through April 15, 2013 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, of which the April 15, 2008 through April 15, 2013 payments have already been paid (the "**Strategic Contribution Payments**").

Under the MSA, each OPM is required to pay an allocable portion of each Annual Payment and Strategic Contribution Payment based on its relative market share (as determined in accordance with the MSA, "**Relative Market Share**") of cigarettes shipped in the United States by the OPMs during the preceding calendar year. Each SPM has Annual Payment and Strategic Contribution Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share (as determined in accordance with the MSA, "**Market Share**"). However, any SPM that became a party to the MSA within 90 days after it became effective pays only if its Market Share exceeds the higher of its 1998 Market Share or 125% of its 1997 Market Share (such higher share, the "**Base Share**").

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 Citibank, N.A., as the MSA Escrow Agent appointed pursuant to the MSA (the "**MSA Escrow Agent**"), which is required, in turn, to remit an allocable share of such payments to the State. Upon the sale of the Pledged TSRs, the State directed the MSA Escrow Agent to remit the Pledged TSRs directly to the Indenture Trustee. Such direction is irrevocable until the Bonds have been repaid. Under the MSA, the State is entitled to 2.0532582% of the Annual Payments and 5.7647432% of the Strategic Contribution Payments made by the PMs under the MSA.

As reported by the National Association of Attorneys General ("**NAAG**"), based upon OPM shipments reported to Management Science Associates, Inc., an independent third-party database management organization that collects wholesale shipment data ("**MSAI**"), the OPMs accounted for approximately 84.81%* of the U.S. domestic cigarette market in payment year 2013 (sales year 2012), based upon shipments and measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate, or approximately 84.52%* measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate.

Also as reported by NAAG, based upon shipments reported to MSAI, the SPMs accounted for approximately 9.11%* of the U.S. domestic cigarette market in payment year 2013 (sales year 2012), based upon shipments and measuring roll your own cigarettes at 0.09 ounces per cigarette conversion rate, or approximately 9.39%* measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate.

Payments under the MSA are subject to various adjustments, offsets and recalculations, including the NPM Adjustment, as described herein. On September 11, 2013, a panel arbitrating the 2003 NPM Adjustment claims determined that the State is not subject to the 2003 NPM Adjustment because the State diligently enforced its Qualifying Statute (defined herein) in 2003. No assurance can be given as to whether the State will be subject to NPM Adjustments for sales years subsequent to 2003.

See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT."

Industry Overview .... The three OPMs – Philip Morris, Reynolds American and Lorillard – are the largest manufacturers of cigarettes in the United States (based on 2012 domestic market share). The market for cigarettes is highly competitive and is characterized by brand recognition. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY."

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* The aggregate market share information is based on information as reported by NAAG and may differ materially from the market share information as reported by the OPMs for purposes of their filings with the Securities and Exchange Commission. See "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" and "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY." The aggregate market share information for 2013 from NAAG used in the Cash Flow Assumptions may differ materially in the future from the market share information used by the MSA Auditor in calculating the adjustments to Annual Payments and Strategic Contribution Payments in future years. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT– Adjustments to Payments."

Cigarette Consumption .... As described in the IHS Global 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, 1990s and 2000s, falling to less than 400 billion cigarettes in 2003 and when measured by cigarette shipments, is estimated to have fallen to approximately 290.1 billion cigarettes (measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate) in sales year 2012, as reported by NAAG. Reynolds Tobacco reported in its 10-K filed with the SEC for calendar year 2012 that total domestic tobacco cigarette shipment volume fell to 286.5 billion cigarettes in calendar year 2012. See "SUMMARY OF IHS GLOBAL REPORT."

IHS Global Report .... IHS Global Inc. ("**IHS Global**"), formerly known as DRI•WEFA, Inc., has prepared a report dated October 2, 2013 on the consumption of cigarettes in the United States from 2013 through 2033 entitled, "A Forecast of U.S. Cigarette Consumption (2013-2033) for the Tobacco Settlement Authority" (the "**IHS Global Report**"). IHS Global is an internationally recognized econometric and consulting firm of over 300 economists and is a part of IHS Inc., a global information company with over 1,000 researchers, analysts, and economists in more than 30 countries.

IHS Global has developed a cigarette consumption model based on historical United States data between 1965 and 2012. IHS Global constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building this empirical model of adult per capita cigarette consumption in the U.S. (real cigarette prices, real per capita disposable personal income, the impact of workplace smoking restrictions first instituted widely in the 1980s, the stricter restrictions on smoking in public places instituted over the last decade, and the trend over time in individual behavior and preferences), IHS Global employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The multivariate regression analysis showed, among other things, (i) long-run price elasticity of consumption of –-0.33; (ii) income elasticity of consumption of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.4% per year, resulting in IHS Global's projection of the average annual rate of decline in U.S. cigarette consumption from 2012 through 2033 to be 3.1% and of total consumption in 2033 to be 149 billion cigarettes (a 48% decline from the 2012 level). The projections and forecasts regarding future cigarette consumption included in the IHS Global 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. See "SUMMARY OF IHS GLOBAL REPORT" herein and "APPENDIX D—IHS GLOBAL REPORT" attached hereto.

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 as defined in the MSA.

Liquidity Reserve Account. .... A reserve account (the "**Liquidity Reserve Account**") will be established and maintained by the Indenture Trustee under the Indenture in an amount equal to $31,997,719.44 (the "**Liquidity Reserve Requirement**"). Amounts on deposit in the Liquidity Reserve Account will be available to pay interest and Principal Maturities and Sinking Fund Installments, if any, to the extent amounts in the Capitalized Interest Subaccount (in the case of interest), the Debt Service Account, the Partial Lump Sum Payment Account and the Surplus Account are insufficient for such purpose. Any amount remaining after such payments in excess of the Liquidity Reserve Requirement will be deposited in the Collections Account. See "SECURITY—Application of Revenues" herein.

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*."

Flow of Funds .... The State has provided irrevocable directions to the MSA Escrow Agent to disburse the amounts constituting the Pledged TSRs from the Washington-Specific Account directly to the Indenture Trustee. Promptly upon receipt, the Indenture Trustee will deposit all such amounts in an account established and maintained by the Indenture Trustee under the Indenture (the "**Collections Account**"). No later than five Business Days following each deposit of Pledged TSRs to the Collections Account (but in no event later than the next Distribution Date), the Indenture Trustee (unless an Event of Default has occurred) will withdraw funds on deposit in the Collections Account and transfer such amounts to the accounts and in the order of priority set forth in the Indenture. After making the transfers required by the order of priority set forth in the Indenture, the Indenture Trustee (unless an Event of Default has occurred) will transfer the remaining balance in the Collections Account into the Surplus Account. On each Distribution Date, the Indenture Trustee will apply amounts in such accounts in the order of priority set forth in the Indenture (and, upon the occurrence of an Event of Default, as defined herein, the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account and the Partial Lump Sum Payment Account as set forth in the Indenture). See "SECURITY—Application of Revenues" herein.

Additional Bonds .... 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 has occurred; and (3) based upon updated cash flow projections, the amounts expected to be delivered to the owner of the Residual Certificate, assuming delivery of such Refunding Bonds, are

greater than the amounts expected to be delivered to the owner of the Residual Certificate, assuming such Refunding Bonds are not issued. See “SECURITY—Additional Bonds”. No bonds other than the Series 2013 Bonds and Refunding Bonds may be issued under the Indenture.

“**Refunding Bonds**” means Bonds, other than the Series 2013 Bonds, issued pursuant to the Indenture for the purposes of refunding any Outstanding Bonds.

“**Residual Certificate**” means an instrument in the form attached 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.

Events of Default .... For a description of the Events of Default under the Indenture and the remedies available therefor, see “THE SERIES 2013 BONDS—Events of Default and Remedies.”

Interest on the Series 2013 Bonds. .... Interest on the Outstanding principal amount of the Series 2013 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, 2014. 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 2013 Bonds when due is an Event of Default under the Indenture. See “SECURITY—Flow of Funds” and “THE SERIES 2013 BONDS—Events of Default and Remedies.”

Optional Redemption.................. The Series 2013 Bonds maturing on or prior to June 1, 2023 are not subject to optional redemption.

The Series 2013 Bonds maturing on the Maturity Dates set forth in the table below are subject to redemption in whole or in part, at any time on or after the first optional redemption date set forth in the table below, at the option of the Authority at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

Maturity Date (June 1)	First Optional Redemption Date (June 1)
2024	2014
2025	2015
2026	2016
2027	2017
2028	2018
2029	2018
2030	2019
2031	2020
2032	2021
2033	2022

Mandatory Clean Up Call .... The Series 2013 Bonds other than Defeased 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.
Surplus Account..........................	Except for an amount not greater than $5,000, amounts deposited in the Surplus Account will be applied or set aside by the Indenture Trustee, in the following order of priority and in accordance with directions in an Officer's Certificate, at any time not later than the Distribution Date following such deposit: (1) in chronological order of maturity, to pay or provide for the payment of the redemption price of Outstanding Bonds then subject to optional redemption, or to become subject to optional redemption as of the next succeeding June 1, if any, or to purchase such Outstanding Bonds at a price no greater than 100% of the principal amount thereof plus accrued interest thereon, (2) to the extent that, as set forth in an Officer's Certificate, Outstanding Bonds are not available for optional redemption or purchase pursuant to clause (1) hereof, to pay the purchase price of Outstanding Bonds of any maturity in accordance with the Indenture, or (3) to the extent that, as set forth in an Officer's Certificate, Outstanding Bonds are not available for optional redemption or purchase pursuant to clause (2) hereof, to transfer any remaining balance to the Debt Service Account to pay or provide for the debt service on Bonds on any date; provided, however, that between April 15 and the next Distribution Date in each year, no amounts in the Surplus Account will be applied or set aside pursuant to clauses (1) through (3) above unless there is held in the Collections Account, the Debt Service Account and the Partial Lump Sum Payment Account sufficient amounts to pay all interest, Principal Maturities and Sinking Fund Installments due on such Distribution Date and on the next succeeding Distribution Date.
Tax Matters.................................	In the opinions of Hawkins Delafield & Wood LLP and Pacifica Law Group LLP, as Co-Bond Counsel to the Authority ("**Co-Bond Counsel**"), under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (1) interest on the Series 2013 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 2013 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."
Continuing Disclosure Agreement...................................	The Authority has agreed to provide, or cause to be provided, to the Municipal Securities Rulemaking Board (the "**MSRB**"), through its Electronic Municipal Market Access ("**EMMA**") system, pursuant to Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission (the "**SEC**"), certain annual financial information and operating data and, in a timely manner, notices of certain specified events. See "CONTINUING DISCLOSURE AGREEMENT" herein.

Ratings. .... Standard & Poor's Ratings Services, a Division of The McGraw-Hill Companies, Inc. ("**S&P**" or the "**Rating Agency**"), is expected to assign a rating of "A" to the Series 2013 Bonds maturing in the years 2014 through 2023, and a rating of "A-" to the Series 2013 Bonds maturing in the years 2024 through 2033.

Such ratings reflect only the views of S&P, and explanations of the significance of such ratings may be obtained only from S&P. The Authority makes no representation as to the appropriateness of the ratings. The ratings for the Series 2013 Bonds address (i) the payment of interest on the Series 2013 Bonds when due, and (ii) the payment of Principal Maturities when due. A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to downward revision or withdrawal at any time. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price or marketability of the Series 2013 Bonds. See "RATINGS."

Legal Considerations. .... See "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS" for a description of certain legal issues relevant to an investment in the Series 2013 Bonds.

Litigation Regarding the MSA and Related Statutes..................... Numerous lawsuits have been filed challenging the MSA and related statutes. The plaintiffs in such cases generally sought, unsuccessfully, determinations that state statutes enacted pursuant to the MSA conflict with, and are preempted by, the federal antitrust laws, among other statutory and constitutional claims. An ultimate determination in a future case that the MSA or a defendant state's legislation enacted pursuant to the MSA is void or unenforceable (a) could have a materially adverse effect on the payments by the PMs under the MSA and the amount and/or timing of the Pledged TSRs available to the Authority, and (b) could lead to a decrease in the market value and or liquidity of the Series 2013 Bonds. Such a determination could result in a complete loss of the Pledged TSRs. See "BONDHOLDERS' RISKS," "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRs" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

Bondholders' Risks..................... See "BONDHOLDERS' RISKS" for a description of certain considerations relevant to an investment in the Series 2013 Bonds.

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INTRODUCTORY STATEMENT

This Official Statement sets forth information concerning the issuance by the Tobacco Settlement Authority (the "**Authority**") of $334,700,000 aggregate principal amount of its Tobacco Settlement Revenue Refunding Bonds, Series 2013 (the "**Series 2013 Bonds**"). The Series 2013 Bonds are being issued pursuant to an Indenture between the Authority and U.S. Bank National Association, Seattle, Washington, as trustee (the "**Indenture Trustee**"), dated as of October 1, 2002, as amended and restated on the date of delivery of the Series 2013 Bonds and the Series 2013 Supplement between the Authority and the Indenture Trustee, dated as of the date of delivery of the Series 2013 Bonds (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 has previously purchased from the State, pursuant to the Purchase and Sale Agreement, dated as of October 2, 2002 (the "**Sale Agreement**"), by and between the State and the Authority, all right, title and interest of the State in and to the Pledged TSRs (as such term is defined below) required to be paid to the State under the Master Settlement Agreement (the "**MSA**") entered into by participating tobacco product manufacturers (the "**PMs**"), 46 states and six other U.S. jurisdictions on November 23, 1998 in settlement of certain smoking-related litigation, including the State's rights to receive certain annual and strategic contribution payments to be made by the PMs under the MSA and under the Consent Decree (as defined herein). Pursuant to the Indenture, the Authority has pledged all of the Authority's right, title and interest in and to receive the "**Pledged TSRs**" which consist of 29.2% of:

(a) the payments 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.

The Pledged TSRs are subject to numerous adjustments, offsets and recalculations, some of which are material, including the NPM Adjustment discussed herein. On September 11, 2013, a panel arbitrating the 2003 NPM Adjustment claims determined that the State is not subject to the 2003 NPM Adjustment because the State diligently enforced its Qualifying Statute (defined herein) in 2003. No assurance can be given as to whether the State will be subject to NPM Adjustments for sales years subsequent to 2003. See "BONDHOLDERS" RISKS—Potential Payment Decreases Under the Terms of the MSA—*NPM Adjustment*" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Potential Payment Decreases Under the Terms of the MSA—*NPM Adjustment*—Application of NPM Adjustment" and "—2003 NPM Adjustment; Arbitration Results." A copy of the Arbitration Final Award Re: State of Washington in the 2003 NPM Adjustment Proceedings is attached hereto as APPENDIX C.

The proceeds of the Series 2013 Bonds will be applied, together with other available funds of the Authority, (i) to refund on a current basis all of the Authority's outstanding Tobacco Settlement Asset-Backed Bonds, Series 2002 (the "**Series 2002 Bonds**") which were issued to finance the Authority's

purchase of the Pledged TSRs and (ii) to pay the costs of issuance incurred in connection with the issuance of the Series 2013 Bonds.

The MSA 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 Annual Payments made by the PMs under the MSA and 5.7647432% of the Strategic Contribution Payments made by the PMs under the MSA.

Pursuant to Chapter 365, Laws of Washington, 2002, codified at RCW §43.340.005 et seq., as amended (the "**Act**") and under the Indenture, the Series 2013 Bonds, together with any Refunding Bonds (as defined below) to be issued under the Indenture (collectively, the "**Bonds**") are secured by a first-priority pledge of the Collections and certain funds and accounts, and amounts therein, established for the Bonds under the Indenture. See "SECURITY" below.

Interest on the Outstanding principal amount of the Series 2013 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 (each, a "**Distribution Date**"), commencing June 1, 2014. Principal of the Series 2013 Bonds is payable according to the schedules of Principal Maturities, all as described under "THE SERIES 2013 BONDS."

Failure to pay interest, Principal Maturities and Sinking Fund Installments, if any, when due will constitute an Event of Default under the Indenture.

Certain methodologies and assumptions were utilized to establish the amounts and Maturity Dates of the Series 2013 Bonds, as described under "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS." The amount and timing of payments on the Series 2013 Bonds may be affected by various factors. See "BONDHOLDERS' RISKS" herein.

SECURITY

Sale of Pledged TSRs; Pledge of Collateral

Pursuant to the Act and the Sale Agreement, the State sold to the Authority the Pledged TSRs. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—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, whether now owned or later acquired, 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 (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 described in the following paragraph, all rights and interest of the Authority under the Sale Agreement, including the representations, warranties and covenants of the State in the Sale Agreement; (5) 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; (6) all proceeds of the foregoing; and (7) 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 Collateral does not include: (i) the "**Unpledged TSRs**" (which are 70.8% of: (a) the payments 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), (ii) 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 (iii) any right or power reserved to the Authority pursuant to the Act or other law; nor does the assignment and pledge of the Collateral preclude the Authority's enforcement of its rights under and pursuant to the Sale Agreement for the benefit of the Bondholders. 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 and are not subject to the lien of the Indenture. The right of the Authority to receive the Pledged TSRs is valid and enforceable and on a parity with the claim of the State to the Unpledged TSRs. Neither the Authority nor the Indenture Trustee has 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 has 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 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 2013 Bonds. The Authority has no taxing power. **The Series 2013 Bonds are limited obligations of the Authority. The Series 2013 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 2013 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 2013 Bonds.**

Payment by MSA Escrow Agent to Indenture Trustee

Upon the sale by the State of the Pledged TSRs to the Authority, the State directed 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 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 that have been identified by an Officer's Certificate as consisting of Partial Lump Sum Payments will be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Partial Lump Sum Payment Account, in accordance with the instructions received by the Indenture Trustee pursuant to an Officer's Certificate. All Collections that have been identified by an Officer's Certificate as consisting of Total Lump Sum Payments will be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) applied in the manner described in the seventh paragraph under "*Distribution Date Transfers*" below, in accordance with the instructions received by the Indenture Trustee pursuant to an Officer's Certificate. 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*" below (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 realized gains from investments (other than investment earnings) determined pursuant to the valuation of investments in each Account by the Indenture Trustee as of each Deposit Date (excluding such gains in the Costs of Issuance Account, the Rebate Account and the Partial Lump Sum Payment Account).

To the extent that the Indenture Trustee receives an amount constituting Unpledged TSRs (as confirmed in writing to the Indenture Trustee in an Officer's Certificate), the Indenture Trustee will promptly remit such amount to or upon the order of the State and thereupon notify the State of such remittance in accordance with an Officer's Certificate.

"**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, an amount sufficient to cause the amount therein to equal the amount specified by the Officer's Certificate most recently delivered (or deemed delivered) pursuant to the Indenture 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 (as certified or deemed certified in accordance with the Indenture);

(b) to the Debt Service Account, an amount sufficient to cause the amount therein to equal the sum of (i) interest on the Outstanding Bonds that will come due on the next two Distribution Dates, 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 subparagraph (b) will be calculated

assuming that principal of the Bonds will have been paid as described in subparagraphs (b), (c) and (d) under "*Distribution Date Transfers*" below;

(c) to the Debt Service Account, an amount sufficient to cause the amount therein to equal the amount specified in subparagraph (b) above plus the sum of (i) the Principal Maturities and Sinking Fund Installments, if any, due in or scheduled for the next succeeding Bond Year, plus (ii) any such Principal Maturities and Sinking Fund Installments unpaid from prior Distribution Dates; provided, that there will be applied to or credited against any such Sinking Fund Installment, in chronological order, the principal amount of any Bonds subject to redemption therefrom that have been defeased, purchased or redeemed and not previously so applied or credited;

(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 delivered pursuant to the Indenture in order to pay, for the Fiscal Year applicable to such Officer's Certificate, the Operating Expenses in excess of the Operating Cap; and

(f) unless an Event of Default has occurred, to the Surplus Account, the remaining amount.

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

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

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

"**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 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 Authority, 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 Sale Agreement, the Authority Tax Certificate or the Bonds, and all other expenses so identified as Operating Expenses in the Indenture.

"**Operating Cap**" means (i) $351,973.64 in the Fiscal Year ending June 30, 2014, 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 the calendar year ending in such Fiscal Year, and "y" equals the Inflation Adjustment Percentage applicable to MSA payments due in the preceding Fiscal Year, plus (ii) in each Fiscal Year, arbitrage payments, rebate, and penalties specified in an Officer's Certificate.

"**Principal Maturity** " means the principal payment required to be made on a Bond on the final date on which all remaining principal of such Bonds is due and payable.

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

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

(b) on each Distribution Date, from the Debt Service Account, the Partial Lump Sum Payment Account, the Surplus Account and the Liquidity Reserve Account, in that order, to pay, in the following order, the Principal Maturities and the Sinking Fund Installments, if any, due on or scheduled for such Distribution Date; *provided*, that there will be applied to or credited against any such Sinking Fund Installment, in chronological order, the principal amount of any Bonds subject to redemption therefrom that have been defeased, purchased or redeemed and not previously so applied or credited;

(c) on each Distribution Date, from the Partial Lump Sum Payment Account, to the Surplus Account for the purchase or redemption of Bonds, but only as directed in an Officer's Certificate delivered by the Authority and accompanied by evidence from each rating agency that has a rating then in effect for the Bonds that no rating then in effect with respect to the Bonds will be withdrawn, reduced or suspended solely as a result of such application of amounts in the Partial Lump Sum Payment Account; and

(d) except for an amount not greater than $5,000, from the Surplus Account, to be applied or set aside by the Indenture Trustee in the following order of priority and in accordance with directions in an Officer's Certificate, at any time not later than the Distribution Date following such deposit: (1) in chronological order of maturity, to pay or provide for the payment of the redemption price of Outstanding Bonds then subject to optional redemption, or to become subject to optional redemption as of the next succeeding June 1, if any, or to purchase such Outstanding Bonds at a price no greater than 100% of the principal amount thereof plus accrued interest thereon, (2) to the extent that, as set forth in an Officer's Certificate, Outstanding Bonds are not available for optional redemption or purchase pursuant to subclause (1) of this clause (d), to pay the purchase price of Outstanding Bonds of any maturity in accordance with the open market purchase provisions described below, or (3) to the extent that, as set forth in an Officer's Certificate, Outstanding Bonds are not available for optional redemption or purchase pursuant to subclause (2) of this clause (d), to transfer any remaining balance to the Debt Service Account to pay or provide for the debt service on Bonds on any date; provided, however, that between April 15 and the next Distribution Date in each year, no amounts in the Surplus Account will be applied or set aside pursuant to subclauses (1) through (3) hereof unless there is held in the Collections Account, the Debt Service Account and the Partial Lump Sum Payment Account sufficient amounts to pay all interest, Principal Maturities and Sinking Fund Installments due on such Distribution Date and on the next succeeding Distribution Date.

The Authority may cause the Indenture Trustee to purchase Bonds in the open market from money in the Surplus Account available therefor pursuant to subclause (1) of clause (d) above, at any price not exceeding 100% of the principal amount of the Outstanding Bonds being purchased at such time, plus accrued interest thereon.

The Authority may cause the Indenture Trustee to purchase Bonds in the open market from money in the Surplus Account available therefor pursuant to subclause (2) of clause (d) above, at any price not exceeding the sum of 100% of the principal amount of the Outstanding Bonds being purchased at such time, plus a premium not greater than the interest rate payable on such Bonds being purchased multiplied by a fraction (a) the numerator of which is the number of days from the purchase date thereof to the next date on which such Bonds are subject to optional redemption, and (b) the denominator of which is 360, plus accrued interest thereon, *provided* that such purchase price, including accrued interest, is no greater than the cost of purchasing a portfolio of securities on such purchase date consisting exclusively of investments described in the Indenture sufficient to defease and redeem such Bonds as of their first optional redemption date as set forth in an Officer's Certificate, which may rely on a report of a nationally recognized financial advisory firm or a firm of nationally recognized defeasance escrow verification agents.

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 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).

On each Distribution Date after the occurrence of any Event of Default the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account and the Partial Lump Sum Payment Account to pay Pro Rata, first, the accrued interest on the Bonds (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 sum that has been identified by an Officer's Certificate as a Total Lump Sum Payment, the Indenture Trustee will, after making provision for the amounts required to be deposited pursuant to subparagraph (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 (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.

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

See APPENDIX E—"DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS."

THE SERIES 2013 BONDS

The following summary describes certain terms of the Series 2013 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 2013 Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee.

The Series 2013 Bonds will initially be represented by one or more bond certificates registered in the name of The Depository Trust Company, New York, New York ("**DTC**") or its nominee. DTC will act as securities depository for the Series 2013 Bonds. The Series 2013 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 2013 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Series 2013 Bonds. See "THE SERIES 2013 BONDS—Book—Entry Only System."

Payments of Interest

Interest on the Outstanding principal balance of the Series 2013 Bonds will be payable on each Distribution Date. Interest will accrue from and including the Closing Date. Interest on the Series 2013 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 under the Indenture.

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. See "SECURITY—Application of Revenues—*Distribution Date Transfers.*"

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 a Saturday, a Sunday, a day on which banking institutions in New York, New York, Seattle, Washington, or the city in which the Corporate Trust Office of the Indenture Trustee is located are required or authorized by law to be closed; a day on which the New York Stock Exchange is closed; or a day on which the payment system of the Federal Reserve System is not operational.

Redemption Provisions

Optional Redemption

The Series 2013 Bonds maturing on or prior to June 1, 2023 are not subject to optional redemption.

The Series 2013 Bonds maturing on the Maturity Dates set forth in the table below are subject to redemption in whole or in part, at any time on or after the first optional redemption date set forth in the table below, at the option of the Authority at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

Maturity Date (June 1)	First Optional Redemption Date (June 1)
2024	2014
2025	2015
2026	2016
2027	2017
2028	2018
2029	2018
2030	2019
2031	2020
2032	2021
2033	2022

Mandatory Clean-Up Call

The Series 2013 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 2013 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 2013 Bonds to be redeemed, state the date fixed for redemption and state that such Series 2013 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 2013 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 20 days' notice (or such shorter period permitted by DTC if DTC or its nominee is the Bondholder at the time such notice is given), by mail or otherwise transmit the redemption notice in accordance with any appropriate provisions of the Indenture, to the registered owners of any Series 2013 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 2013 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 2013 Bond. 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 5 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. The Indenture Trustee is required to comply with the rules, procedures, customs or practices of DTC in order to achieve a result consistent with the meaning and intent of the Indenture.

Additional Bonds

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 has occurred; and (3) based

upon updated cash flow projections, the amounts expected to be delivered to the owner of the Residual Certificate, assuming delivery of such Refunding Bonds, are greater than the amounts expected to be delivered to the owner of the Residual Certificate, assuming such Refunding Bonds are not issued. In determining compliance with clause (3) above, the Authority may rely conclusively on a certificate of a financial advisory or underwriting firm with respect to calculating amounts anticipated to be delivered to the owner of the Residual Certificate. Such calculations are to be based on new projections of Pledged TSRs and assume that projected balances in the Surplus Account are periodically utilized pursuant to the Indenture to optionally redeem, purchase, pay debt service on or defease Bonds. Further, the financial advisory or underwriting firm may rely on a report of a nationally recognized firm of economic experts on matters related to projected or forecasted cigarette consumption in the United States in order to develop new projections of Pledged TSRs.

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 2013 Bonds and Refunding Bonds may be issued under the Indenture. "**Refunding Bonds**" means Bonds, other than the Series 2013 Bonds, issued pursuant to the Indenture for the purposes of refunding any Outstanding Bonds.

Events of Default and Remedies

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, any Principal Maturity, Sinking Fund Installment or interest on any Bond (a "**Payment Default**"); (2) 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 (3) a material breach by the State of certain specified 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 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 clause (2) or (3), 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 or the State, as applicable, within said 60-day period and diligently pursued until the default is corrected.

Remedies

If an Event of Default occurs and is continuing, the Indenture Trustee may, and upon written request of the Holders of at least 25% in principal amount of the Bonds then Outstanding will, in its own name by action or proceeding in accordance with law: (1) enforce all rights of the Bondholders and require the Authority and the State to carry out their respective agreements with the Bondholders; (2) sue upon the Bonds; (3) require the Authority to account as if it were the trustee of an express trust for the Bondholders; and (4) enjoin any acts or things which may be unlawful or in violation of the rights of the Bondholders.

Upon a Payment Default, or a failure actually known to an Authorized Officer of the Indenture Trustee to make any other payment required by the Indenture within seven 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 certain provisions of the Indenture 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 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 will act for the protection of the Bondholders with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

On each Distribution Date after the occurrence of an Event of Default, the Bonds will be paid on a Pro Rata basis as described in the sixth paragraph under "SECURITY—Application of Revenues—*Distribution Date Transfers*."

Book-Entry Only System

DTC, the world's largest securities 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 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("**Direct Participants**") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("**DTCC**"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("**Indirect Participants**"). DTC has a Standard &

Poor's rating of AA+. 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 Series 2013 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2013 Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2013 Bond ("**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 2013 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 Series 2013 Bonds, except in the event that use of the book-entry system for the Series 2013 Bonds is discontinued.

To facilitate subsequent transfers, all Series 2013 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2013 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 2013 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2013 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Series 2013 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2013 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2013 Bond documents. For example, Beneficial Owners of the Series 2013 Bonds may wish to ascertain that the nominee holding the Series 2013 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices will be sent to DTC. If less than all of the Series 2013 Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2013 Bonds unless authorized by a Direct Participant in accordance with DTC's MMI 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 2013 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds and principal and interest payments on the Series 2013 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, 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 and principal and interest payments to Cede & Co. (or such 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 depository with respect to the Series 2013 Bonds at any time by giving reasonable notice to the Authority or the Indenture Trustee. Under such circumstances, in the event that a successor depository is not obtained, certificates for the Series 2013 Bonds are required to be printed and delivered.

The Authority may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered to DTC.

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 2013 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 2013 Bonds and the giving of notices, instructions or directions under the Indenture) as the sole Bondholder, and the rights of Beneficial Owners will be exercised only through DTC.

If (1) DTC is no longer willing or able to properly discharge its responsibilities with respect to the Series 2013 Bonds or other portion thereof, and the Authority advises the Indenture Trustee in writing that it is unable to locate a qualified successor Securities Depository, (2) the Authority at its option advises the Indenture Trustee in writing that it elects to terminate the book-entry system through DTC or (3) after the occurrence of any Event of Default, Beneficial Owners representing a majority of the principal amount of the Series 2013 Bonds held by DTC advise DTC in writing that the continuation of a book-entry system through DTC is no longer in the best interests of the Beneficial Owners, then DTC shall notify its Participants and the Indenture Trustee of the occurrence of any such event and of the availability of Series 2013 Bonds to registered owners requesting the same. Upon surrender to the Indenture Trustee of the typewritten Series 2013 Bonds held by DTC, accompanied by registration instructions, the Authority will execute and provide to the Indenture Trustee, and the Indenture Trustee will authenticate, Series 2013 Bonds in accordance with the instructions of DTC. Neither the Authority nor the Indenture Trustee will be liable for any delay in delivery of such instructions and may conclusively rely on, and will be fully protected in relying on, such instructions. Unless otherwise specified in an Officer's Certificate, the regular record date will in that event be the close of business on the tenth Business Day preceding a Distribution Date.

BENEFICIAL OWNERS SHOULD MAKE APPROPRIATE ARRANGEMENTS WITH THEIR BROKER OR DEALER TO RECEIVE NOTICES (INCLUDING NOTICES OF REDEMPTION) AND OTHER INFORMATION REGARDING THE SERIES 2013 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 DIRECT OR INDIRECT PARTICIPANTS WILL DISTRIBUTE PAYMENTS OF INTEREST, PREMIUM, IF ANY, PRINCIPAL MATURITIES, OR OTHER REDEMPTIONS WITH RESPECT TO THE SERIES 2013 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 OR DIRECT OR INDIRECT Participants WILL ACT IN THE MANNER DESCRIBED IN THIS OFFICIAL STATEMENT.

So long as Cede & Co. is the registered owner of the Series 2013 Bonds, as nominee for DTC, references in this Official Statement to Bondholders or registered owners of the Series 2013 Bonds (other than under "TAX MATTERS" below) will mean Cede & Co., as aforesaid, and will not mean the Beneficial Owners of the Series 2013 Bonds.

THE AUTHORITY

The Authority was created in 2002 as a public instrumentality and agency of the State of Washington, separate and distinct from the State, exercising public and essential governmental functions. The Authority is authorized to issue revenue bonds and refunding bonds secured by a portion of the future revenue stream available to the State under the MSA. Proceeds from the Series 2002 Bonds were used by the State for various purposes.

Pursuant to the Act, prior to 366 days after the Authority's bonds are no longer 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.

The Authority's address is 1000 Second Avenue, Seattle, Washington 98104 and its telephone number is (206) 464-7139. Additional information regarding the Authority and can be accessed at www.tsa-wa.org. Neither the information on the Authority's website, nor any links from that website, is part of this Official Statement, and such information cannot be relied upon to be accurate as of the date of this Official Statement, nor should any such information be relied upon to make investment decisions regarding the Series 2013 Bonds.

The powers of the Authority are vested in and exercised by a board which consists of five members appointed by the Governor of the State. The Chair of the Authority serves at the pleasure of the Governor. The other members of the Authority serve for overlapping terms of four years.

As of June 30, 2013, the members of the Authority and their principal occupations are as follows:

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Name	Principal Occupation
Carla M. DewBerry, Chair	Partner, K&L Gates, Seattle; practicing law in the areas of healthcare, mergers and acquisitions, and federal, state and local tax. A member of the Washington State Bar, the National Bar Association and the National Health Lawyers Association.
Mike Roberts, Secretary	Retired former State Senior Budget Assistant in the areas of transportation and capital construction/finance in the Office of Financial Management. Acted as the State's representative to the finance team and the Authority board for the Series 2002 Bonds issuance. Served as former Governor Locke's representative to the Transportation Improvement Board.
Jeff Newgard	Current President and former Chief Executive Officer of Yakima National Bank. Former Regional President of AmericanWest Bank and Regional Team Leader for Baker Boyer Bank. Also former Financial Chair for the Hanford Economic Investment Fund Committee, appointed by former Governor Locke. Member of the Yakima Masonic Lodge and the Heritage University Board.
Doug Breckel	Assistant Vice President of the Treasury Office and Finance and Facilities at the University of Washington overseeing the Asset and Liability, Real Estate, and Risk Management Offices. Also serves as the Senior Associate Treasurer for the Board of Regents at the University. Currently on the Board of Directors for the Washington Trails Association, serving as treasurer.
Marlis Petersen Spawn	Finance Director/Chief Financial Officer at Gonzaga Preparatory School. Licensed as a certified public accountant since 1989. Former Director of Accounting and Finance for Spokane Teachers Credit Union. Formerly served on the Board of Directors of Northwest Farm Credit Services, ACA and Spokane Teachers Credit Union.

The Authority's Executive Director is Kim Herman. Mr. Herman also serves as the Executive Director of the Washington State Housing Finance Commission (the "**Commission**") and the Washington Higher Education Facilities Authority. Mr. Herman is a native of Washington State and has served as a member of the Commission, as Washington Project Director of the United States Department of Housing and Urban Development's Rural Assistance Initiative Program, as Executive Director of the Housing Authority of the City of Yakima and as Manager of Single-Family Housing for the Portland Development Commission. Mr. Herman served on the Board of Directors of the National Council of State Housing Agencies for many years and served as the association's President from September 2006 to October 2008. He formerly served on the Board of Trustees for the Washington Center for Real Estate Research at Washington State University. He also has served on Fannie Mae's Western Regional Advisory Board, and the boards of the Rural Community Assistance Corporation and the Washington Low Income Housing Alliance. He currently serves on the Board of the National Rural Housing Coalition, the Board of Impact Capital, and the Affordable Housing Advisory Board. Mr. Herman is a graduate of Washington State University (B.A. 1967).

The Authority's Deputy Director is Paul R. Edwards. Mr. Edwards also serves in this capacity for the Washington State Housing Finance Commission and the Washington Higher Education Facilities

Authority. Mr. Edwards joined the Commission in November of 1998 as Director of Capital Projects, and became Deputy Director on November 1, 1999. He is a graduate of Morehouse College in Atlanta, Georgia (B.A. in Economics & Business Administration 1970), and received his Master of Science Industrial Administration degree from Carnegie-Mellon University in Pittsburgh, Pennsylvania (M.S.I.A. 1973). Mr. Edwards has held positions in corporate and real estate lending for more than twenty years. Prior to joining the Commission, Mr. Edwards was the Community Reinvestment Act Compliance Officer for Pacific First Bank and Manager of its Community Development Department. Mr. Edwards currently serves on the Board of the Washington Community Reinvestment Association.

The Authority's Senior Director of Finance and IT Services is Robert D. Cook. Mr. Cook also serves in this capacity for the Washington State Housing Finance Commission and the Washington Higher Education Facilities Authority. Mr. Cook joined the Commission in June 1996 with 18 years of accounting and finance experience in cooperative and nonprofit organizations. He is a graduate of the University of Missouri-Columbia (B.S., Business Administration-Accountancy 1978) and Northern Illinois University-DeKalb (M.B.A. 1990).

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ESTIMATED SOURCES AND USES OF FUNDS

The Authority will apply the proceeds of the Series 2013 Bonds, together with certain amounts available under the Indenture, to refund all of the Series 2002 Bonds and pay the costs of issuance of the Series 2013 Bonds. The expected application of such amounts is set forth below.

Sources of Funds:

Principal Amount:	$334,700,000.00
Original Issue Premium:	24,048,170.30
Liquidity Reserve Account for the Series 2002 Bonds:	45,534,107.25
Other Funds Held for the Series 2002 Bonds:	12,141,390.35
Total Sources	$416,423,667.90

Uses of Funds:

Refunding Escrow for the Series 2002 Bonds:	$381,157,600.47
Deposit to the Liquidity Reserve Account:	31,997,719.44
Costs of Issuance*:	1,294,657.80
Underwriters' Discount:	1,973,690.19
Total Uses	$416,423,667.90

*Includes legal fees, IHS Global's fees, verification agent's fees, printing costs, rating fees and certain other expenses related to the issuance of the Series 2013 Bonds.

TABLE OF PROJECTED DEBT SERVICE COVERAGE

Debt Service Coverage

The following table sets forth the projected debt service coverage for the Series 2013 Bonds based on application of the Collection Methodology and Assumptions and the Bond Structuring Methodology described herein under "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS", and assuming the Series 2013 Bonds bear interest at the rates described on the inside cover hereof and are not redeemed prior to maturity. Under such methodologies and assumptions, which include annual cigarette consumption in the United States as forecast in the IHS Global Report, the average projected debt service coverage ratio is 1.83x, with a minimum projected debt service coverage ratio of 1.25x in 2014 and a maximum projected debt service coverage ratio in 2033 of 5.05x. 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 Pledged TSRs received in such period plus earnings on the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement, and the denominator of which is Operating Expenses at the Operating Cap plus the net debt service which equals, for the Series 2013 Bonds, the sum of interest and principal required to be paid in such period. ***No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2013 Bonds will be as assumed, or that the other assumptions underlying the Collection Methodology and Assumptions and the Bond Structuring Methodology, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Collection Methodology and Assumptions and the Bond Structuring Methodology, the amounts available to the Authority to pay the principal of***

and interest on the Series 2013 Bonds could be adversely affected. See "BONDHOLDERS' RISKS" herein.

Estimated Series 2013 Bonds Debt Service Coverage
Based on IHS Global Forecast Consumption Decline, 2014-2033

Calendar Year	Total Collections[1]	Operating Expenses[2]	Principal	Interest	Total Debt Service and Operating Expenses[3]	Debt Service Coverage
2014	$53,918,930	$351,974	$24,515,000	$18,293,764	$43,160,738	1.25x
2015	49,464,630	362,533	20,495,000	15,245,300	36,102,833	1.37x
2016	49,314,150	373,409	19,730,000	14,239,675	34,343,084	1.44x
2017	49,134,355	384,611	19,025,000	13,270,800	32,680,411	1.50x
2018	41,042,472	396,149	13,215,000	12,464,800	26,075,949	1.57x
2019	40,867,358	408,034	13,665,000	11,792,800	25,865,834	1.58x
2020	40,692,132	420,275	13,970,000	11,101,925	25,492,200	1.60x
2021	40,573,284	432,883	13,880,000	10,405,675	24,718,558	1.64x
2022	40,488,124	445,870	14,510,000	9,695,925	24,651,795	1.64x
2023	40,460,495	459,246	15,235,000	8,952,300	24,646,546	1.64x
2024	40,484,071	473,023	15,815,000	8,176,050	24,464,073	1.65x
2025	40,562,497	487,214	16,485,000	7,368,550	24,340,764	1.67x
2026	40,684,111	501,830	17,240,000	6,525,425	24,267,255	1.68x
2027	40,835,341	516,885	17,550,000	5,655,675	23,722,560	1.72x
2028	41,004,714	532,392	17,670,000	4,753,088	22,955,479	1.79x
2029	41,177,532	548,363	18,125,000	3,813,469	22,486,832	1.83x
2030	41,347,210	564,814	18,125,000	2,861,906	21,551,721	1.92x
2031	41,516,922	581,759	18,940,000	1,888,950	21,410,709	1.94x
2032	41,690,120	599,212	19,060,000	891,450	20,550,662	2.03x
2033	41,746,617	617,188	7,450,000	195,563	8,262,750	5.05x

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(1) Includes Pledged TSRs plus earnings on the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement.
(2) Includes Operating Expenses at the Operating Cap.
(3) Includes principal, interest and Operating Expenses at the Operating Cap.

DEBT SERVICE COVERAGE UNDER ALTERNATIVE CONSUMPTION DECLINE SCENARIOS

Constant Year-Over-Year Consumption Declines

The following tables set forth projected debt service coverage for the Series 2013 Bonds based on alternative assumptions for annual cigarette consumption in the United States over the term of the Series 2013 Bonds and, with the exception of the forecast of cigarette consumption contained in the IHS Report, application of the Collection Methodology and Assumptions and the Bond Structuring Methodology described herein under "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS". In order to calculate Pledged TSRs under these alternative scenarios, constant year-over-year shipment declines of (i) 5%, (ii) 7%, and (iii) 10.38% were applied to NAAG reported sales year 2012 domestic cigarette shipments of 290.10 billion (measuring roll-your-own cigarettes at a 0.0325 ounces per cigarette conversion rate). The resulting calculated annual cigarette shipments in the United States corresponding to these four constant annual rates of decline are shown below:

Cigarette Consumption (in Billions of Cigarettes)

Sales Year	IHS Global Case	5% Decline Case	7% Decline Case	10.38% Decline Case
2013	279.30	275.60	269.80	259.99
2014	269.77	261.82	250.91	233.00
2015	260.49	248.73	233.35	208.82
2016	251.43	236.29	217.01	187.14
2017	242.41	224.48	201.82	167.72
2018	233.77	213.25	187.69	150.31
2019	225.60	202.59	174.55	134.71
2020	218.02	192.46	162.34	120.72
2021	210.86	182.84	150.97	108.19
2022	204.24	173.69	140.40	96.96
2023	198.08	165.01	130.58	86.90
2024	192.37	156.76	121.44	77.88
2025	187.03	148.92	112.94	69.79
2026	181.97	141.48	105.03	62.55
2027	177.12	134.40	97.68	56.06
2028	172.40	127.68	90.84	50.24
2029	167.79	121.30	84.48	45.02
2030	163.29	115.23	78.57	40.35
2031	158.91	109.47	73.07	36.16
2032	154.65	104.00	67.95	32.41
2033	150.40	98.80	63.20	29.04

Breakeven Consumption Decline Rates by Maturity

The following table sets forth the "breakeven" constant annual rate of consumption declines at which each maturity of the Series 2013 Bonds would be timely paid in full if (i) the Liquidity Reserve Account is maintained at the Liquidity Reserve Requirement and (ii) the Liquidity Reserve Account is used to pay debt service on or prior to maturity of each Series 2013 Bond and each such Series 2013 Bond is paid in full on a timely basis.

Series 2013 Bond Maturity	Breakeven Consumption Decline(1)	Breakeven Consumption Decline(2)(3)
2014	25.46%	90.17%
2015	18.46%	48.56%
2016	15.39%	33.36%
2017	13.83%	26.14%
2018	12.99%	22.25%
2019	11.81%	19.52%
2020	11.03%	17.44%
2021	10.61%	15.91%
2022	10.03%	14.65%
2023	9.55%	13.61%
2024	9.55%	13.61%
2025	9.55%	13.05%
2026	9.55%	12.45%
2027	9.55%	11.94%
2028	9.55%	11.51%
2029	9.55%	11.15%
2030	9.55%	10.86%
2031	9.55%	10.60%
2032	9.55%	10.38%
2033	9.55%	10.38%

(1) Assumes the Liquidity Reserve Account is maintained at the Liquidity Reserve Requirement. Assumes the Liquidity Reserve Account earnings earned each December 1 in excess of the Liquidity Reserve Requirement will not be included in available funds for the current annual period and will be included in available funds for the following annual period.

(2) Assumes the Liquidity Reserve Account is used to pay debt service on or prior to each respective maturity date and each such Series 2013 Bond is paid in full on a timely basis.

(3) The Liquidity Reserve Account earnings earned each December 1 in excess of the Liquidity Reserve Requirement will not be included in available funds for the current annual period and will be included in available funds for the following annual period, provided that, if the amount on deposit in available funds is insufficient to make all required interest payments on the Series 2013 Bonds, such Liquidity Reserve Account earnings will be used to make interest payments on the Series 2013 Bonds after application of available funds and included in "Total Available Funds" for the current annual period.

The following tables present the projected debt service on the Series 2013 Bonds assuming optional redemptions from the Surplus Account under the following scenarios: (i) IHS Global Forecast, (ii) 5% year-over-year consumption decline, (iii) 7% year-over-year consumption decline, and (iv) 10.38% year-over-year breakeven consumption decline. Pledged TSRs are received in accordance with the Cash Flow Assumptions (see "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein) and applied, subject to payment priorities set forth in the

Indenture including the application of Collection in accordance with the Surplus Account. See "SECURITY" herein.

Debt Service Schedule Assuming Optional Redemption of the Series 2013 Bonds from the Surplus Account IHS Global Forecast Consumption Decline

Calendar Year	Total Available Funds[1][2]	Principal	Interest	Optional Redemption	Operating Expenses	Total Debt Service[3]
2014	$53,914,130	$24,515,000	$18,018,139	$11,025,000	$351,974	$53,910,113
2015	49,433,450	20,495,000	14,338,175	14,235,000	362,533	49,430,708
2016	49,292,893	19,730,000	12,561,050	16,625,000	373,409	49,289,459
2017	49,121,791	19,025,000	10,701,300	19,010,000	384,611	49,120,911
2018	41,019,353	13,215,000	8,943,088	18,465,000	396,149	41,019,237
2019	40,851,475	13,665,000	7,282,381	19,495,000	408,034	40,850,415
2020	40,693,191	13,970,000	5,534,681	20,765,000	420,275	40,689,956
2021	40,576,519	13,880,000	3,701,150	22,560,000	432,883	40,574,033
2022	72,488,329	14,510,000	1,380,975	39,515,000	445,870	55,851,845

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(1) Total available funds for debt service include Pledged TSRs, plus Liquidity Reserve Account earnings in excess of the Liquidity Reserve Requirement, plus unused Surplus Account amounts at the end of the prior annual period.

(2) Assumes the Liquidity Reserve Account earnings earned each December 1 in excess of the Liquidity Reserve Requirement will not be included in available funds for the current annual period and will be included in available funds for the following annual period, provided that, if the amount on deposit in available funds is insufficient to make all required interest payments on the Series 2013 Bonds, such Liquidity Reserve Account earnings will be used to make interest payments on the Series 2013 Bonds after application of available funds and included in "Total Available Funds" for the current annual period.

(3) Totals may not add due to rounding.

Expected Optional Redemptions from the Surplus Account
IHS Global Forecast Consumption Decline

	Series 2013 Bond Maturities									
June 1	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
2014	$11,025,000									
2015	4,790,000	$ 9,445,000								
2016		7,040,000	$ 9,585,000							
2017			7,655,000	$11,355,000						
2018				6,195,000	$12,270,000					
2019					5,400,000	$14,095,000				
2020						4,030,000	$16,735,000			
2021							1,390,000	$18,940,000	$ 2,230,000	
2022									16,830,000	$7,450,000
Total	**$15,815,000**	**$16,485,000**	**$17,240,000**	**$17,550,000**	**$17,670,000**	**$18,125,000**	**$18,125,000**	**$18,940,000**	**$19,060,000**	**$7,450,000**
Average Life (in years)	0.925	2.049	3.066	3.975	4.928	5.845	6.699	7.622	8.505	8.622

Debt Service Schedule Assuming Optional Redemption of the Series 2013 Bonds from the Surplus Account 5% Year-Over-Year Consumption Decline

Calendar Year	Total Available Funds[1][2]	Principal	Interest	Optional Redemption	Operating Expenses	Total Debt Service[3]
2014	$53,283,704	$24,515,000	$18,034,264	$10,380,000	$351,974	$53,281,238
2015	48,034,681	20,495,000	14,407,050	12,770,000	362,533	48,034,583
2016	47,163,517	19,730,000	12,723,800	14,335,000	373,409	47,162,209
2017	46,299,796	19,025,000	10,999,300	15,890,000	384,611	46,298,911
2018	38,134,163	13,215,000	9,416,688	15,105,000	396,149	38,132,837
2019	37,453,712	13,665,000	7,960,550	15,420,000	408,034	37,453,584
2020	36,765,973	13,970,000	6,446,869	15,925,000	420,275	36,762,144
2021	36,085,176	13,880,000	4,889,488	16,880,000	432,883	36,082,371
2022	35,417,393	14,510,000	3,285,794	17,175,000	445,870	35,416,663
2023	66,763,729	15,235,000	1,236,100	32,580,000	459,246	49,510,346

(1) Total available funds for debt service include Pledged TSRs, plus Liquidity Reserve Account earnings in excess of the Liquidity Reserve Requirement, plus unused Surplus Account amounts at the end of the prior annual period.

(2) Assumes the Liquidity Reserve Account earnings earned each December 1 in excess of the Liquidity Reserve Requirement will not be included in available funds for the current annual period and will be included in available funds for the following annual period, provided that, if the amount on deposit in available funds is insufficient to make all required interest payments on the Series 2013 Bonds, such Liquidity Reserve Account earnings will be used to make interest payments on the Series 2013 Bonds after application of available funds and included in "Total Available Funds" for the current annual period.

(3) Totals may not add due to rounding.

Expected Optional Redemptions from the Surplus Account
5% Year-Over-Year Consumption Decline

	Series 2013 Bond Maturities									
June 1	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
2014	$10,380,000									
2015	5,435,000	$ 7,335,000								
2016		9,150,000	$ 5,185,000							
2017			12,055,000	$ 3,835,000						
2018				13,715,000	$ 1,390,000					
2019					15,420,000					
2020					860,000	$15,065,000				
2021						3,060,000	$13,820,000			
2022							4,305,000	$12,870,000		
2023								6,070,000	$19,060,000	$7,450,000
Total	**$15,815,000**	**$16,485,000**	**$17,240,000**	**$17,550,000**	**$17,670,000**	**$18,125,000**	**$18,125,000**	**$18,940,000**	**$19,060,000**	**$7,450,000**
Average Life (in years)	0.966	2.177	3.321	4.404	5.592	6.791	7.860	8.943	9.622	9.622

Debt Service Schedule Assuming Optional Redemption of the Series 2013 Bonds from the Surplus Account 7% Year-Over-Year Consumption Decline

Calendar Year	Total Available Funds(1)(2)	Principal	Interest	Optional Redemption	Operating Expenses	Total Debt Service(3)
2014	$52,294,582	$24,515,000	$18,059,639	$9,365,000	$351,974	$52,291,613
2015	46,119,850	20,495,000	14,508,300	10,750,000	362,533	46,115,833
2016	44,385,692	19,730,000	12,950,675	11,330,000	373,409	44,384,084
2017	42,708,777	19,025,000	11,401,175	11,895,000	384,611	42,705,786
2018	34,492,508	13,215,000	10,026,550	10,850,000	396,149	34,487,699
2019	33,223,088	13,665,000	8,825,300	10,320,000	408,034	33,218,334
2020	31,986,992	13,970,000	7,617,806	9,975,000	420,275	31,983,081
2021	30,790,930	13,880,000	6,398,469	10,075,000	432,883	30,786,352
2022	29,650,929	14,510,000	5,174,350	9,520,000	445,870	29,650,220
2023	28,558,778	15,235,000	3,946,806	8,915,000	459,246	28,556,052
2024	27,522,819	-	2,692,594	24,355,000	473,023	27,520,617
2025	58,530,364	-	1,026,638	39,110,000	487,214	40,623,851

(1) Total available funds for debt service include Pledged TSRs, plus Liquidity Reserve Account earnings in excess of the Liquidity Reserve Requirement, plus unused Surplus Account amounts at the end of the prior annual period.

(2) Assumes the Liquidity Reserve Account earnings earned each December 1 in excess of the Liquidity Reserve Requirement will not be included in available funds for the current annual period and will be included in available funds for the following annual period, provided that, if the amount on deposit in available funds is insufficient to make all required interest payments on the Series 2013 Bonds, such Liquidity Reserve Account earnings will be used to make interest payments on the Series 2013 Bonds after application of available funds and included in "Total Available Funds" for the current annual period.

(3) Totals may not add due to rounding.

Expected Optional Redemptions from the Surplus Account
7% Year-Over-Year Consumption Decline

	Series 2013 Bond Maturities									
June 1	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
2014	$ 9,365,000									
2015	6,450,000	$ 4,300,000								
2016		11,330,000								
2017		855,000	$11,040,000							
2018			6,200,000	$ 4,650,000						
2019				10,320,000						
2020				2,580,000	$ 7,395,000					
2021					10,075,000					
2022					200,000	$9,320,000				
2023						8,805,000	$ 110,000			
2024							18,015,000	$ 6,340,000		
2025								12,600,000	$19,060,000	$7,450,000
Total	**$15,815,000**	**$16,485,000**	**$17,240,000**	**$17,550,000**	**$17,670,000**	**$18,125,000**	**$18,125,000**	**$18,940,000**	**$19,060,000**	**$7,450,000**
Average Life (in years)	1.030	2.413	3.982	5.504	7.215	9.108	10.616	11.287	11.622	11.622

Debt Service Schedule Assuming Optional Redemption of the Series 2013 Bonds from the Surplus Account 10.38% Year-Over-Year Consumption Decline

Calendar Year	Total Available Funds[(1)(2)]	Principal	Interest	Optional Redemption	Operating Expenses	Total Debt Service[(3)]
2014	$50,622,968	$24,515,000	$18,102,514	$ 7,650,000	$351,974	$50,619,488
2015	42,976,076	20,495,000	14,676,800	7,440,000	362,533	42,974,333
2016	39,947,145	19,730,000	13,322,175	6,520,000	373,409	39,945,584
2017	37,144,416	19,025,000	12,048,175	5,685,000	384,611	37,142,786
2018	29,005,880	13,215,000	10,990,050	4,400,000	396,149	29,001,199
2019	27,029,508	13,665,000	10,137,675	2,815,000	408,034	27,025,709
2020	25,186,445	13,970,000	9,340,050	1,455,000	420,275	25,185,325
2021	23,474,602	13,880,000	8,593,300	565,000	432,883	23,471,183
2022	22,825,295	14,510,000	7,869,425	-	445,870	22,825,295
2023	22,820,046	15,235,000	7,125,800	-	459,246	22,820,046
2024	15,832,241	-	6,524,050	8,835,000	473,023	15,832,073
2025	17,914,270	-	6,018,050	11,405,000	487,214	17,910,264
2026	16,801,328	-	5,461,406	10,835,000	501,830	16,798,236
2027	15,776,808	-	4,918,463	10,340,000	516,885	15,775,348
2028	14,837,796	6,815,000	4,386,769	3,100,000	532,392	14,834,160
2029	19,305,457	15,025,000	3,732,094	-	548,363	19,305,457
2030	21,551,721	18,125,000	2,861,906	-	564,814	21,551,721
2031	21,410,709	18,940,000	1,888,950	-	581,759	21,410,709
2032	20,550,662	19,060,000	891,450	-	599,212	20,550,662
2033	11,364,455	7,450,000	195,563	-	617,188	8,262,750

(1) Total available funds for debt service include Pledged TSRs, plus Liquidity Reserve Account earnings in excess of the Liquidity Reserve Requirement, plus unused Surplus Account amounts at the end of the prior annual period, plus withdrawals from the Liquidity Reserve Account to pay debt service without a Payment Default.

(2) Assumes the Liquidity Reserve Account earnings earned each December 1 in excess of the Liquidity Reserve Requirement will not be included in available funds for the current annual period and will be included in available funds for the following annual period, provided that, if the amount on deposit in available funds is insufficient to make all required interest payments on the Series 2013 Bonds, such Liquidity Reserve Account earnings will be used to make interest payments on the Series 2013 Bonds after application of available funds and included in "Total Available Funds" for the current annual period.

(3) Totals may not add due to rounding.

Expected Optional Redemptions from the Surplus Account
10.38% Year-Over-Year Consumption Decline

	Series 2013 Bond Maturities									
June 1	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
2014	$ 7,650,000									
2015	7,440,000									
2016	725,000	$ 5,795,000								
2017		5,685,000								
2018		4,400,000								
2019		605,000	$ 2,210,000							
2020			1,455,000							
2021			565,000							
2022			-							
2023			-							
2024			8,835,000							
2025			4,175,000	$ 7,230,000						
2026				10,320,000	$ 515,000					
2027					10,340,000					
2028					6,815,000	$ 3,100,000				
2029						15,025,000				
2030							$18,125,000			
2031								$18,940,000		
2032									$19,060,000	
2033										$7,450,000
Total	**$15,815,000**	**$16,485,000**	**$17,240,000**	**$17,550,000**	**$17,670,000**	**$18,125,000**	**$18,125,000**	**$18,940,000**	**$19,060,000**	**$7,450,000**
Average Life (in years)	1.184	3.611	9.788	12.210	13.979	15.451	16.622	17.622	18.622	19.622

BONDHOLDERS' RISKS

Potential purchasers of the Series 2013 Bonds are advised to carefully consider the following factors, among others, and to review the other information in this Official Statement in evaluating an investment in the Series 2013 Bonds.

*The following discussion of the risks facing the domestic tobacco industry and potentially impacting the Pledged TSRs has been compiled from certain publicly available documents of the tobacco companies and their current or former parent companies, certain publicly available analyses of the tobacco industry and other public sources. Certain of those companies file annual, quarterly and certain other reports with the Securities and Exchange Commission (the "**SEC**"). Such reports are available on the SEC's website (www.sec.gov) and upon request from the SEC's Investor Information Service, 100 F Street, NE, Washington, D.C. 20549 (phone: (800) SEC-0330 or (202) 551-5450; fax: (202) 343-1028; e-mail: publicinfo@sec.gov).*

The list of risks set forth herein is not a complete list of the risks associated with the Pledged TSRs, nor does the order of presentation necessarily reflect the relative importance of the various and separate risks.

Any one or more of the risks discussed, and other risks, could lead to a decrease in the market value and/or the liquidity of the Series 2013 Bonds, a downward revision or withdrawal of ratings on the Series 2013 Bonds, or, in certain circumstances, in combination could lead to a complete loss of a Bondholder's investment. There can be no assurance that other BONDHOLDERS' RISKS will not become material in the future. Further information regarding these BONDHOLDERS' RISKS can be found under "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" and "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" herein.

Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments

The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material, including without limitation, the NPM Adjustment discussed below. Such adjustments, offsets and recalculations could significantly reduce the Pledged TSRs available to the Authority. Any such adjustments could trigger the Offset for Miscalculated or Disputed Payments and lead to significant reductions in Pledged TSRs. See "—Disputed MSA Payments and Potential for Significant Future Year Offsets to MSA Payments" below for a description of disputes concerning MSA payments and the calculation thereof, including a recent partial settlement that certain Settling States entered into regarding the NPM Adjustment. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments."

Disputed MSA Payments and Potential for Significant Future Year Offsets to MSA Payments

The Settling States and one or more of the PMs are disputing or have disputed the calculations of some Annual Payments and Strategic Contribution Payments totaling over $8.5 billion for the sales years 2003 through 2012 according to NAAG; including moneys withheld outright, deposited to the Disputed Payments Account or, as in the case of the largest OPM (Philip Morris USA), moneys actually paid by the PM to the states, but with the PM asserting a reservation of right to dispute such amount paid pursuant to the MSA. This total includes amounts that the OPMs have indicated that they have filed dispute

notices with respect to and significant additional amounts that may lead to claimed reductions in their MSA payments due in future years.

Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments that arise in prior years may result in the application of offsets against subsequent Annual Payments and Strategic Contribution Payments and such offsets may materially adversely affect the amount and timing of the payment of Pledged TSRs. The future diversion of disputed payments to the Disputed Payments Account, the withholding of all or a portion of any disputed amounts, or the application of offsets against future payments could lead to a decrease in the amount and/or timing of Pledged TSRs. Amounts held in the Disputed Payments Account relating to any sales year could be released to the PMs if, in the future, any Settling State is found to have not diligently enforced its Qualifying Statute during such sales year, or to those Settling States which, in the future, are found to have diligently enforced their respective Qualifying Statutes during such sales year. As discussed below, the State is expected to receive approximately $14.9 million with respect to the 2003 NPM Adjustment pursuant to the decision by a panel of three former federal judges arbitrating the 2003 NPM Adjustment claims (the "**Arbitration Panel**") that the State diligently enforced its Qualifying Statute in 2003; however, no assurance can be given as to the timing of such payment, or as to the future payment of amounts recovered with respect to the NPM Adjustment in years subsequent to 2003. Amounts held in the Disputed Payments Account could also be released pursuant to a settlement of the disputes among the Settling States and the PMs, as was the case in April 2013 in connection with the partial settlement (which the State has not joined) regarding the NPM Adjustment, as discussed below. See "—NPM Adjustment" below. Such amounts released from the Disputed Payments Account to the State could be used to optionally redeem, purchase, pay or defease Bonds pursuant to the Indenture. See "SECURITY—Application of Revenues—*Distribution Date Transfers*" above.

Any adjustments made in the form of a credit against future MSA payments could lead to material reductions in the Pledged TSRs available to pay principal and interest on the Series 2013 Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Adjustments to Payments — *Offset for Miscalculated or Disputed Payments"* and "— Potential Payment Decreases Under the Terms of the MSA - *NPM Adjustment* – Application of the NPM Adjustment*."*

NPM Adjustment

One of the adjustments under the MSA is the "**NPM Adjustment**," which operates in certain circumstances to reduce the payments of the PMs under the MSA in the event of losses in market share by PMs (who are subject to the payment obligations and marketing restrictions of the MSA) to non-participating manufacturers ("**NPMs**") (who are not subject to such obligations and restrictions), during a calendar year as a result of such PMs' participation in the MSA. Three conditions must be met in order to trigger an NPM Adjustment for one or more Settling States: (1) a market share loss for the applicable year must exist (as described herein); (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a "significant factor" contributing to the market share loss for the year in question; and (3) the Settling States in question must be found to not have diligently enforced their Qualifying Statutes. If the PMs make a claim for an NPM Adjustment for any particular year and the State is determined to be one of a few states (or the only state) not to have diligently enforced its Qualifying Statute in such year, the amount of the NPM Adjustment applied to the State in the year following such determination could be as great as the amount of Annual Payments and Strategic Contribution Payments that could otherwise have been received by the State in such year. No assurance can be made as to the magnitude of the effect of the NPM Adjustment on the amount and/or timing of Pledged TSRs available to the Authority to pay debt service on the Series 2013 Bonds.

Results of 2003 NPM Adjustment Arbitration; Future NPM Adjustment Arbitrations. The PMs have disputed MSA payments in sales years 2003 through 2012 on the basis that certain Settling States, including the State, did not diligently enforce their respective Qualifying Statutes in each of those years. The State was one of 15 contested states that were in arbitration proceedings with the PMs regarding the 2003 NPM Adjustment. The Arbitration Panel released its decision on September 11, 2013. The Arbitration Panel unanimously determined that the State diligently enforced its Qualifying Statute during sales year 2003 and therefore is not subject to the NPM Adjustment for 2003 pursuant to the MSA. The 2003 NPM Adjustment was allocated among those six states (which do not include the State), comprising an aggregate allocable share of 14.6792685%, that were determined by the Arbitration Panel to have failed to diligently enforce their respective Qualifying Statutes during sales year 2003. Proceedings to determine state diligent enforcement claims for sales years 2004 through 2012 have not yet been scheduled. The decision that the State diligently enforced its Qualifying Statute during sales year 2003 may not necessarily indicate that the State will be determined in future arbitrations to have diligently enforced its Qualifying Statute in additional sales years. A future determination that the State failed to diligently enforce its Qualifying Statute could result in a complete loss or substantial reduction in the amount of future Pledged TSRs up to the amount of the State's Pledged TSRs for such future sales years, plus interest due on all or a portion of such amount, if any. The State's Attorney General's office maintains that the State has been and is diligently enforcing its Qualifying Statute. For a more complete description of the 2003 NPM Adjustment arbitration and the 2004 through 2012 NPM Adjustment claims, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Potential Payment Decreases Under the Terms of the MSA—*NPM Adjustment*—Application of NPM Adjustment," "—2003 through 2012 NPM Adjustment Claims Generally," "—2003 NPM Adjustment; Arbitration Results," and "—Ongoing 2004 through 2012 NPM Adjustment Claims." A copy of the Arbitration Final Award Re: State of Washington in the 2003 NPM Adjustment Proceedings is attached hereto as APPENDIX C.

Stipulated Partial Settlement and Award. On December 17, 2012, terms of a settlement agreement (the "**NPM Adjustment Settlement Term Sheet**") were agreed to by 19 jurisdictions (which do not include the State), the OPMs and certain SPMs regarding claims related to the 2003 through 2012 NPM Adjustments and the determination of future NPM Adjustments. Three additional jurisdictions (Oklahoma, Connecticut and South Carolina) have joined the NPM Adjustment Settlement Term Sheet as of the date hereof. On March 12, 2013, the Arbitration Panel issued a Stipulated Partial Settlement and Award (the "**NPM Adjustment Stipulated Partial Settlement and Award**"), in which it ruled that the NPM Adjustment Settlement Term Sheet was binding on the signatory jurisdictions (the "**Term Sheet Signatories**") and directed PricewaterhouseCoopers LLP, the independent auditor under the MSA (the "**MSA Auditor**"), to implement the terms of the NPM Adjustment Settlement Term Sheet (including to release to the Term Sheet Signatories certain funds from the MSA's Disputed Payments Account). In connection with the April 2013 MSA Payment, the MSA Auditor implemented the provisions of the NPM Adjustment Settlement Term Sheet relating to the distributions from the Disputed Payments Account to 20 of the Term Sheet Signatories (Connecticut and South Carolina did not opt into the settlement until May 2013) and the credits to be allocated to the PMs in April 2013. The MSA Auditor had noted that, by implementing such distributions and credits with respect to the MSA payments due in April 2013, it was not committing to implement any provision of the NPM Adjustment Settlement Term Sheet other than those provisions relating to such distributions and credits with respect to the MSA payments that were due in April 2013. Under the NPM Adjustment Settlement Term Sheet, OPMs have received certain reductions in April 2013 and will receive reductions to future MSA payments to reflect a percentage of the Term Sheet Signatories' aggregate share of the OPMs' 2003 through 2012 NPM Adjustment claims, and each of the Term Sheet Signatories has received its allocable share of over $4.7 billion from the Disputed Payments Account under the MSA in connection with the April 2013 MSA Payment. The NPM Adjustment Settlement Term Sheet also details the determination of NPM Adjustments for 2013 onward for the Term Sheet Signatories.

Non-signatory jurisdictions, including the State (the "**Term Sheet Non-Signatories**") have objected to the NPM Adjustment Settlement Term Sheet and the jurisdiction of the Arbitration Panel and had attempted to instruct the MSA Auditor not to take any action to implement the NPM Adjustment Stipulated Partial Settlement and Award until proceedings initiated by Term Sheet Non-Signatories in objection to the NPM Adjustment Stipulated Partial Settlement and Award have been concluded. Two states, Colorado and Ohio, filed motions for preliminary injunctions against the implementation of the NPM Adjustment Stipulated Partial Settlement and Award in connection with the April 2013 MSA payment; both such motions were denied. As noted above, the MSA Auditor implemented the NPM Adjustment Stipulated Partial Settlement and Award as it related to the April 2013 MSA payments, over the objections of the Term Sheet Non-Signatories. Fourteen Term Sheet Non-Signatories filed motions to vacate and/or modify the NPM Adjustment Stipulated Partial Settlement and Award, including Connecticut and South Carolina, which subsequently became Term Sheet Signatories in May 2013. No assurance can be given that other challenges to the NPM Adjustment Stipulated Partial Settlement and Award will not be commenced in other MSA courts. For a discussion of the terms of the NPM Adjustment Settlement Term Sheet, the NPM Adjustment Stipulated Partial Settlement and Award and subsequent developments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Potential Payment Decreases Under the Terms of the MSA—*NPM Adjustment*—NPM Adjustment Settlement and Award." No assurance can be given as to the impact or the magnitude of the effect of the NPM Adjustment Stipulated Partial Settlement and Award on Term Sheet Non-Signatories such as the State, as to whether or not the NPM Adjustment Stipulated Partial Settlement and Award will be revised or reversed and any consequences thereto, or as to any final settlement or resolution of disputes concerning the NPM Adjustment Stipulated Partial Settlement and Award and the effect of such factors on the amount and/or timing of Pledged TSRs available to the Authority to pay debt service on the Series 2013 Bonds.

If Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation Were Successful, Payments under the MSA Might be Suspended or Terminated

Certain parties, including smokers, smokers' rights organizations, consumer groups, cigarette importers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have filed actions against some, and in certain cases all, of the signatories to the MSA, alleging, among other things, that the MSA and related legislation including the Settling States' Qualifying Statutes, Allocable Share Release Amendments and Complementary Legislation (as each such term is defined herein), as well as other legislation such as "**Contraband Statutes**", are void or unenforceable under certain provisions of law, such as the U.S. Constitution, state constitutions, federal antitrust laws, state consumer protection laws, bankruptcy laws, federal cigarette advertising and labeling law, and unfair competition laws and the North American Free Trade Agreement ("**NAFTA**"). Certain of the lawsuits further sought, among other relief, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA. In addition, class action lawsuits have been filed in several federal and state courts alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco related diseases should be paid directly to Medicaid recipients.

All of the judgments rendered to date on the merits have rejected challenges to the MSA, Qualifying Statutes and Complementary Legislation presented in the cases. In the most recent decision, *VIBO Corporation, Inc. d/b/a/ General Tobacco v. Conway*, *et al.*, 669 F.3d 675 (6th Cir. 2012) ("***VIBO***"), a three-judge panel of the U.S. Court of Appeals for the Sixth Circuit (the "**Sixth Circuit**") ruled on February 22, 2012 that the MSA does not amount to an unlawful conspiracy or anti-competitive behavior by the government and, accordingly, affirmed the district court's order dismissing plaintiffs' federal antitrust, federal constitutional and common law challenges to the enforceability of the MSA. The

time period for the plaintiffs to file a petition for certiorari to the U.S. Supreme Court expired. In *Grand River Enters. Six Nations, Ltd. v. King*, 2012 WL 263100 (S.D.N.Y. 2012) ("***Grand River***"), the U.S. District Court for the Southern District of New York (the "**Southern District**") on January 30, 2012 denied the plaintiffs' motion to amend the Southern District's March 22, 2011 dismissal by summary judgment of plaintiffs' claims that the MSA and related legislation violated Section 1 of the Sherman Antitrust Act of 1890 (the "**Sherman Act**") and the Commerce Clause of the Constitution of the United States. Plaintiffs had appealed to the U.S. Court of Appeals for the Second Circuit (the "**Second Circuit**") both the Southern District's March 22, 2011 dismissal and January 30, 2012 denial, but on June 1, 2012 withdrew both appeals, which withdrawals were ordered by the Second Circuit on August 10, 2012. In *Freedom Holdings v. Cuomo,* 624 F.3d 38 (2d Cir. 2010) ("***Freedom Holdings***"), the Second Circuit affirmed the judgment of the Southern District that New York State's Qualifying Statute did not violate federal antitrust laws or the Commerce Clause of the U.S. Constitution. The U.S. Supreme Court denied plaintiff's petition for certiorari. These cases are discussed more fully herein. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY."

The MSA and related state legislation may continue to be challenged in the future. A determination by a court having jurisdiction over the State and the Authority that the MSA or related State legislation is void or unenforceable could have a materially adverse effect on the payments by the PMs under the MSA and the amount and/or the timing of Pledged TSRs available to the Authority. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT." For a description of the opinions of Hawkins Delafield & Wood LLP and Pacifica Law Group LLP addressing such matters, see "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS — MSA and Qualifying Statute Enforceability."

Litigation Seeking Monetary Relief from Tobacco Industry Participants May Adversely Impact the Ability of the PMs to Continue to Make Payments Under the MSA

The tobacco industry has been the target of litigation for many years. Both individual and class action lawsuits have been brought by or on behalf of smokers alleging various theories of recovery including that smoking has been injurious to their health, by non-smokers alleging harm from environmental tobacco smoke ("**ETS**"), also known as "secondhand smoke", and by the federal, state and local governments seeking recovery of expenditures relating to the adverse effects on the public health caused by smoking. The MSA was the result of such litigation. If additional litigation against the PMs is successful on a significant level, the ability of the PMs to continue to operate their businesses and make payments under the MSA may be adversely affected. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY — Civil Litigation" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" for more information regarding the litigation described below.

The tobacco companies are defendants in over 7,800 tobacco-related lawsuits, which are extremely costly to defend, could result in substantial judgments, liabilities and bonding difficulties, and may negatively impact their ability to continue to operate.

Numerous legal actions, proceedings and claims arising out of the sale, distribution, manufacture, development, advertising, marketing and claimed health effects of cigarettes are pending against the PMs and it is likely that similar claims will continue to be filed for the foreseeable future. The claimants have sought recovery on a variety of legal theories, including, among others, negligence, fraud, misrepresentation, strict liability in tort, design defect, breach of warranty, enterprise liability (including claims asserted under the Racketeer Influenced and Corrupt Organizations Act ("**RICO**"), civil conspiracy, intentional infliction of harm, injunctive relief, indemnity, restitution, unjust enrichment, public nuisance, unfair trade practices, claims based on antitrust laws and state consumer protection acts, and claims based on failure to warn of the harmful or addictive nature of tobacco products. Various

forms of relief are sought, including compensatory and, where available, punitive damages in amounts ranging in some cases into the hundreds of millions or even billions of dollars. Claimants in some of the cases have sought treble damages, statutory damages, disgorgement of rights, equitable and injunctive relief and medical monitoring, among other damages.

It is possible that the outcome of these and similar cases, individually or in the aggregate, could result in bankruptcy or cessation of operations by one or more of the PMs. It is also possible that the PMs may be unable to post a surety bond in an amount sufficient to stay execution of a judgment in jurisdictions that require such bond pending an appeal on the merits of the case. Even if the PMs are successful in defending some or all of these actions, these types of cases are very expensive to defend. A material increase in the number of pending claims could significantly increase defense costs and have an adverse effect on the results of operations and financial condition of the PMs. Adverse decisions in litigation against the tobacco companies could have an adverse impact on the industry overall.

Any of the foregoing results could potentially lower the volume of cigarette sales and thus the amounts of payments under the MSA. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY — Civil Litigation."

The Florida Supreme Court's ruling in Engle has resulted in additional litigation against cigarette manufacturers

The case of *Engle v. R.J. Reynolds Tobacco Co., et al.* (Circuit Court, Dade County, Florida, filed May 5, 1994) was certified in 1996 as a class action on behalf of Florida residents, and survivors of Florida residents, who were injured or died from medical conditions allegedly caused by addiction to smoking and a multi-phase trial resulted in verdicts in favor of the class. During a three-phase trial, a Florida jury awarded compensatory damages to three individuals and approximately $145 billion in punitive damages to the certified class. In 2006, the Florida Supreme Court issued a ruling that, among other things, vacated the punitive damages award and determined that the case could not proceed further as a class action.

However, the Florida Supreme Court ruling in *Engle* permitted members of the *Engle* class to file individual claims, including claims for punitive damages. The PMs are currently defendants in over 5,000 cases (involving approximately 6,500 plaintiffs) pending in various state and federal courts in Florida that were filed by members of the *Engle* class (the "**Engle Progeny Cases**"). The Florida Supreme Court held that these individual plaintiffs are entitled to rely on a number of the jury's findings in favor of the plaintiffs in the first phase of the *Engle* trial. According to Lorillard, various intermediate state and federal Florida appellate courts have issued rulings that address the scope of the preclusive effect of the findings from the first phase of the *Engle* trial, including whether those findings relieve plaintiffs from the burden of proving certain legal elements of their claims, and these courts have come to differing conclusions, as further discussed herein. Following review of one of those cases, the Florida Supreme Court ruled on March 14, 2013 that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. On August 9, 2013, Philip Morris, R.J. Reynolds and Liggett Group filed a petition for writ of certiorari with the U.S. Supreme Court with respect to that ruling. In two other cases, the United States Court of Appeals for the Eleventh Circuit ruled that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. It has been reported that R.J. Reynolds is seeking a rehearing en banc before the Eleventh Circuit and will seek Supreme Court review if necessary. It is not possible to predict the final outcomes of any of the Engle Progeny Cases, but such outcomes may adversely affect the operations of the defendants and thus payments under the MSA. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY— Civil Litigation — *Engle Progeny Cases.*"

A December 2008 decision by the United States Supreme Court could limit the ability of cigarette manufacturers to contend that certain claims asserted against them in product liability litigation are barred. The Supreme Court's decision also could encourage litigation involving cigarettes labeled as "lights" or "low tar" and medical monitoring cause of action

In December 2008, the United States Supreme Court in a purported "lights" class action, *Good v. Altria Group, Inc.*, issued a decision that neither the Federal Cigarette Labeling and Advertising Act nor the Federal Trade Commission's ("**FTC**") regulation of cigarettes' tar and nicotine disclosures preempts (or bars) some of plaintiffs' claims. The decision also more broadly addresses the scope of preemption based on the Federal Cigarette Labeling and Advertising Act, and could significantly limit cigarette manufacturers' arguments that certain of plaintiffs' other claims in smoking and health litigation, including claims based on the alleged concealment of information with respect to the hazards of smoking, are preempted. In addition, the Supreme Court's ruling could encourage litigation against cigarette manufacturers regarding the sale of cigarettes labeled as "lights" or "low tar", and it may limit cigarette manufacturers' ability to defend such claims with regard to the use of these descriptors prior to the FDA's ban thereof in June 2010. According to Lorillard's Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, there are approximately 16 such "lights" class actions and two class action cases that seek court-supervised medical monitoring programs pending in various courts. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY— Civil Litigation — *Class Action Cases*."

The amount or range of losses that could result from unfavorable outcomes of pending litigation are unable to be meaningfully estimated

Except for the impact of the State Settlement Agreements (as defined below) on an annual basis when calculated, the PMs have stated that they have concluded that it is not probable that a loss has been incurred in any pending tobacco-related litigation against them and that they are unable to estimate the possible loss or range of loss that could result from an unfavorable outcome in any pending tobacco-related litigation. It is possible that their results of operations, cash flows and financial positions could be adversely affected by an unfavorable outcome of certain pending or future litigation, potentially leading to cessation of operations or insolvency or bankruptcy of one or more PMs.

The ultimate outcome of these and any other pending or future lawsuits is uncertain. Verdicts of substantial magnitude that are enforceable as to one or more PMs, if they occur, could encourage commencement of additional litigation, or could negatively affect perceptions of potential triers of fact with respect to the tobacco industry, possibly to the detriment of pending litigation. An unfavorable outcome or settlement or one or more adverse judgments could result in bankruptcy, insolvency or a decision by the affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption. In addition, the financial condition of any or all of the PM defendants could be adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected PM's ability to make payments under the MSA and could have an adverse effect on the amount and/or timing of Pledged TSRs available to the Authority. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY— Civil Litigation" and "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS."

The PMs have substantial payment obligations under litigation settlement agreements which, together with their other litigation liabilities, may adversely affect the ability of the PMs to continue operations in the future

In 1998, the OPMs entered into the MSA with 46 states and various other governments and jurisdictions to settle asserted and unasserted health care cost recovery and other claims. Certain U.S. tobacco product manufacturers had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota (the "**Previously Settled State Settlements**" and, together with the MSA, are referred to as the "**State Settlement Agreements**").

Under the State Settlement Agreements, the PMs are obligated to pay billions of dollars each year. Annual payments under the State Settlement Agreements are required to be paid in perpetuity and are based, among other things, on domestic market share and unit volume of domestic shipments; with respect to the MSA, payments are based on data from the year preceding the year in which payment is due, and, with respect to the Previously Settled State Settlements, payments are based on data from the year in which payment is due. A material reduction in the volume of cigarette sales by the PMs could adversely affect the financial condition of the PMs and the ability of PMs to make payments under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT."

Failures by PMs to make payments coupled with an inability on the part of the Settling States to enforce and collect defaulted payments under the MSA could adversely affect the Pledged TSRs actually received by the Authority

If a PM were to discontinue making payments under the MSA for any reason, the Pledged TSRs would be adversely affected. Any attempts to enforce payments under the MSA from a PM in breach could be costly and time consuming as well as be likely to include litigation. For example, VIBO Corporation, Inc., d/b/a General Tobacco ("**General Tobacco**") ceased production of cigarettes in 2010 and has defaulted upon certain of its MSA payments. General Tobacco has stated that it will be unable to make any back payments it owes under the MSA. Two Settling States brought suit on behalf of all of the Settling States seeking full payment by General Tobacco of its MSA obligations. The ability of the Settling States to enforce and collect such payments in instances such as this is limited by the ability of the defaulting PM to meet its obligations and may be costly. Failure by other PMs to make payments coupled with an inability on the part of the Settling States to enforce and collect defaulted payments under the MSA could adversely affect the payments actually received by the Authority.

The verdict returned in the federal government's reimbursement case could adversely affect PMs' cigarette sales and their profits therefrom and thus payments under the MSA

In August 2006, a final judgment and remedial order was entered in *United States of America v. Philip Morris USA, Inc., et al.* (U.S. District Court, District of Columbia, filed September 22, 1999) (the "***DOJ Case***") and in June 2010 the U.S. Supreme Court denied all petitions for review of the case. The district court based its final judgment and remedial order on the government's only remaining claims, which were based on the tobacco industry defendants' alleged violations of RICO. Although the verdict did not award monetary damages to the plaintiff U.S. government, the final judgment and remedial order imposed a number of requirements on the defendants. Such requirements include, but are not limited to, corrective statements by defendants related to the health effects of smoking. The remedial order placed certain prohibitions on the manner in which defendants market their cigarette products and enjoined any use of "lights" or similar product descriptors. In March 2011, defendants filed a motion to vacate the court's factual findings and remedial order on two grounds; that the Tobacco Control Act extinguished the court's jurisdiction, or that the court should decline to move forward with an injunctive remedy in deference to the FDA's (defined below) authority. On June 1, 2011, the trial court denied defendants'

motion. The defendants appealed the trial court's ruling to the U.S. Court of Appeals for the District of Columbia Circuit. On July 27, 2012, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the district court's denial of the defendants' motion to vacate. On November 27, 2012, the district court released its order on the required text of the corrective statements that the defendants must put on their websites and ordered the parties to engage in negotiations with the special master on a number of issues related to the implementation of the corrective statements remedy, which negotiations are ongoing. According to Altria, unresolved issues will be decided by the special master and the court. Further proceedings are pending before the district court to determine whether the corrective statements will have to be displayed at retail points of sale. On January 30, 2013, defendants appealed to the U.S. Court of Appeals for the District of Columbia Circuit the district court's November 2012 order on the text of the corrective statements. On January 25, 2013, defendants also filed a motion to hold the appeal in abeyance pending the completion of related proceedings in the district court regarding the implementation of the corrective statements, which motion the Court of Appeals granted on February 15, 2013. It is possible that the remedial order, including the additional prohibitions on the use of the descriptors relating to low tar cigarettes and the stark text required in the corrective statements, will negatively affect the PMs' sales of and profits from cigarettes, as well as result in significant compliance costs. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY— Civil Litigation."

Declines in Cigarette Consumption May Materially Adversely Affect Pledged TSRs available for the Series 2013 Bonds

Cigarette consumption in the U.S. has declined significantly over the last several decades. According to a preliminary report issued by the Centers for Disease Control ("**CDC**") on June 18, 2013, the smoking rate for adults in the United States fell in 2012 to 18%, after hovering at 20% to 21% for more than seven years, and approximately 19% in 2010 and 2011. Continuing declines in cigarette consumption could adversely impact the amount and timing of the Pledged TSRs available to pay debt service on the Series 2013 Bonds. The following factors, among others, may negatively impact cigarette consumption in the U.S.

A deterioration in general economic conditions in the U.S. could lead to a decrease in cigarette consumption and adversely affect payments under the MSA

The volume of cigarette sales in the U.S. is adversely affected by general economic downturns as smokers tend to reduce expenditures on cigarettes, especially premium brands, in times of economic hardship. To the extent that such conditions are experienced over the life of the Series 2013 Bonds, payments under the MSA could be adversely affected. In addition, consumers may become more price-sensitive, which may result in some consumers switching to lower priced, deep discount NPM brands or counterfeit brands. Reductions in consumption could lead to reductions of payments under the MSA and could have an adverse effect on the amount and/or timing of Pledged TSRs available to the Authority.

The regulation of tobacco products by the Food and Drug Administration may adversely affect overall consumption of cigarettes in the U.S.

The Family Smoking Prevention and Tobacco Control Act ("**FSPTCA**"), signed by President Obama on June 22, 2009, granted the Food and Drug Administration ("**FDA**") broad authority over the manufacture, sale, marketing and packaging of tobacco products. The legislation, among other things:

- establishes a Tobacco Products Scientific Advisory Committee ("**TPSAC**") to, among other things, evaluate the issues surrounding the use of menthol as a flavoring or ingredient in cigarettes within one year of the committee's establishment;

- grants the FDA the regulatory authority to consider and impose broad additional restrictions through a rule making process, including a ban on the use of menthol in cigarettes upon a finding that such a prohibition would be appropriate for the public health;

- requires larger and more severe health warnings on cigarette packs and cartons;

- bans the use of descriptors on tobacco products, such as "low tar" and "light";

- requires the disclosure of ingredients and additives to consumers;

- requires pre-market approval by the FDA for claims made with respect to reduced risk or reduced exposure products;

- allows the FDA to require the reduction of nicotine or any other compound in cigarettes;

- allows the FDA to mandate the use of reduced risk technologies in conventional cigarettes;

- allows the FDA to place more severe restrictions on the advertising, marketing and sales of cigarettes; and

- permits inconsistent state regulation of the advertising or promotion of cigarettes and eliminates the existing federal preemption of such regulation.

Since the passage of the FSPTCA, the FDA has taken additional actions, including, among others, prohibiting fruit, candy or clove flavored cigarettes (menthol is currently exempted from this ban), prohibiting misleading marketing terms ("Light," "Low," and "Mild") for tobacco products, rejecting applications for the introduction of new tobacco products into the market, and requiring warning labels for smokeless tobacco products.

In August 2009, a group of tobacco manufacturers (including R.J. Reynolds and Lorillard) and a tobacco retailer filed a complaint against the United States of America in the United States District Court for the Western District of Kentucky, *Commonwealth Brands, Inc. v. U.S.*, in which they asserted that various provisions of the FSPTCA violate their free speech rights under the First Amendment, constitute an unlawful taking under the Fifth Amendment, and are an infringement on their Fifth Amendment due process rights. In March 2012, the United States Court of Appeals for the Sixth Circuit affirmed the district court's earlier decision upholding the FSPTCA's restrictions on the marketing of modified-risk tobacco products, the FSPTCA's bans on event sponsorship, branding non-tobacco merchandise, and free sampling, and the requirement that tobacco manufacturers reserve significant packaging space for textual health warnings. The Sixth Circuit further affirmed the district court's grant of summary judgment to plaintiffs on the FSPTCA's restriction of tobacco advertising to black and white text, as well as the district court's decision to uphold the constitutionality of the color graphic and non-graphic warning label requirement. On May 31, 2012, the Sixth Circuit denied the plaintiffs' motion for rehearing en banc, and on October 30, 2012, the plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court. The U.S. Supreme Court denied such petition on April 22, 2013. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues" for a discussion of this case.

On June 22, 2011, the FDA issued a final regulation for the imposition of larger, graphic health warnings on cigarette packaging and advertising, which was scheduled to take effect September 22, 2012 (but which the FDA is currently enjoined from enforcing, as described below). On August 16, 2011, five tobacco companies (including Reynolds Tobacco and Lorillard) filed a lawsuit against the FDA in the U.S. District Court for the District of Columbia, R. J. Reynolds Tobacco Co. v. U.S. Food and Drug Administration, challenging the FDA's final regulation specifying nine new graphic "warnings" pursuant to the FSPTCA and seeking a declaratory judgment that the final regulation violates the plaintiffs' rights under the First Amendment to the U.S. Constitution and the Administrative Procedure Act ("**APA**"). On February 29, 2012, the district court granted the plaintiffs' motion for summary judgment and entered an order permanently enjoining the FDA, until 15 months following the issuance of new regulations that are substantively and procedurally valid and permissible under the United States Constitution and federal law, from enforcing against plaintiffs the new textual and graphic warnings required by the FSPTCA. On August 24, 2012, the Court of Appeals for the District of Columbia Circuit affirmed the district court's decision invalidating the graphic warning rule. On October 9, 2012, the FDA filed a motion for rehearing en banc with the Court of Appeals, and on December 5, 2012, the Court of Appeals denied the FDA's petition for a rehearing en banc. On March 19, 2013, the FDA announced that it would not file a petition for writ of certiorari with the U.S. Supreme Court, but instead would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA. The FDA has not provided a timeline for the revised labels. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues" for a discussion of this case.

The FDA has yet to issue guidance with respect to many provisions of the FSPTCA, which may result in less efficient operation by the PMs in the near term as they may be reluctant to increase production, research or development prior to final regulations from the FDA. According to Lorillard, the FDA has indicated that it intends to regulate electronic cigarettes under the FSPTCA through the issuance of deeming regulations that would include electronic cigarettes under the definition of a "tobacco product" under the FSPTCA subject to the FDA's jurisdiction. In a letter to the Commissioner of the FDA dated September 24, 2013, the attorneys general of 41 states requested that the FDA "take all available measures" to issue proposed regulations that will address the advertising, ingredients, and sale to minors of electronic cigarettes by the FDA's previously stated deadline of October 31, 2013. The letter asked the FDA to regulate electronic cigarettes like other tobacco products, and to move quickly to ensure that all tobacco products are tested and regulated to ensure that tobacco companies do not continue to sell or advertise to young people. In addition, fifteen public health organizations sent a letter to President Obama, dated September 19, 2013, asking for his leadership in ensuring that the FDA moves forward promptly with rules that would assert the FDA's authority over all tobacco products, including e-cigarettes. It is likely that regulations promulgated by the FSPTCA, including regulation of menthol short of an outright ban thereof, could result in a decrease in cigarette sales in the U.S., and an increase in costs to PMs, potentially resulting in a material adverse effect on the PMs' financial condition, results of operations and cash flows. Additionally, the ability of the PMs to gain efficient market clearance for new cigarette products or establish a new brand name could be affected by FDA rules and regulations. The negative impact of the foregoing factors could be to reduce consumption of cigarettes in the U.S., thereby reducing payments under the MSA which could have an adverse effect on the amount and/or timing of Pledged TSRs available to the Authority.

Concerns that mentholated cigarettes may pose greater health risks could result in further FDA regulation which could materially adversely affect the volume of cigarettes sold in the U.S. and thus payments under the MSA

Some plaintiffs and constituencies, including public health agencies and non-governmental organizations, have claimed or expressed concerns that mentholated cigarettes may pose greater health risks than non-mentholated cigarettes, including concerns that mentholated cigarettes may make it easier

to start smoking and harder to quit, and increase smoking initiation among youth. Such plaintiffs and constituencies may seek restrictions or a ban on the production and sale of mentholated cigarettes. Any ban or material limitation on the use of menthol in cigarettes could materially adversely affect the results of operations, cash flow and financial condition of the PMs, especially Lorillard, which is heavily dependent on sales of its *Newport* brand mentholated cigarettes. According to Lorillard, mentholated cigarettes are reported to have comprised 31.1% of the U.S. domestic cigarette market in 2012 and 31.4% in the six months ended June 30, 2013. The FSPTCA directs the TPSAC to evaluate issues surrounding the use of menthol as a flavoring or ingredient in cigarettes. In addition, the legislation permits the FDA to ban menthol upon a finding that such a prohibition would be appropriate for the public health. The TPSAC or the Menthol Report Subcommittee held meetings throughout 2010 and 2011 to consider the issues surrounding the use of menthol in cigarettes. At the March 18, 2011 meeting, TPSAC presented its report and recommendations on menthol. The report's findings included that menthol likely increases experimentation and regular smoking, menthol likely increases the likelihood and degree of addiction for youth smokers, non-white menthol smokers (particularly African-Americans) are less likely to quit smoking and are less responsive to certain cessation medications, and consumers continue to believe that smoking menthol cigarettes is less harmful than smoking nonmenthol cigarettes as a result of the cigarette industry's historical marketing. TPSAC's overall recommendation to the FDA was that "removal of menthol cigarettes from the marketplace would benefit public health in the United States." The FDA submitted a draft report on its independent review of research related to the effects of menthol in cigarettes on public health, if any, to an external peer review panel in July 2011, adding that after peer review, the results and the preliminary scientific assessment would be available for public comment in the Federal Register. At the July 21, 2011 meeting, TPSAC considered revisions to its report, and the voting members unanimously approved the final report for submission to the FDA with no change in its recommendation. On January 26, 2012, the FDA stated that its report had been submitted to the peer review panel and comments had been received from the panel on the report. On July 23, 2013, the FDA released its Independent Preliminary Scientific Evaluation of the Public Health Effects of Menthol Versus Non-menthol Cigarettes (the "**Preliminary Evaluation**") and peer comments for 60 days of public comment (such public comment period was subsequently extended for an additional 60 days to November 22, 2013), and issued an Advance Notice of Proposed Rulemaking seeking additional information to help the FDA make informed decisions about menthol in cigarettes. The Preliminary Evaluation found that although there is little evidence to suggest menthol cigarettes are more toxic than regular cigarettes, the mint flavor of menthol masks the harshness of tobacco, which makes it easier to become addicted and harder to quit, and increases smoking initiation among youth. The FDA concluded that menthol cigarettes likely pose a public health risk above that seen with non-menthol cigarettes. During the public comment period, the FDA will consider all comments, data and research submitted to determine what regulatory action, if any, with respect to menthol cigarettes is appropriate, including the establishment of product standards. In the meantime it will conduct and support research on the differences between menthol and non-menthol cigarettes as they relate to menthol's likely impact on smoking cessation. The FDA is not required to follow the TPSAC's recommendations, and the FDA has not yet taken any action with respect to menthol use. There is no timeline or statutory requirement for the FDA to act on the TPSAC's recommendations. If the FDA determines that the regulation of menthol is warranted, the FDA could promulgate regulations that, among other things, could result in a ban on or a restriction on the use of menthol in cigarettes. A ban or any material restriction on the use of menthol in cigarettes could adversely affect the overall sales volume of cigarettes by the PMs, thereby reducing payments under the MSA which could have an adverse effect on the amount and/or timing of Pledged TSRs available to the Authority.

Payments under the MSA are determined in part by the volume of cigarettes sold by PMs in the U.S. cigarette market, which is expected to continue to decline, negatively impacting such payments

Payments under the MSA are determined in part by the volume of cigarettes sold by the PMs in the U.S. cigarette market. Price increases, restrictions on advertising and promotions, funding of smoking prevention campaigns, increases in regulation and excise taxes, health concerns, a decline in the social acceptability of smoking, smoking bans in public places, increased pressure from anti-tobacco groups and other factors have reduced U.S. cigarette consumption. U.S. cigarette consumption is expected to continue to decline for the reasons stated above and others, such as the raising of the minimum age to possess or purchase tobacco products. Reductions in consumption could lead to reductions of payments under the MSA and could have an adverse effect on the amount and/or timing of Pledged TSRs available to the Authority.

In the U.S., tobacco products are subject to substantial and increasing federal and state excise taxation, which has a negative effect on consumption. On April 2, 2009, Congress increased the federal excise tax per pack of cigarettes to $1.01 per pack (an increase of $0.62), and significantly increased taxes on other tobacco products. The federal excise tax rate for snuff increased $0.925 per pound to $1.51 per pound. The federal excise tax on small cigars, defined as those weighing three pounds or less per thousand, increased from $48.502 per thousand to $50.33 per thousand. All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2012 ranged from $0.17 per pack in Missouri to $4.35 per pack in New York. Since January 1, 2002, 47 states, the District of Columbia and several U.S. territories have raised their cigarette taxes, many of them more than once. According to the American Lung Association's Tobacco Policy Project/State Legislated Actions on Tobacco Issues ("**SLATI**"), the current nationwide average state cigarette tax is $1.51 per pack. In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold. According to Lorillard, for the six months ended June 30, 2013, combined state and local excise taxes ranged from $0.17 to $5.85 per pack. According to Reynolds American, as of June 30, 2013 and December 31, 2012, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.26. According to Philip Morris, between the end of 1998 (the year that the MSA was executed) and July 22, 2013, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.45 per pack, resulting in a total federal, state and local excise tax, on average in the U.S., of approximately $2.42 per pack. As of August 1, 2013, Massachusetts, Minnesota and Puerto Rico have enacted legislation to increase their taxes during 2013.

Legislation introduced by Senator Tom Harkin on January 22, 2013, the Healthy Lifestyles and Prevention America Act (or the HeLP America Act), would double the federal excise tax on cigarettes and roll-your-own tobacco and increase the taxes on smokeless tobacco products (making the excise taxes on smokeless tobacco products comparable to those on cigarettes). Legislation introduced by Senator Richard Durbin on January 31, 2013, the Tobacco Tax Equity Act, would similarly equalize federal excise tax rates on all tobacco products, including pipe tobacco, cigars and smokeless tobacco, so that the tax rates on such products would approximate those of cigarettes. Similar bills have not been introduced in the U.S. House of Representatives. On April 10, 2013, President Obama released a proposed budget which, if approved by the U.S. Congress, would increase the federal excise tax for a pack of cigarettes from $1.01 to $1.95; for snuff from $1.51 per pound to $2.93 per pound; and for chewing tobacco from $0.5033 per pound to $0.98 per pound. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY – Regulatory Issues – "*Excise Taxes*" herein for a further description of state excise taxes on cigarettes.

Increased excise taxes are likely to result in declines in overall sales volume and shifts by consumers to less expensive brands, deep discount brands, counterfeit brands or pipe tobacco for roll-

your-own consumers. Reductions in consumption will lead to reductions of payments under the MSA and could have a negative effect on the amount and/or timing of Pledged TSRs available to the Authority.

Increased restrictions on smoking in public places could adversely affect U.S. tobacco consumption and therefore amounts to be paid under the MSA

In recent years, federal, state and many local and municipal governments and agencies, as well as private businesses, have adopted legislation, regulations, insurance provisions or policies which prohibit, restrict, or discourage smoking generally, smoking in public buildings and facilities, stores, restaurants and bars, and smoking on airline flights and in the workplace. Other similar laws and regulations are currently under consideration and may be enacted by state and local governments in the future. Restrictions on smoking in public and other places may lead to a decrease in the number of people who smoke or a decrease in the number of cigarettes smoked or both. Smoking bans have recently been extended by many state and local governments to outdoor public areas, such as beaches, parks and space outside restaurants, and others may do so in the future. Increased restrictions on smoking in public and other places have caused a decrease, and may continue to cause a decrease, in the volume of cigarettes that would otherwise be sold in the U.S. absent such restrictions, which may have a material adverse effect on payments under the MSA. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY – Regulatory Issues – *State and Local Regulation*."

Several of the PMs and their competitors have developed alternative tobacco and cigarette products, including electronic cigarettes, sales of which would not result in payments under the MSA

Certain of the major cigarette makers have developed and marketed alternative cigarette products. For example, numerous manufacturers have developed and are marketing "electronic cigarettes" or "e-cigarettes," which are not tobacco products but are battery powered devices that vaporize liquid nicotine which is then inhaled. E-cigarettes do not constitute "cigarettes" within the meaning of the MSA because they do not contain or burn tobacco. There are currently over 250 e-cigarette brands on the market. Altria's Nu Mark LLC introduced an electronic cigarette under the "MarkTen" brand with distribution in Indiana initiated in August 2013. MarkTen is a disposable e-cigarette that can be reused with a separate battery recharging kit and additional cartridges in both tobacco and menthol flavors. Altria stated that the MarkTen's "Four Draw" technology is designed to give users a "more consistent experience" that closely resembles the draw of a traditional cigarette. Lorillard has boosted distribution of its blu eCigs to more than 80,000 stores since acquiring the brand in 2012. Reynolds American launched a revamped version of its e-cigarette, VUSE, in Colorado retail outlets in July 2013, with a plan to quickly expand sales nationwide. Reynolds American has stated that it is targeting existing smokers with VUSE and expects some smokers to give up cigarettes in favor of VUSE.

The CDC in February 2013 reported results of a survey that indicated that 6.2% of the adult population, and 12% of smokers, had tried e-cigarettes at some time, which results were approximately double the estimates in 2010. A report released by the CDC and the FDA in September 2013 showed a doubling, to 10%, of the number of high school students who have tried e-cigarettes. Certain reports have predicted that sales of e-cigarettes could outpace traditional cigarettes before 2050. No assurance can be given that regulation of e-cigarettes by the FDA will stop these trends.

In addition, Philip Morris developed an alternative cigarette, called Accord, in which the tobacco is heated rather than burned. Reynolds Tobacco has developed and is marketing dissolvable tobacco tablets, orbs, strips and sticks. Sales of moist snuff products have increased recently. Reynolds Tobacco and Philip Morris are both marketing their versions of "**snus**", a smokeless, spitless tobacco product that originated in Sweden. In May 2006, Reynolds Tobacco introduced Camel Snus. Philip Morris manufactures Marlboro Snus and Marlboro Smokeless Tobacco Stick, and a subsidiary of Altria (Philip

Morris's parent company) manufactures Copenhagen and Skoal smokeless products. In January 2012 Altria announced that it entered into an agreement with Okono, an affiliate of Fertin Pharma, a Danish maker of nicotine chewing gum, to develop non-combustible tobacco products. In May 2012, Altria announced that its subsidiary Nu Mark LLC introduced Verve nicotine discs, a mint-flavored, chewable, disposable tobacco product that contains tobacco-derived nicotine, and on June 11, 2013, Altria announced that it intends to expand its distribution of Verve discs from 60 stores to about 1,200 stores throughout Virginia in the second half of the year.

It has been reported that increases in cigarette taxes have caused an increase in the sale of e-cigarettes and other alternatives to cigarettes. Should such alternative cigarette products that do not involve burning tobacco gain a significant share of the domestic cigarette market, payments under the MSA, and thus amounts of Pledged TSRs available to the Authority, may decrease, as payments under the MSA derive from the sale of products that involve the burning of tobacco. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Smokeless Tobacco Products" and "—E-Cigarettes."

U.S. tobacco companies are subject to significant limitations on advertising and marketing cigarettes that could negatively impact sales volume

Television and radio advertisements of tobacco products have been prohibited since 1971. U.S. tobacco companies generally cannot use billboard advertising, cartoon characters, sponsorship of concerts, non-tobacco merchandise bearing brand names and various other advertising and marketing techniques. In addition, the MSA prohibits the targeting of youth in advertising, promotion or marketing of tobacco products. Accordingly, the tobacco companies have determined not to advertise cigarettes in magazines with large readership among people under the age of 18. The FSPTCA grants authority over the regulation of tobacco products to the FDA. Under the FSPTCA, the FDA has issued rules restricting access and marketing of cigarettes and smokeless tobacco products to youth, and has announced its plans to propose a new rule in the future for the imposition of larger, graphic health warnings on cigarette packaging and advertising, as discussed herein. In addition, many states, cities and counties have enacted legislation or regulations further restricting tobacco advertising, marketing and sales promotions and others may do so in the future. Additional restrictions may be imposed or agreed to in the future. These limitations significantly impair the ability of tobacco product manufacturers to launch new premium brands. Moreover, these limitations may make it difficult to maintain sales volume of cigarettes in the U.S.

Electronic cigarettes are not subject to the advertising restrictions to which tobacco products are subject. Therefore, electronic cigarettes, which can be marketed more extensively than cigarettes and other tobacco products, could gain market share to the detriment of the domestic cigarette market. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY – E-Cigarettes."

Smoking cessation products may reduce cigarette sales volumes and adversely affect payments under the MSA

Large pharmaceutical companies have developed and increasingly expanded their marketing of smoking cessation products. Companies such as GlaxoSmithKline, Johnson & Johnson, Novartis and Pfizer are very well capitalized public companies that have entered this market and have the capability to fund significant investments in research and development and marketing of these products. Smoking cessation products now can be obtained both in prescription and over-the-counter forms. From Nicorette gum in 1984, to nicotine patches, nicotine inhalers and tablets, as well as other non-pharmaceutical smoking cessation products, this market has evolved into a $1 billion business in the U.S., according to

some estimates. Studies have shown that these programs are effective, and that excise taxes and smoking restrictions drive additional expenditures to the smoking cessation market. In 2004, it was estimated that over 50% of all smokers had quit smoking, and it is likely that many of those former smokers were aided by smoking cessation products. Results of a study by the CDC, released in November 2011 found that, in 2010, 52.4% of smokers had attempted to quit and 6.2% had recently quit. To the extent that these products, new products or products used in combination become more effective and more widely available, or that more smokers use these products, sales volumes of cigarettes in the U.S. may decline, adversely affecting payments under the MSA. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY— Smoking Cessation Products."

The U.S. cigarette industry is subject to significant law, regulation and other requirements that could materially adversely affect the businesses, results of operations or financial condition of tobacco product manufacturers

The consumption of cigarettes in the U.S., and therefore the amounts payable under the MSA, could be materially adversely affected by new or future legal requirements imposed by legislative or regulatory initiatives, including but not limited to those relating to health care reform, climate change and environmental matters.

The availability of counterfeit cigarettes could adversely affect payments by the PMs under the MSA

Sales of counterfeit cigarettes in the U.S. could adversely impact sales by the PMs of the brands that are counterfeited and potentially damage the value and reputation of those brands. Smokers who mistake counterfeit cigarettes for cigarettes of the PMs may attribute quality and taste deficiencies in the counterfeit product to the actual branded products brands and discontinue purchasing such brands. Most significantly, the availability of counterfeit cigarettes together with substantial increases in excise taxes and other potential price increases of branded products could result in increased demand for counterfeit products that could have an adverse effect on the sales volume of the PMs, resulting in lower payments under the MSA.

A decline in the overall consumption of cigarettes could have an adverse effect on the payments by PMs under the MSA and the amount and/or timing of Pledged TSRs available to the Authority. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" for a further discussion of the foregoing factors and events.

Other Risks Relating to the MSA and Related Statutes

Severability

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

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. See

"APPENDIX E – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS – The Sale Agreement - Pledges; Protection of Title; Non-Impairment Covenant." The Authority is not a party to the MSA; accordingly, the Authority has no right to challenge any such amendment, waiver or termination. While the economic interests of the State and the Bondholders will presumably 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 receipt of Pledged TSRs by the Authority. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Amendments and Waivers."

Reliance on State Enforcement of the MSA and State Non-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. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Failure by the State to enforce the MSA may have a material adverse effect on the receipt of Pledged TSRs by the Authority. In the Sale Agreement, the State has covenanted that it will enforce, at the expense of the State, the Authority's right to receive the Pledged TSRs to the full extent permitted by the MSA and take all actions as may be required by law and the MSA to preserve, maintain, defend, protect and confirm the interests of the Authority in and to the Pledged TSRs and in the proceeds thereof in all material respects. It is also 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 Bonds. In that event, the Bondholders, the Indenture Trustee or the Authority may assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims. See "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS."

General Economic Conditions and Lack of Access to Favorable Financing May Materially Adversely Impact the Ability of the PMs to Continue to Operate, Leading to Reduced Sales of Volumes of Cigarettes and Payments under the MSA

The ability of the PMs to continue their operations selling cigarettes in the U.S. generally is dependent on the health of the overall economy and the ability to access the capital markets on favorable terms. To the extent that market conditions materially adversely impact their operations, the PMs may sell fewer cigarettes, potentially resulting in reduced payments under the MSA.

Adverse changes in financial market conditions or the credit ratings of the PMs could result in lack of access to financing, losses, higher costs and decreased profitability for the PMs, potentially affecting the volume of cigarette sales

Adverse changes in the liquidity in the financial markets could result in additional realized or unrealized losses associated with the value of the investments of the PMs, which would negatively impact the PMs consolidated results of operations, cash flows and financial position. Changes in financial market conditions could negatively impact the PMs' interest rate risk, foreign currency exchange rate risk and the return on corporate cash, thus increasing costs, lowering income and reducing profitability. If these losses negatively affect the overall volume of cigarette sales, payments under the MSA may decrease.

The outstanding notes issued by certain of the PMs are rated investment grade. If their credit ratings fall below investment grade, certain debt securities may adjust interest payments upwards or require posting of additional collateral. Additionally, if credit ratings fall below investment grade, the PMs affected may not be able to sell additional debt securities or borrow money in such amounts, at the times, at the lower interest rates or upon the more favorable terms and conditions that might be available if its debt was rated investment grade. Furthermore, future debt security issuances or other borrowings may be subject to further negative terms, including limitations on indebtedness or similar restrictive

covenants. If these conditions negatively affect the overall volume of cigarette sales, payments under the MSA may decrease.

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

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 in or reductions or elimination of Pledged TSRs.

In the event of the bankruptcy of a PM, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the Authority, the Indenture Trustee, the Bondholders, or the Beneficial Owners of the Series 2013 Bonds to collect any Pledged TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying the 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 determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to reject the MSA and stop making payments under it.

Furthermore, payments previously made to the Bondholders or the Beneficial Owners of the Bonds could be avoided as preferential payments, so that the Bondholders and the Beneficial Owners of the Bonds would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection of the State, the Authority, the Indenture Trustee, the Bondholders, or the Beneficial Owners of the Series 2013 Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy (including provisions regarding the termination of that PM's obligations) (see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Termination of Agreement"), such provisions may be unenforceable. The National Association of Attorneys General ("**NAAG**") actively monitors any bankruptcy related activity of the PMs with the goals of preventing the debtors from using bankruptcy law to avoid their MSA or state law payment obligations to the state and ensuring that states can continue to perform their regulatory duties despite the bankruptcy filing, but there can be no assurance that the actions of NAAG will be successful. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions in or elimination of Pledged TSRs. Regardless of any specific adverse determination in a PM bankruptcy proceeding, the fact of a PM bankruptcy proceeding could have an adverse effect on the timing of receipt, amount and value of the Pledged TSRs and thus could have an adverse effect on the liquidity and market value of the Series 2013 Bonds. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS — Bankruptcy Considerations."

Rating Agency Actions With Respect to Unenhanced Tobacco Settlement Bonds

In recent years rating agencies have revised their assumptions regarding their ratings of unenhanced tobacco settlement bonds on account of the continuing decline in MSA payments resulting from cigarette volume decline, withholdings by PMs of MSA payments and disputes relating to MSA payments. S&P revised its assumptions for all tobacco settlement securitizations in October 2011 and then placed 86 classes from 23 tobacco settlement securitizations on CreditWatch Negative. The revised S&P assumptions will apply to the Series 2013 Bonds because they are unenhanced. On January 27, 2012, S&P lowered its ratings on 87 classes from 22 tobacco settlement securitizations, among other actions. In September 2011, Moody's Investors Service, Inc. ("**Moody's**") downgraded 60 tranches from 13 tobacco settlement securitizations as a result of updated cash flow modeling assumptions. In July 2012, Fitch Ratings Inc. ("**Fitch**") placed 150 tranches of tobacco settlement bonds on negative watch.

In January 2013, Moody's placed 31 series of tobacco settlement revenue bonds under review (including the Series 2002 Bonds maturing June 1, 2026 and June 1, 2032, respectively) as a result of the potential impact of the NPM Adjustment Settlement Term Sheet, stating that the provisions of the NPM Adjustment Settlement Term Sheet could reduce the cash flow of the joining states and indirectly affect the non-joining states (such as the State).

Series 2013 Bonds Secured Solely by the Pledged TSRs and Moneys in the Pledged Accounts; Limited Resources of the Authority

Investors in the Series 2013 Bonds must look solely to the Pledged TSRs and moneys in the Accounts pledged under the Indenture for repayment of their investment. Payment of the principal of, interest on, and redemption premium, if any, on the Series 2013 Bonds will 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 2013 Bonds. The Authority has no taxing power.

The Series 2013 Bonds are payable only from the assets of the Authority pledged under the Indenture. In the event that such assets of the Authority have been exhausted, no amounts will thereafter be available to be paid on the Series 2013 Bonds. The Series 2013 Bonds are not legal or moral obligations of the State and no recourse may be had with respect thereto for payment of amounts owing on the Series 2013 Bonds. Investors in the Series 2013 Bonds must look solely to the assets of the Authority pledged under the Indenture for repayment of their investment. The Authority's only source of funds for payments on the Series 2013 Bonds is the Collateral. The Authority has no taxing power and no assets are available to pay Series 2013 Bonds other than the assets acquired pursuant to the Sale Agreement, pledged under the Indenture. No assets of the State are pledged to secure or will be available to pay debt service on the Series 2013 Bonds.

Limited Remedies

The Indenture Trustee is limited under the terms of the Sale Agreement to enforcing the terms of the 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 Sale 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 Sale Agreement do not include the repurchase by the State of the Pledged TSRs under any circumstances, including unenforceability of the MSA, the State's Qualifying Statute or breach of any representation or warranty. The remedies of the Series 2013 Bondholders are no greater than those afforded to the Indenture Trustee.

Limited Liquidity of the Bonds; Price Volatility

There is currently a limited secondary market for securities such as the Series 2013 Bonds. The Underwriters are under no obligation to make a secondary market. There can be no assurance that a secondary market for the Series 2013 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 2013 Bonds. Tobacco settlement revenue bonds generally have also exhibited greater price volatility than traditional municipal bonds. Any purchaser of the Series 2013 Bonds must be prepared to hold such securities for an indefinite period of time or until redemption or final payment of such securities.

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

The Series 2013 Bonds will be assigned ratings by S&P. Any rating assigned to the Series 2013 Bonds by S&P will reflect S&P's assessment of the likelihood of the payment of principal or and interest on the Series 2013 Bonds. The rating of the Series 2013 Bonds will not be a recommendation to purchase, hold or sell such Bonds and such rating will not address the marketability of such 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 S&P if, in its judgment, circumstances so warrant based on factors prevailing at the time. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market for, or the market price of, the Series 2013 Bonds.

LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS

The following discussion summarizes some, but not all, of the possible legal issues that could affect the Series 2013 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 are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions.

Bankruptcy Considerations

General

The enforceability of the rights and remedies of the State (and thus the Authority, the Indenture Trustee and the Series 2013 Bondholders as collateral assignees) and of the obligations of a PM under the MSA are subject to the Bankruptcy Code and to other applicable insolvency, moratorium or similar laws relating to or affecting the enforcement of creditors' rights generally. Some of the risks associated with a bankruptcy of a PM are described below and include the risks of delay in or reduction of amount of the payment or of nonpayment under the MSA and the risk that the State (and, thus, the Authority) may be stayed for an extended time from enforcing any rights under the MSA or with respect to the payments owed by the bankrupt PM or from commencing legal proceedings against the bankrupt PM. As a result, if a PM becomes a debtor in a bankruptcy case and defaults in making payments required under the MSA, Pledged TSRs available to the Authority to pay Bondholders may be reduced or eliminated. Furthermore, certain payments previously made to Bondholders could be avoided as preferential payments, so that Bondholders would be required to return such payments to the bankrupt PM.

Chapter 7 Bankruptcy

If a PM becomes bankrupt and does not reorganize under Chapter 11, it may be liquidated under Chapter 7 of the Bankruptcy Code, in which event its operations will cease and its assets will be sold. In such an event, there would likely be a significant reduction, or even elimination, of payments received from the PM that is in the Chapter 7 case. To the extent that the volume of cigarettes sold by other PMs increased as a result of cessation of operations by the PM being liquidated under Chapter 7 of the Bankruptcy Code, the market share of such other PMs should increase.

Chapter 11 Reorganization

Should a PM become a debtor in a Chapter 11 reorganization bankruptcy case, the PM may not be authorized to make any payments owing under the MSA, or may be required to obtain bankruptcy court approval before making such payments. Legal proceedings necessary to determine whether such

PM's obligations under the MSA can be paid during the pendency of the bankruptcy proceedings could be time-consuming and could result in delays in, or elimination of, payments by the bankrupt PM.

Examples of other bankruptcy-related risks include:

MSA as Executory Contract

The treatment of the MSA under the Bankruptcy Code may be dependent upon whether the MSA is construed to be an executory contract (which is not defined by the Bankruptcy Code but generally is considered to be a contract in which material performance remains due to some extent from both parties). Under the Bankruptcy Code, if the MSA is treated as an executory contract, a trustee in bankruptcy or a PM acting as a debtor-in-possession would have the right to assume or reject the MSA. However, there is no time period within which a trustee or PM in bankruptcy would be required to assume or reject the MSA. Legal proceedings necessary to resolve the issue of whether the MSA is an executory contract under the Bankruptcy Code could be time consuming and could result in delays in, or elimination of, payments by the bankrupt PM.

Hawkins Delafield & Wood LLP and Pacifica Law Group LLP will render opinions to the Authority and the Rating Agency, subject to all the facts, assumptions and qualifications stated therein (there being no precedent directly on point), that in a case commenced under the Bankruptcy Code by or against an OPM, a court, exercising reasonable judgment after full consideration of all relevant factors in a properly presented and argued case, would (a) hold that the MSA is an executory contract pursuant Section 365 of the Bankruptcy Code and (b) approve a decision by an OPM to assume or reject the MSA as an executory contract.

Assumption or Rejection of MSA

Should a bankrupt PM determine to assume the MSA, it would have to cure all outstanding MSA payment defaults and provide "adequate assurance" that all future payments under the MSA will be paid in full. "Adequate assurance" is not defined in the Bankruptcy Code and is determined by the bankruptcy court. If the bankruptcy court rules that the PM cannot provide such adequate assurance, payments under the MSA may be delayed or eliminated.

If a bankrupt PM determines to reject the MSA and a court approves such a decision, the State (and thus the Authority, the Indenture Trustee and the Bondholders, as collateral assignees) may then have a prepetition unsecured, nonpriority claim for damages. Rejection of an executory contract should be treated as a breach of the contract by the PM. However, under the Bankruptcy Code, the State (and thus the Authority, the Indenture Trustee and the Bondholders) nevertheless may be enjoined from commencing or continuing any action against the PM to enforce remedies under the MSA (including an action to collect payments due under the MSA). In addition, because amounts owed by the PM under the MSA are not fixed, legal proceedings may be necessary to quantify the claims of the State (and thus the Authority, the Indenture Trustee and the Bondholders) for damages as a result of the PM's rejection of the MSA. Such legal proceedings could be time consuming and could result in delays, reductions, or elimination of, payments by the bankrupt PM.

Modification of MSA Obligations

If the MSA is determined not to be an "executory contract", the PM determines to reject the MSA or the PM is otherwise not authorized to make payments under the MSA, then a bankruptcy of the PM could result in long delays and possibly in large reductions in the amount of Pledged TSRs available to pay the Bondholders because, under the Bankruptcy Code, the obligations of the PM under the MSA

could be modified or discharged in their entirety. For example, the bankruptcy court may approve a plan of reorganization or liquidation of the PM that alters the timing or the amount of payments to be made by the PM under the MSA to the State (and, thus, to the Authority, the Indenture Trustee and Bondholders).

MSA and Qualifying Statute Enforceability

Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. However, if any OPM does not agree to the substitute terms, the MSA would terminate in all Settling States affected by the court's ruling. Even if substitute terms are agreed upon, payments under such terms may be less than payments under the MSA or otherwise could be made according to or subject to different terms and conditions that could reduce the amount available to pay the principal of and interest on the Series 2013 Bonds.

Certain smokers, smokers' rights organizations, consumer groups, cigarette wholesalers, cigarette manufacturers, cigarette importers, cigarette distributors, Native American tribes, taxpayers, taxpayers' groups and other parties have filed lawsuits against some, and in certain cases all, of the signatories to the MSA, alleging, among other things, that the MSA, Qualifying Statutes and Complementary Legislation violate and are void or unenforceable under certain provisions of law, such as the United States Constitution, the federal antitrust laws, federal civil rights laws, state constitutions, state consumer protection laws, bankruptcy laws, federal cigarette advertising and labeling law and unfair competition laws. Certain of the lawsuits have sought, among other relief, 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 or a determination that the MSA is void or unenforceable. To date, all of the judgments on the merits have rejected the challenges presented in the cases. In the most recent decision, *VIBO*, the Sixth Circuit ruled that the MSA does not amount to an unlawful conspiracy or anti-competitive behavior by the government and, accordingly, affirmed the district court's order dismissing plaintiffs' federal antitrust, federal constitutional and common law challenges to the enforceability of the MSA. The time period for the plaintiffs to file a petition for certiorari to the U.S. Supreme Court expired. In *Grand River*, the U.S. district court for the Southern District of New York denied the plaintiffs' motion to amend the Southern District's dismissal by summary judgment of plaintiffs' claims that the MSA and related legislation violated Section 1 of the Sherman Antitrust Act and the Commerce Clause of the Constitution of the United States. Plaintiffs had appealed to the Second Circuit both the Southern District's dismissal and denial, but subsequently withdrew both appeals. In another decision, *Freedom Holdings*, the Second Circuit affirmed the district court's judgment, after a bench trial, in favor of defendants on similar challenges to New York's Qualifying Statute and Complementary Legislation, and the U.S. Supreme Court has denied the plaintiffs' petition for certiorari. These cases are discussed more fully herein. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY." A determination by a court in a future case that a nonseverable provision of the MSA is void or voidable would, in the absence of an agreement to a substitute term, result in the termination of the MSA in any Settling States affected by the court's ruling. Accordingly, in the event of an adverse court ruling, Bondholders could incur a complete loss of the Pledged TSRs. See "BONDHOLDERS' RISKS—If Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation Were Successful, Payments Under the MSA Might be Suspended or Terminated" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Litigation Challenging the MSA, the Qualifying Statute and Related Legislation."

The Qualifying Statutes and related legislation, like the MSA, have been the subject of litigation in cases alleging that the Qualifying Statute and related legislation violate certain provisions of the United States Constitution or state constitutions or are preempted by federal antitrust laws. The lawsuits have

sought, among other relief, injunctions against the enforcement of the Qualifying Statute and related legislation. To date, such challenges have not been ultimately successful. The Qualifying Statutes and related legislation may continue to be challenged in the future. Although a determination that the Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA, such a determination could have an adverse effect on payments to be made under the MSA if an NPM were to gain market share in the future and there occurred the requisite impact on the market share of the PMs under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Litigation Challenging the MSA, the Qualifying Statute and Related Legislation."

In rendering the opinions described below, Hawkins Delafield & Wood LLP and Pacifica Law Group LLP considered the claims asserted in the federal actions as well as other federal and State constitutional and statutory claims described under the caption "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" that it believes are representative of the legal theories that an opponent of the MSA or the State's Qualifying Statute would advance in an attempt to invalidate the MSA or the State's Qualifying Statute. Subject to the qualifications and assumptions set forth in such opinions, Hawkins Delafield & Wood LLP and Pacifica Law Group LLP will render opinions to the Authority and the Rating Agency that, subject to certain qualifications and assumptions expressed therein, a court exercising reasonable judgment, after full consideration of all relevant factors in a properly presented and argued case applying existing legal rules, would hold that the MSA is a valid and enforceable agreement among the states and the tobacco companies that are party thereto and that the State's Qualifying Statute is valid, enforceable and constitutional in all material respects and, as such, is enforceable against the NPMs. This opinion as to the enforceability of the MSA, the State's Qualifying Statute and the obligations of the aforementioned signatories is also subject to the effect of bankruptcy, insolvency, reorganization, receivership, moratorium and other similar 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, and the availability of any specific remedy.

Limitations on Certain Opinions

A court's decision regarding the matters upon which a lawyer is opining would be based on such court's own analysis and interpretation of the factual evidence before it and of applicable legal principles. Thus, if a court reached a different result from that expressed in an opinion, such as that the MSA is void or voidable or that the Qualifying Statute is unenforceable, it would not necessarily constitute reversible error or be inconsistent with that opinion. An opinion of counsel is not a prediction of what a particular court (including any appellate court) that reached the issue on the merits would hold, but, instead, is the opinion of such counsel as to the proper result to be reached by a court applying existing legal rules to the facts as properly found after appropriate briefing and argument and, in addition, is not a guarantee, warranty or representation, but rather reflects the informed professional judgment of such counsel as to specific questions of law. Opinions of counsel are not binding on any court or party to a court proceeding. The descriptions of the opinions set forth herein are summaries, do not purport to be complete, and are qualified in their 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 2013 Bonds. In that event, the Bondholders, the Indenture Trustee or the Authority could assert claims based on contractual or constitutional rights.

Contractual Remedies

Under State law, settlements are treated as contracts and may be enforced according to their terms. The Consent Decree coupled with the MSA is a court-approved settlement of lawsuits that establishes the State's right to receive the Pledged TSRs. Pursuant to the Act and the Sale Agreement, the State has covenanted, among other things, 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, to 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, and not to take any action that will materially and adversely affect the Authority's legal right to receive the Pledged TSRs. Thus, if the State violates such agreement so as to impair the Authority's right to the Pledged TSRs, the Indenture Trustee, as assignee of the Authority's rights under the Sale Agreement, could seek to compel the State to honor such agreement. In general, as interested parties, the Authority on its own behalf, and the Indenture Trustee on behalf of the Bondholders, could also seek to enforce the State's rights under the MSA, although, as third parties to the MSA, their rights to do so are uncertain.

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 contracts similar to the MSA or the financing arrangements in a manner that would substantially impair the rights of the Bondholders to be paid from the Pledged TSRs. In those instances, however, where a state's own contractual obligations involving financing will be substantially impaired, the U.S. Supreme Court applies a stricter standard of judgment to a state's actions due to the risk that a state's self-interest rather than any public necessity will be the motivation for its actions. Indeed, in *United States Trust Company of New York v. New Jersey*, 431 U.S. 1 (1977), the U.S. Supreme Court noted that only once in an entire century had the U.S. Supreme Court upheld the alteration of a municipal bond contract. Thus, in order 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 not only must demonstrate a significant and legitimate public purpose, such as the remedying of a broad and general social or economic problem, but must also demonstrate that its actions under such circumstances satisfy the U.S. Supreme Court's strict standard of judgment employed in *United States Trust Company* and also that the impairment of the Bondholder's rights are based upon reasonable conditions and are of a character appropriate to the public purpose justifying the legislation's adoption.

Constitutional Rights

Bondholders may also have constitutional claims under the Due Process Clauses of the United States Constitution and State Constitution in the event the State attempts to claim some or all of the Pledged TSRs for itself, or otherwise interferes with the security for the Series 2013 Bonds.

No Assurance as to the Outcome of Litigation or Arbitration Proceedings

With respect to all matters (i) of litigation mentioned above that have been brought and may in the future be brought against the PMs, (ii) involving the enforceability or constitutionality of the MSA and/or the State's related legislation, Qualifying Statute or the enforcement of the right to the Pledged TSRs or otherwise filed in connection with the tobacco industry, or (iii) arbitration with respect to the NPM Adjustment, the outcome of such litigation, in general, cannot be predicted with certainty and depends, among other things, on (A) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and (B) the courts, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the

legal merits but upon a balancing of the equities among the parties. Furthermore, with respect to the arbitration proceedings relating to the NPM Adjustment, the outcome of such arbitration cannot be predicted. Accordingly, no assurance can be given as to the outcome of any such litigation or arbitration and any such adverse outcome could have a material and adverse impact on the amount of Pledged TSRs available to the Authority to pay the principal of and interest on the Series 2013 Bonds.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

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 MSA, as amended. A copy of the MSA in its original form is attached hereto as Appendix A, but several amendments have been made to the MSA which are not included in Appendix A. Except for those amendments pursuant to which certain tobacco companies became SPMs (as defined below), such amendments involve technical and administrative provisions not material to the summary below. In addition, the following includes certain information related to litigation challenges to the MSA and disputes regarding the NPM Adjustment, both of which are referenced under "BONDHOLDERS' RISKS" herein.

General

The MSA is an industry-wide settlement of litigation between the Settling States (including the State) and the OPMs and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for other tobacco companies (the "**SPMs**") to become parties to the MSA. The three OPMs together with the 52 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 states. 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, as of June 28, 2013, the most recent posting by NAAG, 55 PMs were parties to the MSA. The chart below identifies each of the PMs which was a party to the MSA as of June 28, 2013:

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OPMs

- Lorillard Tobacco Company
- Philip Morris USA Inc. (formerly Philip Morris Incorporated)
- R.J. Reynolds Tobacco Company (formerly R.J. Reynolds Tobacco Company and Brown & Williamson Tobacco Corporation)

SPMs

- Bekenton, S.A.[*]
- Canary Islands Cigar Co.
- Caribbean-American Tobacco Corp. (CATCORP)
- The Chancellor Tobacco Company, UK Ltd.
- Commonwealth Brands, Inc.
- Daughters & Ryan, Inc.
- M/s. Dhanraj International[*]
- Eastern Company S.A.E.
- Ets L Lacroix Fils NV S.A. (Belgium)
- Farmer's Tobacco Co. of Cynthiana, Inc.
- General Jack's Incorporated
- General Tobacco (VIBO Corporation d/b/a General Tobacco)[†]
- House of Prince A/S
- Imperial Tobacco Limited/ITL (USA) Limited
- Imperial Tobacco Limited/ITL (UK)
- Imperial Tobacco Mullingar (Ireland)
- Imperial Tobacco Polska S.A. (Poland)
- Imperial Tobacco Production Ukraine
- Imperial Tobacco Sigara ve Tutunculuk Sanayi Ve Ticaret S.A. (Turkey)
- International Tobacco Group (Las Vegas), Inc.
- Japan Tobacco International USA, Inc.
- King Maker Marketing
- Konci G&D Management Group (USA) Inc.
- Kretek International
- Liberty Brands, LLC[*]
- Liggett Group, LLC
- Lignum-2, Inc.
- Mac Baren Tobacco Company A/S
- Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)
- NASCO Products Inc.
- OOO Tabaksfacrik Reemtsma Wolga (Russia)
- P.T. Djarum
- Pacific Stanford Manufacturing Corporation
- Peter Stokkebye Tobaksfabrik A/S
- Planta Tabak-manufaktur Gmbh & Co.
- Poschl Tabak GmbH & Co. KG
- Premier Manufacturing Incorporated
- Reemtsma Cigarettenfacbriken GmbH (Reemtsma)
- Santa Fe Natural Tobacco Company, Inc.
- Scandinavian Tobacco Group Lane Ltd. (formerly Lane Limited and Tobacco Exporters International (USA) Ltd.)
- Sherman's 1400 Broadway N.Y.C. Inc.
- Societe National d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)
- Tabacalera del Este, S.A. (TABESA)
- Top Tobacco, LP
- U.S. Flue-Cured Tobacco Growers, Inc.
- Van Nelle Tabak Nederland B.V. (Netherlands)
- Vector Tobacco Inc. (formerly Vector Tobacco Inc. and Medallion Company, Inc.)
- Virginia Carolina Corporation, Inc.
- Von Eicken Group
- Wind River Tobacco Company, LLC
- VIP Tobacco USA, LTD. (formerly Winner Sales Company)
- ZNF International, LLC

[*] Has filed for bankruptcy relief.
[†] Ceased production of cigarettes and other tobacco products.

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 against any other person or entity. Obligations of the SPMs, to the extent that they differ from the obligations of the OPMs, are described below under "—Subsequent Participating Manufacturers."

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, and officers 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 Attorney General of a Settling State does not have the power or authority to bind any of the Releasing Parties in such state, 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; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Payments.* See "Initial Payments," "Annual Payments" and "Strategic Contribution Payments" below. These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "Adjustments to Payments" and "Subsequent Participating Manufacturers" below. SPMs were not required to make Initial Payments. Thus far, the OPMs have made all of the Initial Payments, and most of the PMs† have made Annual Payments for 2000 through and including 2013 (subject to certain withholdings and payments into the Disputed Payments Account under the MSA described in "BONDHOLDERS' RISKS—Potential Payment Decreases Under the Terms of the MSA"). The Pledged TSRs now consist of 29.2% of:

(a) the payments 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.

See "Payments Made to Date" below. Strategic Contribution Payments began April 15, 2008 and will continue through April 15, 2017.

Payments required to be made by the OPMs are calculated annually based on actual domestic shipments of cigarettes in the prior calendar year by reference to the OPMs' domestic shipment of cigarettes in 1997, with consideration under certain circumstances for the profitability of each OPM. Payments to be made by the SPMs are recalculated each year, based on the Market Share of each individual SPM in relation to the Market Share of the OPMs. For SPMs that became signatories to the MSA within 90 days of its execution, payments are recalculated each year based on the Market Share less the Base Share of such SPM in relation to the Market Share of the OPMs. See "– Subsequent Participating Manufacturers" below. Pursuant to an escrow agreement (the "**MSA Escrow Agreement**") established in conjunction with the MSA, the Annual Payments and Strategic Contribution Payments are to be made to Citibank, N.A., as Escrow Agent (the "**MSA Escrow Agent**"), which in turn will disburse the funds to the Settling States. The State has covenanted to irrevocably direct the MSA Escrow Agent and the MSA Auditor (as defined in the MSA) to transfer all Pledged TSRs directly to the Indenture Trustee.

Beginning with the payments due in the year 2000, the MSA Auditor has, among other things, calculated and determined the amount of all payments owed pursuant to the MSA, the adjustments,

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

† VIBO Corporation, Inc., d/b/a General Tobacco, ceased production of cigarettes in 2010 and has defaulted upon certain of its MSA payments. General Tobacco has stated that it will be unable to make any back payments it owes under the MSA.

reductions and offsets thereto (and all resulting carry-forwards, if any), and the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the PMs and among the Settling States. *This information is not publicly available and the MSA Auditor has agreed to maintain the confidentiality of all such information, except that the MSA Auditor may provide such information to PMs and the Settling States as set forth in the MSA.*

Initial Payments

Initial Payments were made only by the OPMs. In December 1998, the OPMs collectively made an up-front Initial Payment of $2.40 billion. The 2000 Initial Payment, which had a scheduled base amount of $2.47 billion, was paid in December 1999 in the approximate amount of $2.13 billion due to various adjustments. The 2001 Initial Payment, which had a scheduled base amount of $2.55 billion, was paid in December 2000 in the approximate amount of $2.04 billion after taking into account various adjustments and an earlier overpayment. The 2002 Initial Payment, which had a scheduled base amount of $2.62 billion, was paid in December 2001, in the approximate amount of $1.89 billion after taking into account various adjustments and a deposit made to the Disputed Payments Account. Approximately $204 million, which was substantially all of the money previously deposited in the Disputed Payments Account for payment to the Settling States, was distributed to the Settling States with the Annual Payment due April 15, 2002. The 2003 Initial Payment, which had a scheduled base amount of $2.7 billion, was paid in December 2002 and January 2003, in the approximate amount of $2.14 billion after taking into account various adjustments.

Annual Payments

The OPMs and the SPMs are required to make Annual Payments on each April 15 in perpetuity. Most of the PMs made the first fourteen Annual Payments due April 15 in each of the years 2000 through 2013. The scheduled base amounts of the Annual Payments and the approximate amounts actually paid after application of adjustments discussed herein are set forth in the following table.

Annual Payments*

Year	Base Amount	Adjusted Payment**	Year	Base Amount	Adjusted Payment**
2000	$4,500,000,000	$3,500,000,000	2010	$8,139,000,000	$5,700,000,000
2001	5,000,000,000	4,100,000,000	2011	8,139,000,000	5,400,000,000
2002	6,500,000,000	5,200,000,000	2012	8,139,000,000	5,500,000,000
2003	6,500,000,000	5,100,000,000	2013	8,139,000,000	6,700,000,000***
2004	8,000,000,000	6,200,000,000	2014	8,139,000,000	
2005	8,000,000,000	6,300,000,000	2015	8,139,000,000	
2006	8,000,000,000	5,800,000,000	2016	8,139,000,000	
2007	8,000,000,000	6,000,000,000	2017	8,139,000,000	
2008	8,139,000,000	6,200,000,000	Thereafter	9,000,000,000	
2009	8,139,000,000	6,300,000,000			

* The Annual Payments from 2000 through 2013 have been made. Subsequent adjustments to Annual Payments for a given year may impact Annual Payments due in subsequent years.
** Amounts are approximated.
*** Includes adjustments resulting from the NPM Adjustment Settlement Term Sheet.

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 (defined below) 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. Each SPM has Annual Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its Market Share. However, any SPM that became a party to the MSA within 90 days after it became effective pays only if its Market Share exceeds the higher of its 1998 Market Share or 125% of its 1997 Market Share (such higher share, the "**Base Share**").

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

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

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

Application of these adjustments resulted in a material reduction from the scheduled base amounts of the Annual Payments made by the PMs for the years 2000 through 2013, as discussed below under "—Payments Made to Date."

Strategic Contribution Payments

The OPMs are also required to make Strategic Contribution Payments on April 15 of each year from 2008 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 Market Share increases above their respective Base Shares. See "—Subsequent Participating Manufacturers."

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

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

Application of these adjustments resulted in a material reduction from the scheduled base amounts of the Strategic Contribution Payments made by the PMs for the years 2008 through 2013, as discussed below under "—Payments Made to Date."

Adjustments to Payments

The base amounts of the Initial Payments were, and the Annual Payments and Strategic Contribution Payments described 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 adjustment percentages are compounded annually on a cumulative basis beginning in 1999 and were first applied in 2000.

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

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

If the Actual Volume in a given year is less than the Base Volume, the base amount due from the OPMs (in the case of Annual Payments and Strategic Contribution Payments, after application of the Inflation Adjustment) is decreased by 98% of the percentage by which the Actual Volume is less than the Base Volume, multiplied by such base amount. If, however, the aggregate operating income of the OPMs from sales of cigarettes in the United States during the year (the "**Actual Operating Income**") is greater than $7,195,340,000, as adjusted for inflation in accordance with the Inflation Adjustment (the "**Base Operating Income**"), all or a portion of the volume reduction is added back (the "**Income Adjustment**"). The amount by which the Actual Operating Income of the OPMs exceeds the Base Operating Income is multiplied by the percentage of the allocable shares under the MSA represented by Settling States in which State-Specific Finality has been reached and divided by four, then added to the payment due. However, in no case will the amount added back due to the increase in operating income exceed the amount deducted due to the decrease in domestic volume. Any add-back due to an increase in Actual Operating Income will be allocated among the OPMs on a pro rata basis in accordance with their respective increases in Actual Operating Income over 1997 Base Operating Income.

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

the Previously Settled States Reduction. Initial Payments were not, and Strategic Contribution Payments are not, subject to the Previously Settled States Reduction.

Non-Settling States Reduction. In the event that the MSA terminates as to any Settling State, the remaining Annual Payments and Strategic Contribution Payments, if any, 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. The "**NPM Adjustment**" is based upon market share increases, measured by domestic sales of cigarettes by NPMs, and operates to reduce the payments of the PMs under the MSA in the event that the PMs incur losses in Market Share to NPMs during a calendar year as a result of the MSA. Under the MSA, three conditions must be met in order to trigger an NPM Adjustment: (1) the aggregate Market Share of the PMs in any year must fall more than 2% below the aggregate Market Share held by those same PMs in 1997, (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the Market Share loss for the year in question, and (3) the Settling States in question must fail to prove that they have diligently enforced their Model Statutes. The NPM Adjustment is applied to the subsequent year's Annual Payment and Strategic Contribution Payment and the decrease in total funds available as a result of the NPM Adjustment is then allocated on a pro rata basis among those Settling States that have been found (i) to not diligently enforce their Qualifying Statutes, or (ii) to have enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 Market Share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate Market Share is between 0% and $16\,^{2}/_{3}\%$ less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs would be decreased by three times the percentage decrease in the PMs' actual aggregate Market Share. If, however, the aggregate Market Share loss from the Base Aggregate Participating Manufacturer Market Share is greater than $16\,^{2}/_{3}\%$, the NPM Adjustment will be calculated as follows:

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

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

The NPM Adjustment is also state-specific, in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute. Any Settling State that adopts and diligently enforces the Model Statute or a Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute, which is a Qualifying Statute, and by letter agreement from counsel to the OPMs dated February 7, 2001, the OPMs confirmed that Washington has in effect a Model Statute within the meaning of MSA. See "— MSA Provisions Relating to Model/Qualifying Statues – *Washington Qualifying Statute*" below. 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 a Model Statute or Qualifying Statute, or (2) enacted a

Model Statute or 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 for any given year will not exceed 65% of the amount of such state's allocated payment for the subsequent year. If a Qualifying Statute that is not the Model Statute is held invalid or unenforceable, however, such state is not entitled to any protection from the NPM Adjustment. Moreover, if a state adopts the 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. See "BONDHOLDERS' RISKS—Potential Payment Decreases Under the Terms of the MSA" above and "—Potential Payment Decreases Under the Terms of the MSA—*NPM Adjustment*" and "—MSA Provisions Relating to Model/Qualifying Statutes" below. See also "—'Most Favored Nation' Provisions" below. For a discussion of recent developments regarding disputes with respect to the NPM Adjustment, including arbitration decisions regarding the 2003 NPM Adjustment and the stipulated partial settlement and award and objections thereto, see "—*NPM Adjustment*—2003 NPM Adjustment; Arbitration Results" and "—NPM Adjustment Settlement and Award" below.

Offset for Miscalculated or Disputed Payments. If the MSA Auditor receives notice of a miscalculation of 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 may be paid into the Disputed Payments Account pending resolution of the dispute, or may be withheld. Failure to pay such disputed amounts into the Disputed Payments Account can result in liability for interest at the penalty rate if the disputed amount was in fact properly due and owing. See "BONDHOLDERS' RISKS—Potential Payment Decreases Under the Terms of the MSA."

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

Offset for Claims-Over. If a Releasing Party pursues and collects on a released claim against an NPM or a retailer, supplier or distributor arising from the sale or distribution of tobacco products of any NPM or the supply of component parts of tobacco products to any NPM (collectively, the "**Non-Released Parties**"), and the Non-Released Party in turn successfully pursues a claim for contribution or indemnification against a Released Party (as defined herein), the Releasing Party must (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 which are made at the same times as the Annual Payments and Strategic Contribution Payments to be made by OPMs. Annual Payments and Strategic Contribution Payments for SPMs are calculated differently, however, from Annual Payments and Strategic Contribution Payments for OPMs. Each SPM's payment obligation is determined according to its market share if, and only if, its "**Market Share**" (defined in the MSA to mean a manufacturer's share, expressed as a percentage, of the total number of cigarettes sold in the United States in a given year, as measured by excise taxes (or similar taxes, in the case of Puerto Rico)), for the year preceding the payment exceeds its Base Share. If an SPM executes the MSA after February 22, 1999 (i.e., 90 days after the effective date of the MSA), its Base Share is deemed to be zero. Fourteen of the current 52 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 also 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.

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, most PMs have made Annual Payments since 2000 and Strategic Contribution Payments since 2008, and the MSA Escrow Agent has disbursed to the State its allocable portions thereof and certain other amounts under the MSA totaling approximately $2.07 billion to the State to date, according to NAAG. Under the MSA, the computation of Initial Payments, Annual Payments and Strategic Contribution Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA.

Payments Made to Date

	State Unadjusted Allocable Share of MSA Base Payment Amount*	State's Actual Receipts*[(1)]
Up-Front Initial Payment	$49,278,197	$45,646,394
2000 Initial Payment	50,715,477	50,695,566
2001 Initial Payment	52,358,084	44,950,150
2002 Initial Payment	53,795,365	40,943,886
2003 Initial Payment	55,437,971	43,923,921
2000 Annual Payment	$ 92,396,619	$ 73,187,182
2001 Annual Payment	102,662,910	83,770,900
2002 Annual Payment	133,461,783	109,290,120
2003 Annual Payment	133,461,783	108,026,543
2004 Annual Payment	164,260,656	129,027,835
2005 Annual Payment	164,260,656	130,884,571
2006 Annual Payment	164,260,656	119,867,619
2007 Annual Payment	164,260,656	124,674,184
2008 Annual Payment	167,114,685	127,248,676
2009 Annual Payment	167,114,685	140,324,413
2010 Annual Payment	167,114,685	116,778,108
2011 Annual Payment	167,114,685	110,715,241
2012 Annual Payment	167,114,685	112,909,329
2013 Annual Payment	167,114,685	112,829,008
2008 Strategic Contribution Payment	$49,634,439	$45,744,076
2009 Strategic Contribution Payment	49,634,439	46,872,225
2010 Strategic Contribution Payment	49,634,439	40,693,711
2011 Strategic Contribution Payment	49,634,439	37,086,114
2012 Strategic Contribution Payment	49,634,439	37,770,010
2013 Strategic Contribution Payment	49,634,439	37,803,456

* Rounded.

(1) As reported by the State, to the best of the State's knowledge, 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. Accordingly, actual receipts in any year may include payments attributable to prior years as a result of adjustments or disputes regarding such prior years.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the headings "—Initial Payments," "—Annual Payments," "—Strategic Contribution Payments" and "—Adjustment to Payments." One or more of the PMs are disputing or have disputed the calculations of some of the Initial Payments for the years 2000 through 2003, and some Annual Payments for the years 2000 through 2013, as described further herein. In addition, subsequent revisions in the information delivered to the MSA Auditor (on which the MSA Auditor's calculations of the Initial Payments and Annual Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

"Most Favored Nation" Provisions

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

In the event that any Settling State should reach a settlement of released claims with NPMs that provides more favorable terms to the NPMs than the MSA does to the PMs, or relieves in any respect the obligation of any PM to make payments under the MSA, the terms of the MSA will be deemed modified to match the NPM settlement or such payment terms, but only with respect to the particular Settling State. In no event will the adjustments discussed in this paragraph modify the MSA with regard to other Settling States. See "BONDHOLDERS' RISKS — Potential Payment Decreases Under the Terms of the MSA."

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**" marks 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 will be processed in the normal course. Challenges will be submitted to binding arbitration. The information provided by the MSA Auditor to the State with respect to calculations of amounts to be paid by PMs is confidential under the terms of the MSA and may not be disclosed to the 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; and (3) the sale or distribution in the Settling States of any non-tobacco items containing tobacco brand names or selling messages.

In addition, the OPMs 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 by 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. Each OPM 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 (as adjusted by the Inflation Adjustment, the Volume Adjustment and the offset for miscalculated or disputed payments) in perpetuity if, during the year preceding the year when payment is due, the sum of the Market Shares of the OPMs equals or exceeds 99.05%. The Foundation may also be funded by contributions made by other entities.

Remedies upon the Failure of a PM to Make a Payment

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

Termination of 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 and Strategic Contribution Payments are subject to, among other adjustments and reductions, the NPM Adjustment, which may reduce the amount of money that a Settling State receives pursuant to the MSA. The NPM Adjustment will reduce payments of a PM if such PM experiences certain losses of Market Share in the United States in a particular year as a result of participation in the MSA and any of the Settling States fail to prove that they have diligently enforced their Qualifying Statutes in such year.

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

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 diligently enforce a Qualifying Statute. In addition, if the NPM Adjustment allocated to a particular Settling State exceeds its allocated payment, the excess is to be reallocated equally among the remaining Settling States that have not adopted and diligently enforced a Qualifying Statute. Thus, Settling States that do not adopt and diligently 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 the 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 the 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 an amount for each cigarette that constitutes a "unit sold" into an escrow account (which amount increases on a yearly basis, as set forth in the Model Statute).

The State's Qualifying Statute defines "**units sold**" as the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor,

retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs bearing the excise tax stamp of the State or "roll-your-own" tobacco containers.

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

In recent years legislation has been enacted in all of the Settling States except Missouri to amend the Qualifying or Model Statutes in those states by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain under the Model Statute to the excess above the total payment that the NPM would have paid for its cigarettes had it been a PM (each an "**Allocable Share Release Amendment**"). NAAG has endorsed these legislative efforts. A majority of the PMs, including all OPMs, have indicated their agreement in writing that in the event a Settling State enacts legislation substantially in the form of the model Allocable Share Release Amendment, such Settling State's previously enacted Model Statute or Qualifying Statute will continue to constitute the Model Statute or a Qualifying Statute within the meaning of the MSA.

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

Washington Qualifying Statute

The Qualifying Statute adopted by the State, in the form of the Model Statute attached to the MSA as Exhibit T with certain modifications approved by the OPMs, is codified at Revised Code of Washington §70.157 and became effective on May 18, 1999. By letter agreement from counsel to the OPMs dated February 7, 2001, the OPMs confirmed that Washington has in effect a Model Statute within

the meaning of MSA. See “BONDHOLDERS’ RISKS–Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation.”

In 2003, the State enacted an Allocable Share Release Amendment to amend its Qualifying Statute. The amendment changed the release calculation from being based on the State’s allocable share of the payments the NPM would have made if it were a signatory to the MSA to being based on the payments that the NPM would have made as a signatory to the MSA on account of units sold in the State by the NPM. A majority of the PMs, including all three OPMs, had indicated in writing that in the event a Settling State enacted legislation substantially in the form of the Model Allocable Share Release Amendment, the Settling State’s previously enacted Qualifying Statute would continue to constitute a Model Statute and a Qualifying Statute within the meaning of the MSA. The State’s Allocable Share Release Amendment is in the form of the Model Allocable Share Release Amendment.

Pursuant to RCW §70.157 of the State’s Qualifying Statute, each tobacco product manufacturer that elects to place funds into escrow pursuant to the State’s Qualifying Statute will annually certify to the Attorney General of the State that it is in compliance with the State’s Qualifying Statute. The Attorney General of the State 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 the State’s Qualifying Statute. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under the State’s Qualifying Statute will: (a) be required within fifteen days to place such funds into escrow as will bring it into compliance and the court, upon a finding of a violation of the State’s Qualifying Statute, may impose a civil penalty in an amount not to exceed 5% of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100% of the original amount improperly withheld from escrow; (b) in the case of a knowing violation, be required within fifteen days to place such funds into escrow as will bring it into compliance with the State’s Qualifying Statute; the court, upon a finding of a knowing violation of the State’s Qualifying Statute, may impose a civil penalty in an amount not to exceed 15% of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300% 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 two years. Each failure to make an annual deposit required under the State’s Qualifying Statute constitutes a separate violation.

Washington Complementary Legislation

Pursuant to the provisions of RCW §70.158 (the “**State’s Complementary Legislation**”), every tobacco product manufacturer whose cigarettes are sold in the State, whether directly or through a wholesaler, distributor, retailer, or similar intermediary or intermediaries, will execute and deliver on a form prescribed by the Attorney General of the State a certification to the Attorney General of the State, no later than April 30 of each year, certifying under penalty of perjury that, as of the date of such certification, such tobacco product manufacturer either: is a PM; or is in full compliance with the State’s Qualifying Statute, including all payments required by the State’s Complementary Legislation. A PM will include in its certification a list of its brand families. The PM will update such list 30 calendar days prior to any addition to or modification of its brand families by executing and delivering a supplemental certification to the Attorney General of the State. An NPM will include in its certification: (i) a list of all of its brand families and the number of units sold for each brand family that were sold in the State during the preceding calendar year; (ii) a list of all of its brand families that have been sold in the State at any time during the current calendar year; (iii) indicating, by an asterisk, any brand family sold in the State during the preceding calendar year that is no longer being sold in the State as of the date of such certification; (iv) identifying by name and address any other manufacturer of such brand families in the preceding or current calendar year; and (v) any other information required by the State’s Complementary

Legislation. The NPM will update such list thirty calendar days prior to any addition to or modification of its brand families by executing and delivering a supplemental certification to the Attorney General of the State. In the case of an NPM, the State's Complementary Legislation requires further certifications as to, among other details, establishment and maintenance of a qualified escrow fund. Furthermore, the State's Complementary Legislation provides that not later than twenty-five calendar days after the end of each calendar month, and more frequently if so directed by the Director of the State's Department of Revenue (the "**DOR**"), each wholesaler and distributor will submit such information as the Director of the DOR requires to facilitate compliance with the State's Complementary Legislation, including but not limited to a list by brand family of the total number of cigarettes, or, in the case of roll your own, the equivalent stick count, for which the wholesaler or distributor affixed stamps during the previous calendar month or otherwise paid the tax due for such cigarettes.

In addition, the State's Complementary Legislation requires that the Attorney General of the State develop and publish on its website a directory listing all tobacco product manufacturers that have provided current and accurate certifications conforming to the requirements described in the immediately preceding paragraph and all brand families that are listed in such certifications (the directory), except as specified in the State's Complementary Legislation. No person may sell or distribute cigarettes, or acquire, hold, own, possess, transport, import, or cause to be imported cigarettes that the person knows or should know are intended for distribution or sale in the State in violation of the State's Complementary Legislation. Any cigarettes that have been sold or distributed, or acquired, held, owned, possessed, transported, imported, or caused to be imported with the intent to distribute or sell in the State in violation of the State's Complementary Legislation will be subject to seizure and forfeiture.

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

State Statutory Enforcement Framework

State Statutory Enforcement Provisions

The State's statutory framework for enforcing laws relating to the manufacture, distribution, sale, possession and taxation of cigarettes within the State of Washington includes, but is not limited to the State's Qualifying Statute (RCW §70.157 as amended, including the Allocable Share Release Amendment to the Qualifying Statute previously described herein), known as the National Uniform Tobacco Settlement - Nonparticipating Tobacco Product Manufacturers Act, and the State's Complementary Legislation, as well as the following:

- Tax on Cigarettes Act (RCW §82.24) (including cigarette stamping requirements, licensing requirements and cigarette and roll-your-own tobacco tax rates),

- Cigarette Ignition Propensity Act (RCW §19.305, effective August 1, 2009) (requiring "self-extinguishing" cigarettes, written certifications filed with the Washington State Director of Fire Protection, and Fire Standards Compliant markings on cigarettes that have been certified that indicate compliance with such requirements),

- Smoking in Public Places Act (RCW §70.160, formerly the Washington Clean Indoor Air Act) (prohibiting smoking in public places or places of employment);

- RCW §26.28.080 (prohibits selling or giving tobacco products to persons under the age of 18); and RCW §70.155 (Tobacco–Access to Minors Act) (regulates the sale or distribution of tobacco products to persons under the age of 18 and the purchase of tobacco products by such minors, including prohibitions concerning shipment of cigarettes by mail, internet sales and the location of vending machines);

- Prohibition on Use of Tobacco Products on School Property Act (RCW §28A.210 and 310 prohibiting use of tobacco products on school property);

- Various implementing regulations promulgated by the Washington Office of the Attorney General (the "**AGO**") and the DOR.

Federal Laws

In addition to State laws, rules and regulations, state enforcement agencies have certain shared enforcement powers under various federal laws relating to tobacco control, including the Jenkins Act (regulating and restricting the mail order and internet sales of tobacco and other controlled products), as amended by the Prevent All Cigarette Trafficking ("**PACT**") Act of 2010 and the FSPTCA.

This statutory enforcement framework is administered and enforced by the AGO, the Liquor Control Board (the "**LCB**"), the DOR, and the Washington State Director of Fire Protection.

Washington Office of the Attorney General

The AGO enforces the provisions of the MSA. The AGO works closely with the National Association of Attorneys General and Attorney General offices from other states. The AGO's duties include:

- Handling litigation arising from or relating to the MSA;

- Monitoring compliance with the MSA;

- Monitoring the payment stream from the MSA;

- Monitoring and enforcing the statutory compliance of NPMs.

The AGO maintains the State of Washington Directory of Certified Tobacco Product Manufacturers (including brand-specific information), and receives the annual and quarterly compliance certifications from PMs and NPMs. Tobacco product manufacturers report directly to the Attorney General and senior officers or directors of the manufacturers must file quarterly certifications of compliance with the AGO; reporting under the penalties of perjury both the units of cigarettes sold and the payment of the amount calculated to be required and deposited into a qualified escrow fund. Cigarette and roll-your-own brands and manufacturers that are not listed on the State of Washington Directory of

Certified Tobacco Product Manufacturers, and that do not bear Washington cigarette tax stamps, may not be sold in Washington. The directory is published on the AGO's website at www.atg.wa.gov/Tobacco/SuppliersandManufacturers.aspx. Additionally, the AGO serves the public by providing general information on the MSA and other tobacco-related issues.

The AGO has brought numerous enforcement actions and has been responsible since inception for pursuing non-compliant NPMs. The Qualifying Statute requires that an NPM deposit funds into an escrow account for the benefit of the State for all "units sold" in the State during the preceding year. The State estimates that the market share of NPMs in Washington in each year since 2004 has been less than 3% and believes that all NPMs currently certified are in compliance with their NPM escrow obligations under the State's Qualifying Statute.

The AGO also has taken action against PMs who have not complied with their MSA Payment obligations or to remedy violations of other provisions of the MSA. In 2006, Washington joined with other Settling States in reaching a settlement with a PM (House of Prince) for selling cigarettes in the State and other states without making MSA payments and obtained a $55.4 million settlement, including $1,101,864.44 for the State of Washington. Two states have filed suit seeking full payment by General Tobacco (*VIBO Corp. d/b/a General Tobacco*) of its MSA payment obligations. Such actions will benefit all Settling States, including the State, if payments are ordered and made. General Tobacco is no longer certified to sell cigarettes in the State. The AGO also has filed lawsuits and participated actively in various multi-state initiatives against certain OPMs to enforce the advertising and promotion restrictions in the MSA.

Washington Department of Revenue, Liquor Control Board

The DOR controls the sale of cigarettes and tobacco products in Washington through the issuance of wholesale dealer, retail dealer, tobacconist, Commercial Cigarette-Making Machines (RYO Machines) and vending machine operator permits. The Tobacco Tax Unit of the LCB covers the entire State of Washington and proactively enforces all tobacco laws as well as criminal laws. Seventy-two LCB officers are responsible for ensuring the lawful compliance of the approximately 1,425 spirits and alcohol and 6,625 tobacco outlets situated in Washington. The LCB officers inspect cigarette and Other Tobacco Product (OTP) retailers, wholesalers and distributors, and investigate and halt illegal acquisition and shipments of cigarettes and OTP by persons and businesses not licensed to sell them. The LCB strives to maintain a visible presence at retailers through inspections and observations. During inspections, officers present themselves in uniform to complete a checklist of qualifications of the licensed establishment. Observations are done undercover in attempts to observe instances of illegal sales to underage youth.

The mission of the Tobacco Tax Unit of the LCB is to ensure that businesses that sell tobacco in Washington are properly licensed, have paid the appropriate state taxes, and keep tobacco out of the hands of those under 18 years old. The Tobacco Tax Unit also maintains state and federal partnerships, educates wholesalers, distributors and retailers on tobacco laws, and works with Native American tribes.

The DOR is responsible for working with the AGO to enforce the MSA, the Qualifying Statute and the Complementary Legislation. The DOR enforces the State's cigarette and tobacco products excise tax and stamping regulations. Cigarette wholesaler licensees must file with the DOR a monthly report of sales of NPM brands and such sales must bear Washington cigarette tax stamps. Distributors that are licensed to pay the tobacco products tax must file monthly reports for sales of NPM roll-your-own tobacco.

The LCB is responsible for licensing all cigarette wholesalers. The LCB and the DOR both track cigarette shipments in and out of the State and enforce the collection of cigarette taxes, among other

duties. All cigarette sales are subject to the state cigarette excise tax. The DOR keeps track of all shipments of cigarettes in and out of Washington, compares those records to the cigarette sales records of licensed wholesalers and maintains a computer matching program to identify data exceptions that may warrant further investigation.

The State also shares data with the U.S. Treasury's Alcohol and Tobacco Tax and Trade Bureau and with other state revenue departments, and has used the provisions of the Federal Jenkins Act to enforce its laws relating to Internet sales and taxation of cigarettes and other tobacco products.

DOR Actions Seeking Penalties, Seizure and Forfeiture of Contraband Cigarettes

The DOR and the LCB coordinate with the U.S. Bureau of Alcohol Tobacco and Firearms in investigating and seizing unstamped cigarettes and referring the results of its investigations to the AGO for forfeiture proceedings. The LCB may revoke or suspend the license of any distributor that violates these laws, and any cigarettes that have been sold, offered for sale or possessed for sale in the State or imported for personal consumption in the State in violation of the law described in the preceding sentence are deemed "contraband" and subject to seizure and forfeiture.

Nation or Tribal Reservation Cigarette Sales

Under federal case law, Indian nations and tribes are exempt from a state's taxes on cigarettes that they purchase on their own reservation for their own personal consumption. But the State has authority to tax "[o]n reservation cigarette sales to persons other than reservation Indians." *Dep't of Taxation & Finance of N.Y. v. Milhelm Attea & Bros*., 512 U.S. 61, 64 (1994). According to the State, there are two tribal manufacturers of cigarettes located in the State. Other in-state tribes engage in the distribution and sale of cigarettes and other tobacco products. In 2001, the Washington Legislature authorized the Governor to enter into cigarette contracts with tribal governments. (RCW §43.06.450-466.) Under the Cigarette Tax Contracts, the State agrees not to impose its State cigarette tax in exchange for the tribes' agreement to collect a tribal tax equal to the State cigarette tax. These Cigarette Tax Contracts allow the tribes to retain the cigarette taxes, which must be used for essential government services as defined by law.

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation

General Overview

Certain smokers, smokers' rights organizations, consumer groups, cigarette importers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have filed actions against some, and in certain cases all, of the signatories to the MSA alleging, among other things, that the MSA and Settling States' Qualifying Statutes and Complementary Legislation are void or unenforceable under certain provisions of law, such as the U.S. Constitution, state constitutions, federal antitrust laws, state consumer protection laws, bankruptcy laws, federal cigarette advertising and labeling law, and unfair competition laws as described below in this subsection. Certain of the lawsuits have further sought, among other relief, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA. In addition, class action lawsuits have been filed in several federal and state courts alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco related diseases should be paid directly to Medicaid recipients.

Qualifying Statute and Related Legislation

Under the MSA's NPM Adjustment, downward adjustments may be made to the Annual Payments and Strategic Contribution Payments payable by a PM if the PM experiences a loss of Market Share in the United States to NPMs as a result of the PM's participation in the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—*NPM Adjustment*", "—MSA Provisions Relating to Model/Qualifying Statutes" and "—Potential Payment Decreases Under the Terms of the MSA." A Settling State may avoid the effect of this adjustment by adopting and diligently enforcing a Qualifying Statute, as hereinafter described. The State has adopted the Model Statute, which is a Qualifying Statute under the MSA. See "—MSA Provisions Relating to Model/Qualifying Statutes—*Washington Qualifying Statute*" above. The Model Statute, in its original form, required an NPM to make escrow deposits approximately in the amount that the NPM would have had to pay to all of the states had it been a PM and further authorized the NPM to obtain from the applicable Settling State the release of the amount by which the escrow deposit in that state exceeded that state's allocable share of the total payments that the NPM would have made as a PM. Allocable Share Release Amendments have been enacted in the State and all other Settling States except Missouri, amending the Qualifying Statutes in those states by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain under the statute to the excess above the total payment that the NPM would have paid had it been a PM.

In addition, at least 45 Settling States (including the State) have passed legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making escrow payments required by the states' respective Qualifying Statutes, as well as other legislation to assist in the regulation of tobacco sales. Pursuant to the State's Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold in the State, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, is required to certify annually to the Attorney General of the State that it is either a PM or an NPM in full compliance with the State's Qualifying Statute. See "—MSA Provisions Relating to Model/Qualifying Statutes—*Washington Complementary Legislation*" above.

The Qualifying Statutes and related legislation (including those of the State), like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the U.S. Constitution and/or state constitutions and are preempted by federal antitrust laws. The lawsuits have sought, among other relief, injunctions against the enforcement of the Qualifying Statutes and the related legislation. To date, such challenges have not been ultimately successful. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Challenges to the Qualifying Statutes and related legislation are described below under "*Litigation*" in this subsection.

A determination that a Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA itself; such a determination could, however, have an adverse effect on payments to be made under the MSA if one or more NPMs were to gain market share. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—*NPM Adjustment*", "—MSA Provisions Relating to Model/Qualifying Statutes" and "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS."

A determination that an Allocable Share Release Amendment is unenforceable would not constitute a breach of the MSA but could permit NPMs to exploit differences among states, and thereby potentially increase their market share at the expense of the PMs. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—MSA Provisions Relating to Model/Qualifying Statutes."

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

Litigation

All of the judgments rendered to date on the merits have rejected the challenges to the MSA and Settling States' Qualifying Statutes and Complementary Legislation presented in the cases. In *VIBO*, a tobacco manufacturer who became a party to the MSA in 2004 (General Tobacco)* sued the attorneys general of the Settling States, the OPMs, and other SPMs in the U.S. District Court for Western Kentucky in 2008. It alleged that the MSA and the refusal of the PMs to waive the PMs' most-favored nation rights and the Settling States' refusal to settle with the plaintiff on terms that the plaintiff preferred violated the federal antitrust laws and the Equal Protection, Commerce, Due Process, and Compact Clauses of the U.S. Constitution, and that the settling governmental entities fraudulently induced it to enter into the MSA. The plaintiff alleged that MSA participants, such as itself, that were not in existence when the MSA was executed in 1998 but subsequently became participants, were unlawfully required to pay significantly more sums to the states than companies that joined the MSA within 90 days after its execution. In 2009, the district court granted motions to dismiss on all claims. First, the district court held that the PMs' involvement in the creation of the MSA, and their assertion of influence on the Settling States by refusing to give up any most favored nation protections that they held under the MSA (and thus deterring the Settling States from providing the plaintiff the settlement terms that the plaintiff desired) was protected from antitrust liability by the *Noerr-Pennington* ("***NP***") doctrine. The judicially created *NP* doctrine protects from antitrust liability persons or entities who petition or lobby the federal or state government to take actions that may impose restraints on trade. Second, the district court held that the attorneys general's involvement in and enforcement of the MSA, and their refusal to grant the plaintiff certain settlement terms, were sovereign acts of the states and immune from antitrust attack under the state action exemption. Third, the district court ruled that plaintiff had waived all of its federal constitutional challenges based on the Equal Protection, Due Process, and Commerce Clauses when it became a party to the MSA because the MSA provides in Section XV that all parties agree to waive "for the purposes of performance of the [MSA] any and all claims that the provisions of [the MSA] violate the state or federal constitutions." The district court further held that plaintiffs' Compact Clause claim should be dismissed because the MSA does not enhance state power to the detriment of the federal government power. Plaintiff appealed the dismissal of its claims to the U.S. Court of Appeals for the Sixth Circuit. On February 22, 2012, a three judge panel of the U.S. Court of Appeals for the Sixth Circuit ruled that the MSA does not amount to an unlawful conspiracy or anti-competitive behavior by the government and, accordingly, affirmed the district court's order and dismissed plaintiffs' appeal in this case. The time period for the plaintiffs to file a petition for certiorari to the U.S. Supreme Court expired.

In *Grand River*, certain cigarette manufacturers and distributors who were NPMs brought suit in 2002 against 31 states, including the State, and their attorneys generals, alleging, among other things, that the Escrow Statutes contravened the Commerce Clause of the U.S. Constitution, the Sherman Act, and in the case of plaintiff Grand River, the Constitution's Indian Commerce Clause. The district court had dismissed all claims against the states other than New York for lack of personal jurisdiction, and dismissed all claims except the antitrust claim against New York. On interlocutory appeal, the Second Circuit reversed the district court's dismissal against the non-New York defendants, reversed the dismissal of the dormant Commerce Clause claim, and affirmed the dismissal of the plaintiffs' other

* General Tobacco ceased production of cigarettes and other tobacco products in 2010.

constitutional claims. As to the Commerce Clause claim, the Second Circuit held that the plaintiffs "state a possible claim that the practical effect of the challenged statutes and the MSA is to control prices outside of the enacting states by tying both the SPM settlement and NPM escrow payments to national market share, which in turn affects interstate pricing decisions." On remand, the Southern District on March 22, 2011 granted summary judgment to the defendants on all of plaintiffs' Sherman Act and Commerce Clause claims. Plaintiffs appealed to the Second Circuit and petitioned the Southern District to amend its dismissal of plaintiffs' Sherman Act and Commerce Clause claims. On January 30, 2012 the Southern District denied the plaintiffs' motion to amend the Southern District's March 22, 2011 dismissal by summary judgment of plaintiffs' claims that the MSA and related legislation violated the Sherman Act and the Commerce Clause. Plaintiffs then appealed this denial to the Second Circuit. On June 1, 2012 plaintiffs withdrew both appeals before the Second Circuit, which withdrawals were ordered by the Second Circuit on August 10, 2012. The case is now closed before the Second Circuit.

In *Freedom Holdings*, two cigarette importers who were NPMs sought in 2002 to enjoin the enforcement of New York State's Qualifying Statute and Contraband Statute, claiming that the MSA and the legislation violated Section 1 of the Sherman Act, and the Commerce Clause of the U.S. Constitution. The Southern District dismissed the plaintiffs' complaint for failure to state a claim. On appeal, a three judge panel of the Second Circuit reversed the district court's dismissal. The Court held that, accepting the allegations of the complaint as true, the complaint alleged an "express market-sharing agreement among private tobacco manufacturers", and that the MSA, Escrow Statutes, and complementary legislation allowed the originally settling defendants to "set supracompetitive prices that effectively cause other manufacturers either to charge similar prices or to cease selling." The Court additionally held that, at the pleading stage, the defendants had not established that the legislation was protected by the state action exemption articulated under *Parker v. Brown* ("**Parker**") and its progeny, or as protected petitioning of government under the NP doctrine. The Court upheld the dismissal of the plaintiffs' Commerce Clause claim—although reserving the dormant Commerce Clause issue that plaintiffs had not asserted—and permitted the plaintiffs to amend to add allegations in their Fourteenth Amendment Equal Protection claim. The Second Circuit issued a subsequent opinion denying a motion for rehearing. The plaintiffs thereafter amended their complaint and brought a motion for a preliminary injunction against the New York Qualifying Statute and Contraband Statute. The district court granted an injunction against the Allocable Share Release Amendment, but otherwise denied the motion. The plaintiffs appealed and the Second Circuit affirmed the district court's denial of the broader preliminary injunction on the ground that plaintiffs had not established irreparable injury. After remand from the Second Circuit, the district court in *Freedom Holdings* conducted an evidentiary hearing and bench trial, and issued judgment for defendants on all of the plaintiffs' claims. The court held that the MSA and its implementing legislation were not illegal per se and not pre-empted by the Sherman Act, that even if it were necessary to reach the issue of state action exemption, that it shielded the defendants' conduct, and that the MSA and the legislation did not contravene the dormant Commerce Clause. On October 18, 2010, the Second Circuit affirmed the dismissal of the plaintiffs' claims. The U.S. Supreme Court has denied plaintiffs' petition for writ of certiorari.

In *S&M Brands v. Caldwell*, certain NPMs and cigarette distributors brought an action in a federal district court in Louisiana in 2005 seeking, among other relief: (1) a declaration that the MSA and Louisiana's Qualifying Statute and Complementary Legislation are invalid as violations of the U.S. Constitution and the Federal Cigarette Labeling and Advertising Act; and (2) an injunction barring the enforcement of the MSA and Louisiana's Qualifying Statute and Complementary Legislation. Following the state defendant's motion to dismiss the complaint for lack of jurisdiction, the U.S. District Court for the Western District of Louisiana (the "**Western District**") allowed the case to proceed on claims that the MSA and Louisiana's Complementary Legislation are violations of the federal antitrust laws and of the Compact Clause, Commerce Clause, Due Process Clause and First Amendment of the U.S. Constitution, and the Federal Cigarette Labeling and Advertising Act, and dismissed the claims that alleged violation of

the Tenth Amendment of the U.S. Constitution. In September 2009, the Western District granted defendant's motion for summary judgment and dismissed with prejudice all claims by the plaintiffs. In August 2010, the Fifth Circuit affirmed the Western District's order granting summary judgment for the defendants. The Fifth Circuit held that the district court correctly concluded that the MSA did not violate the Compact Clause because the MSA only increases states' power vis-à-vis the PMs and does not result in an accompanying decrease of the power of the federal government. The Fifth Circuit also ruled that the Escrow Statute did not violate the federal antitrust laws for the reasons set forth in its prior decision in *Xcaliber Int'l Ltd. v. Caldwell*, and held that the MSA did not violate federal antitrust laws after adopting the rationales of the Sixth Circuit and other circuits that previously considered the issue. In addition, the Fifth Circuit affirmed the dismissal of plaintiffs' Commerce Clause and Due Process Clause claims because plaintiffs had failed to show that the Louisiana Escrow Statute and the MSA had the effect of increasing cigarette prices outside of Louisiana. With respect to plaintiffs' First Amendment challenge to the MSA and the Escrow Statute, the Fifth Circuit found that the only statute applicable to plaintiffs as NPMs was the Escrow Statute, which the court determined did not compel or abridge plaintiffs' speech. Similarly, the Fifth Circuit found that the MSA and Escrow Statute did not violate the Federal Cigarette Labeling and Advertising Act because plaintiffs are not compelled to join the MSA and the Escrow Statute does not have any connection with cigarette packaging, advertising, or promotion. The U.S. Supreme Court denied plaintiffs' petition for writ of certiorari.

In the Ninth Circuit, in which the State is located, the U.S. Court of Appeals for the Ninth Circuit (the "**Ninth Circuit**"), in *Sanders v. Brown*, affirmed the United States District Court for the Northern District of California's dismissal of an antitrust challenge to the MSA and California's Qualifying Statute and Complementary Legislation brought by a class of California consumers against the State of California and the OPMs, and held that the class failed to show that California's Qualifying Statute and Complementary Legislation are per se illegal under the Sherman Act. The United States Supreme Court denied plaintiff's petition for certiorari in 2008. In *PTI, Inc. v. Philip Morris Inc.*, certain cigarette importers and cigarette distributors sought to enjoin the passage or enforcement of California's Qualifying Statute, alleging that the passage, implementation and/or enforcement of the Qualifying Statute would violate federal antitrust laws and certain provisions of the federal constitution, and the court dismissed with prejudice all federal antitrust and constitutional claims on the merits.

In the other decisions upholding the MSA or accompanying legislation, the decisions were rendered either on motions to dismiss or motions for summary judgment. Courts rendering those decisions include the U.S. Courts of Appeals for the Tenth Circuit in *KT & G Corp. v. Edmondson*, and *Hise v. Philip Morris Inc.*; the Eighth Circuit in *Grand River Enterprises v. Beebe*; the Third Circuit in *Mariana v. Fisher*, and *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*; the Fourth Circuit in *Star Sci., Inc. v. Beales*; the Sixth Circuit in *S&M Brands v. Cooper*, *S&M Brands, Inc. v. Summers* and *Tritent Inter'l Corp. v. Commonwealth of Kentucky*; and multiple lower courts.[*]

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[*] In *King Mountain Tobacco Co., Inc. v. McKenna* (E.D. Wash. 2013), the plaintiff is an NPM that is privately owned by a member of the Yakama Nation, a Native American tribe located in the State. The plaintiff engages in a multistate business in which tobacco is grown and purchased, and cigarettes and roll-your-own tobacco are manufactured and sold, in several states and over the Internet. The plaintiff sued the Attorney General of the State, alleging that the Washington Qualifying Statute violated the plaintiff's trade, travel and exclusive use and benefit rights under an 1855 treaty between the United States and the Yakama Nation, and violated unspecified federal law. In April 2013, the district court denied the plaintiff's motion for summary judgment and granted the defendant's motion for summary judgment, relying on established law that off-reservation activities may be subject to non-discriminatory state regulation and taxation. The court did not read the 1855 treaty expansively and found the Washington Qualifying Statute to be non-discriminatory. The court held that, based on the finding that the plaintiff's products were not principally generated from the use of reservation land and resources, the plaintiff could

(Footnote continued on next page)

In January 2011, an international arbitration tribunal rejected claims brought against the United States challenging MSA-related legislation in various states under NAFTA.

Among several U.S. Courts of Appeals and other lower courts that have rejected challenges to the MSA and related statutes, there have been conflicting interpretations of federal antitrust law immunity doctrines. The existence of a conflict as to the rulings of different federal courts on these and other related issues, especially between Circuit Courts of Appeals, is one factor that the U.S. Supreme Court may take into account when deciding whether to exercise its discretion in agreeing to hear an appeal. Any final decision by the U.S. Supreme Court on the substantive merits of a case challenging the validity or enforceability of the MSA or related legislation would be binding everywhere in the United States, including in the State.

The MSA and related state legislation may be challenged in the future. A determination by a court having jurisdiction over the State and the Authority that the MSA or related State legislation is void or unenforceable could have a materially adverse effect on the payments by the PMs under the MSA and the amount and/or the timing of Pledged TSRs available to the Authority and could ultimately result in the complete cessation of the Pledged TSRs available to the Authority. A determination by any court that the MSA or State legislation enacted pursuant to the MSA is void or unenforceable could also lead to a decrease in the market value and/or liquidity of the Series 2013 Bonds. See "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS" for a further discussion of these matters as well as a description of the opinions of Hawkins Delafield & Wood LLP and Pacifica Law Group LLP, Co-Bond Counsel to the Authority, addressing such matters.

Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments

The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments." Such adjustments, offsets and recalculations could reduce the Pledged TSRs available to the Authority below the respective amounts required to pay the Series 2013 Bonds and could lead to a decrease in the market value and/or the liquidity of the Series 2013 Bonds. See "—2003 NPM Adjustment Claims; Arbitration Results" for a discussion of arbitration proceedings with respect to the 2003 NPM Adjustment and the recent determination of the Arbitration Panel (as defined below) with respect to the State's diligent enforcement of its Qualifying Statute in 2003, and see "—*NPM Adjustment*—NPM Adjustment Settlement and Award" below for a discussion of a settlement entered into by 22 jurisdictions (which do not include the State), the OPMs and certain SPMs regarding disputes with respect to the NPM Adjustment.

Growth of NPM Market Share and Other Factors

Should a decline in consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments and Strategic Contribution Payments by the PMs due to application of the Volume Adjustment, even for Settling States (including the State) that have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and

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prove no set of facts in support of the claim that the Washington Qualifying Statute is in conflict with the 1855 treaty or federal law which would entitle the plaintiff to relief. The case is currently on appeal before the U.S. Court of Appeals for the Ninth Circuit.

are thus exempt from the NPM Adjustment. One SPM has introduced a cigarette with reportedly no nicotine. If consumers used this product to quit smoking, it could reduce the size of the cigarette market. The capital costs required to establish a profitable cigarette manufacturing facility are relatively low, and new cigarette manufacturers, whether SPMs or NPMs, are less likely than OPMs to be subject to frequent litigation.

The Model Statute in its original form had required each NPM to make escrow deposits approximately in the amount that the NPM would have had to pay had it been a PM, but entitled the NPM to a release, from each Settling State in which the NPM had made an escrow deposit, of the amount by which the escrow deposit exceeds that Settling State's allocable share of the total payments that the NPM would have been required to make had it been a PM. The State and all the other Settling States except Missouri have enacted Allocable Share Release Amendments that amend this provision in their Model/Qualifying Statutes by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain to the excess above the total payment that the NPM would have paid had it been a PM. NPMs have unsuccessfully challenged Allocable Share Release Amendments in several states, and it is possible that NPMs will challenge similar legislation in other states. See "—Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation." To the extent that either: (1) other jurisdictions do not enforce Allocable Share Release Amendments (or, in the case of Missouri, which did not enact an Allocable Share Release Amendment, to the extent that such state continues not to enact an Allocable Share Release Amendment); or (2) a jurisdiction's Allocable Share Release Amendment is invalidated, NPMs could concentrate sales in such jurisdiction to take advantage by limiting the amount of its escrow payment obligations to only a fraction of the payment it would have been required to make had it been a PM. Because the price of cigarettes affects consumption, NPM cost advantage is one of the factors that has resulted and could continue to result in increases in market share for the NPMs.

A significant loss of Market Share by PMs to NPMs could have a material adverse effect on the payments by PMs under the MSA and on the amount and/or timing of Pledged TSRs available to the Authority.

NPM Adjustment

The following discussion describes how the NPM Adjustment works under the MSA. See "—2003 NPM Adjustment Claims; Arbitration Results" for a discussion of arbitration proceedings with respect to the 2003 NPM Adjustment and the recent determination by the Arbitration Panel (as defined below) with respect to the State's diligent enforcement of its Qualifying Statute in 2003, and see "—NPM Adjustment Settlement and Award" below for a discussion of a settlement entered into by 22 jurisdictions (which do not include the State), the OPMs and certain of the SPMs, and the calculation and application of the NPM Adjustment under such settlement.

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

question; and (3) the Settling States in question must be found to not have diligently enforced their Qualifying Statutes.*

Application of the NPM Adjustment. The entire NPM Adjustment is ultimately applied to a subsequent year's Annual Payment and Strategic Contribution Payment due to those Settling States: (1) that have been found to have not diligently enforced their Qualifying Statutes throughout the year; or (2) that have enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 Market Share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate Market Share is between 0% and 16 2/3% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs would be decreased by three times the percentage decrease in the PMs' actual aggregate Market Share. If, however, the PMs' Market Share loss is greater than 16 2/3%, then the NPM Adjustment will equal 50% plus an amount determined by formula as set forth in the footnote below.†

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

Regardless of how the NPM Adjustment is calculated, it is always subtracted from the total Annual Payments and Strategic Contribution Payments due from the PMs and then ultimately allocated on a Pro Rata (as defined in the MSA) basis only among those Settling States: (1) that have been proven to have not diligently enforced their Qualifying Statute; or (2) that have enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction.‡ However, the practical effect of a decision by a PM to claim an NPM Adjustment for a given year and pay its portion of the amount of such claimed NPM Adjustment into the Disputed Payments Account, or withhold payment of such amount, would be to reduce the payments to all Settling States on a pro rata basis until a resolution is reached regarding the diligent enforcement dispute for all Settling States for such year, or until a settlement is reached for some or all such disputes for such year. If the PMs make a claim for an NPM Adjustment for any particular year and the State is determined to be one of a few states (or the only state) not to have diligently enforced its Model Statute or Qualifying Statute in such year, the amount of the NPM Adjustment applied to the State in the year following such determination could be as great as the amount of Annual Payments and Strategic Contribution Payments that could otherwise have been received by the State in such year, and could have a material adverse effect on the amount and/or timing of Pledged TSRs available to the Authority.

As previously noted, any Settling State that adopts, maintains and diligently enforces its Qualifying Statute is exempt from the NPM Adjustment. The "diligent enforcement" exemption afforded a Settling State is based on actual enforcement efforts for the calendar year preceding each Annual

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

† If the aggregate market share loss from the Base Aggregate Participating Manufacturer Market Share is greater than 16 2/3%, the NPM Adjustment will be calculated as follows:

NPM Adjustment = 50% +
[50% / (Base Aggregate Participating Manufacturer Market Share – 16 2/3%)]
x [market share loss – 16 2/3%]

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

Payment. A final resolution of "diligent enforcement" for a sales year does not preclude a PM from disputing "diligent enforcement" in a subsequent year. If the other preconditions to an NPM Adjustment exist for a given year, an NPM Adjustment would apply, absent the protection of the Settling State "diligently enforcing" its Qualifying Statute. The State has enacted the Model Statute, which is a Qualifying Statute. No provision of the MSA, however, attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. Furthermore, the MSA does not explicitly state which party bears the burden of proving or disproving whether a Settling State has diligently enforced its Qualifying Statute, or whether any diligent enforcement dispute would be resolved in state courts or through arbitration. However, regarding the 2003 NPM Adjustment dispute, the State's MSA court has determined that the 2003 NPM Adjustment dispute was to be determined by a panel of arbitrators, and such panel of arbitrators has determined that, when contested, a state bears the burden of proving its diligence. As discussed further below, Washington was a contested state in the 2003 NPM Adjustment arbitration and the Arbitration Panel (as defined below) unanimously determined that the State diligently enforced its Qualifying Statute during sales year 2003. The decision that the State diligently enforced its Qualifying Statute during sales year 2003 may not necessarily indicate that the State will be determined in future arbitrations to have diligently enforced its Qualifying Statute in subsequent sales years. Any such further determination that the State failed to diligently enforce its Qualifying Statute in sales years 2004 through 2012 could result in a complete loss or substantial reduction in the amount of future Pledged TSRs up to the amount of the State's Pledged TSRs for sales years 2004 through 2012, plus interest due on all or a portion of such amount, if any. The State's Attorney General's office maintains that the State has been and is diligently enforcing its Qualifying Statute.

The MSA provides that arbitration, if required by the MSA, will be governed by the United States Federal Arbitration Act. The decision of an arbitration panel under the Federal Arbitration Act may only be overturned under limited circumstances, including a showing of a manifest disregard of the law by the panel. Regardless of the forum in which a diligent enforcement dispute is heard, no assurance can be given as to how long it will take to resolve such a dispute with finality.

The Collection Methodology and Assumptions and debt service coverage tables for the Series 2013 Bonds do not include any NPM Adjustments (other than certain 2014-2017 PM credit amounts projected pursuant to the NPM Adjustment Stipulated Partial Settlement and Award, discussed below) or withholdings or Disputed Payments Account deposits relating to PM claims of entitlement to NPM Adjustments, based on the assumptions that the State has and will diligently enforce its Qualifying Statute and that such Qualifying Statute is not held to be unenforceable. If the assumptions are not realized and future NPM Adjustments, withholdings or Disputed Payments are taken against MSA payments to the State, it could have a material adverse effect on the payments by PMs under the MSA, and could have a material adverse effect on the amount and/or timing of Pledged TSRs available to the Authority. See "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

Settlement of 1999 through 2002 NPM Adjustment Claims. In June 2003, the OPMs, certain SPMs and the Settling States settled all NPM Adjustment claims for the payment years 1999 through 2002, subject, however, under limited circumstances, to the reinstatement of a PM's right to an NPM Adjustment for the payment years 2001 and 2002. In connection therewith, such PMs and the Settling States agreed prospectively that PMs claiming an NPM Adjustment for any year will not make such a deposit into the Disputed Payments Account or withhold payment with respect thereto unless and until the selected economic consultants determine that the disadvantages of the MSA were a significant factor contributing to the Market Share loss giving rise to the alleged NPM Adjustment. If the selected economic consultants make such a "significant factor" determination regarding a year for which one or more PMs have claimed an NPM Adjustment, such PMs may, in fact, either make a deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment. As discussed

below under "Ongoing 2004 Through 2012 NPM Adjustment Claims Generally," the Settling States have since agreed that no "significant factor" determination will be necessary for certain years. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments."

2003 Through 2012 NPM Adjustment Claims Generally. Pursuant to the provisions of the MSA, domestic tobacco product manufacturers have participated in proceedings regarding the 2003 NPM Adjustment, results of which were released on September 11, 2013, as discussed below. In addition, PMs have disputed payments attributable to sales years 2004 through 2012, which could lead to offsets against the Pledged TSRs paid in future years. According to NAAG, one or more of the PMs are disputing or have disputed the calculations of some Annual Payments and Strategic Contribution Payments totaling over $8.5 billion for the sales years 2003 through 2012 (payment years 2006 through 2015 for the OPMs and payment years 2004 through 2013 for the SPMs) as part of the NPM Adjustment. A discussion of the arbitration and the decisions of the Arbitration Panel with respect to the 2003 NPM Adjustment appears below under "—2003 NPM Adjustment Claims; Arbitration Results" and a discussion of the status of the settlement of claims regarding the 2003 through 2012 NPM Adjustments (which the State did not join) appears below under "—NPM Adjustment Settlement and Award."

As part of the NPM Adjustment proceedings, an independent economic consulting firm jointly selected by the MSA parties or otherwise selected pursuant to the MSA's provisions is required to determine whether the disadvantages of the MSA were a "significant factor" contributing to the participating manufacturers' collective loss of market share for the year in question. If the firm determines that the disadvantages of the MSA were such a "significant factor," each Settling State may avoid a downward adjustment to its share of the PMs' annual payments for that year by establishing that it diligently enforced its Qualifying Statute during the entirety of that year. Any potential downward adjustment would then be reallocated to any states that do not establish such diligent enforcement. According to the Form 10-Q of Altria (Philip Morris's parent company) filed with the SEC for the six-month period ended June 30, 2013, Philip Morris (the largest PM) believes that the MSA's arbitration clause requires a state to submit its claim to have diligently enforced a qualifying escrow statute to binding arbitration before a panel of three former federal judges in the manner provided for in the MSA. A number of states have taken the position that this claim should be decided in state court on a state-by-state basis. According to Reynolds American, as of June 30, 2013, 47 of the 48 courts that had addressed the question whether the dispute concerning the 2003 NPM Adjustment (discussed below) is arbitrable had ruled that arbitration is required under the MSA.

Once a significant factor determination in favor of the PMs for a particular year has been made by an economic consulting firm, or the states' agreement not to contest that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share in a particular year has become effective, a PM has the right under the MSA to pay the disputed amount of the NPM Adjustment for that year into the MSA's Disputed Payments Account or withhold it altogether.

2003 NPM Adjustment Claims; Arbitration Results. An independent economic consulting firm, jointly selected by the MSA parties, determined that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for 2003. Following the "significant factor" determination with respect to 2003, each of 38 Settling States filed a declaratory judgment action in state court seeking a declaration that such Settling State diligently enforced its Qualifying Statute during 2003. The OPMs and SPMs responded to these actions by filing motions to compel arbitration in accordance with the terms of the MSA, including motions to compel arbitration in 11 states and territories that did not file declaratory judgment actions. Courts in all but one of the 46 MSA states and the District of Columbia and Puerto Rico have ruled that the question of whether a state diligently enforced its Qualifying Statute during 2003 is subject to arbitration. Several of these rulings may be subject to further review, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30,

2013. The Montana state courts have ruled that the diligent enforcement claims regarding that state must be litigated in state court, rather than in arbitration. In June 2012, following the denial of the OPMs' petition to the United States Supreme Court for writ of certiorari, the PMs and Montana entered into a consent decree pursuant to which Montana will not be subject to the 2003 NPM Adjustment.

The OPMs and approximately 25 other PMs entered into an agreement regarding arbitration with 45 states and territories, including the State, concerning the 2003 NPM Adjustment. The agreement effectively provides for a partial liability reduction for the 2003 NPM Adjustment for states that entered into the agreement by January 30, 2009 and are determined in the arbitration not to have diligently enforced a Qualifying Statute during 2003. Based on the number of states that entered into the agreement by January 30, 2009 (45), the partial liability reduction for those states is 20%. This partial liability reduction would be effectuated by the PMs jointly reimbursing such states 20% of their respective amounts of the NPM Adjustment. The selection of a three-judge panel arbitrating the 2003 NPM Adjustment claims (the "**Arbitration Panel**") was completed in July 2010.

Following the completion of discovery, the PMs determined to continue to contest the 2003 diligent enforcement claims of 33 states (including the State), the District of Columbia and Puerto Rico and to no longer contest such claims by 12 other states (which do not include the State) and four U.S. territories (the "**non-contested states**"). Eighteen of these contested states, the District of Columbia and Puerto Rico, as well as two non-contested states, subsequently entered into the NPM Adjustment Settlement Term Sheet with the OPMs and certain of the SPMs as discussed below, leaving 15 states contested in the arbitration proceedings. As a result, Montana and the 14 non-contested states that did not enter into the NPM Adjustment Term Sheet (which do not include the State) are not subject to the 2003 NPM Adjustment, and their share of any such NPM Adjustment, along with the shares of those states found by the Arbitration Panel to have diligently enforced their respective Qualifying Statutes during sales year 2003 (such as the State), will be reallocated in accordance with the MSA to those states found by the Arbitration Panel to have not diligently enforced their respective Qualifying Statutes during 2003.

A common issues hearing was held in April 2012 and state-specific evidentiary hearings began in May 2012 and were completed in May 2013. On September 11, 2013, the Arbitration Panel released its decisions with respect to each of the fifteen contested states that are Term Sheet Non-Signatories (defined below), including the State. The Arbitration Panel determined that nine states (including the State) diligently enforced their respective Qualifying Statutes during 2003, and six states (Indiana, Kentucky, Maryland, Missouri, New Mexico and Pennsylvania, which have an aggregate allocable share of 14.6792685%) did not diligently enforce their respective Qualifying Statutes during 2003. As a result, those nine states, including the State, that were determined to have diligently enforced their respective Qualifying Statutes, as well as 15 other jurisdictions that were either not contested or were not subject to the arbitration proceedings, are not subject to the 2003 NPM Adjustment, and their share of the 2003 NPM Adjustment will be reallocated in accordance with the MSA to the six states found by the Arbitration Panel to have not diligently enforced their respective Qualifying Statutes during 2003.

The Arbitration Panel's decision relating to the State defined diligent enforcement as "an ongoing and intentional consideration of the requirements of a Settling State's Qualifying Statute, and a significant attempt by the Settling State to meet those requirements, taking into account a Settling State's competing laws and policies that may conflict with its MSA contractual obligations." The Arbitration Panel considered various factors in deciding whether or not a state met the diligent enforcement standard, including, in no particular order, (i) such state's collection rate of amounts to be deposited by NPMs into escrow accounts, (ii) the number of lawsuits against manufacturers brought by such state, (iii) how the state gathered reliable data, (iv) resources allocated to enforcement, (v) prevention of non-compliant NPMs from future sales, (vi) legislation enacted by the state, (vii) actions short of legislation taken by the

state, and (viii) efforts made to be aware of NAAG and other states' enforcement efforts. The Arbitration Panel stated that such factors were not necessarily given equal weight, but were considered as a whole. Where certain terms defined in the Model Statute were disputed, the Arbitration Panel relied on the plain meaning of the defined terms and did not penalize states for a rational interpretation of the terms in enforcing their Qualifying Statutes. The Arbitration Panel did not penalize states that provided rational reasons for implementing policies and legislation with respect to enforcement of their Qualifying Statutes, finding that a good faith effort to address an issue where there is no evidence of intentional escrow evasion was an indication of diligent enforcement. The Arbitration Panel also stated that although the Settling States are required under the MSA to diligently enforce their Qualifying Statutes, the Settling States are not required "to elevate those obligations above other statutory or rational policy considerations." A copy of the Arbitration Final Award Re: State of Washington in the 2003 NPM Adjustment Proceedings is attached hereto as APPENDIX C.

On September 24, 2013, the Pennsylvania Attorney General's office filed a motion with the Arbitration Panel to amend the Arbitration Panel's determination that Pennsylvania did not diligently enforce its Qualifying Statute in 2003. The Pennsylvania Attorney General's office has stated that if its efforts to overturn such determination fail, the Attorney General will review all of Pennsylvania's available remedies and could challenge the Arbitration Panel's determination in court or revive its lawsuit challenging in state court the terms of the NPM Adjustment Stipulated Partial Settlement and Award. It is not known if any of the other states that were determined to have not diligently enforced their respective Qualifying Statutes in sales year 2003 will appeal any decision by the Arbitration Panel or take any other legal action, or when the amounts withheld by the PMs or deposited into the Disputed Payments Account pursuant to the 2003 NPM Adjustment will be paid out by the MSA Escrow Agent. The State has reported that the Disputed Payments Account currently contains approximately $412.4 million deposited by certain of the PMs related to the 2003 NPM Adjustment, of which the State's share is approximately $14.9 million. It is also not known the method by which such funds will be disbursed to the states (including the State) determined to have diligently enforced their Qualifying Statutes. The State expects that, in the absence of an injunction preventing the MSA Auditor from directing the disbursement of funds or the MSA Escrow Agent from disbursing the money in the Disputed Payments Account related to the 2003 NPM Adjustment, and in the absence of any delays resulting from challenges of the Arbitration Panel's decisions by states that were determined to have not diligently enforced their Qualifying Statutes in 2003, the State's share of the money in the Disputed Payments Account will be paid no later than April 2014. Such amount will be paid to the State either by (i) reallocating a portion of the 2014 Annual Payments and Strategic Contribution Payments otherwise due to the six non-diligently enforcing states, or (ii) a release of the State's share of the money in the Disputed Payments Account. However, some states may take legal action to prevent the distribution of the disputed payments until all the 2003 NPM Adjustment disputes have been resolved with finality. See "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

Ongoing 2004 Through 2012 NPM Adjustment Claims. An independent economic consulting firm, jointly selected by the MSA parties, determined that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for sales years 2004 and 2005 (as well as 2003, as discussed above). A different independent economic consulting firm, jointly selected by the MSA parties, determined that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for the sales year 2006. Following the firm's determination for 2006, the OPMs and the Settling States agreed that the Settling States would not contest that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for the sales years 2007, 2008 and 2009. Accordingly, the OPMs and the Settling States have agreed that no "significant factor" determination by an independent economic consulting firm will be necessary with respect to the PMs' collective loss of market share for the sales years 2007, 2008 and 2009 (the "**significant factor agreement**"). This agreement became effective for sales years 2007, 2008 and 2009

on February 1, 2010, 2011 and 2012, respectively. The OPMs and the Settling States have agreed to extend the significant factor agreement to apply to the PMs' collective loss of market share for sales years 2010, 2011 and 2012. This agreement became effective for sales year 2010 on February 1, 2013 and will become effective for sales year 2011 on February 1, 2014. If the MSA Auditor determines that the PMs collectively lost market share for sales year 2012, this agreement will become effective for sales year 2012 on February 1, 2015. Proceedings with respect to diligent enforcement claims for the sales years 2004 through 2012 have not yet been scheduled.

Altria, Philip Morris's parent company, has indicated in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that Philip Morris's approximate share of disputed NPM Adjustments for sales years 2003 to 2012 is $2.261 billion (plus an asserted claim for interest on such moneys at the prime rate, but not reflecting the partial liability reduction for the 2003 NPM Adjustment pursuant to the agreement regarding arbitration or the NPM Adjustment Settlement Term Sheet described below). Philip Morris further reports that it has made its full MSA payment due in each year from 2006 to 2010 to the Settling States (subject to a right to recoup the NPM Adjustment amount in the form of a credit against future MSA payments), even though it had the right to deduct the disputed amounts of the 2003 - 2007 NPM Adjustments, as described above, from such MSA payments. Philip Morris paid its share of the amount of the disputed 2008, 2009 and 2010 NPM Adjustments into the Disputed Payments Account in connection with its MSA payments due in 2011, 2012 and 2013, respectively.

Philip Morris has further indicated that it will deposit the allocable share of the 2011-2012 NPM Adjustments for the Term Sheet Signatories (as defined below) into the Disputed Payments Account in connection with its April 2014–2015 MSA payments and then, following such deposit, authorize the release of such share to the Term Sheet Signatories.

Reynolds American, Reynolds Tobacco's parent company, has reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that Reynolds Tobacco has disputed a total of approximately $4.7 billion for the payment years 2003 through 2012 in connection with the NPM Adjustment. Reynolds Tobacco reports that it placed its share of the 2004 NPM Adjustment and 2005 NPM Adjustment (net of certain slight adjustments to reflect revised MSA Auditor calculations) into the Disputed Payments Account in connection with its MSA payments due in 2007 and 2008, respectively. In April 2009, Reynolds Tobacco retained approximately $406.5 million of its 2009 MSA payment to reflect its share of the 2006 NPM Adjustment as calculated by the MSA Auditor. Based on revised calculations by the MSA Auditor, in April 2010, Reynolds Tobacco withheld an additional amount, bringing the total amount withheld with respect to the 2006 NPM Adjustment to approximately $420 million. Again based on revised calculations by the MSA Auditor, in April 2011, Reynolds Tobacco paid approximately $1 million extra to account for a downward adjustment in its share of the 2006 NPM Adjustment. In connection with its MSA payments due in April 2010, 2011 and 2012, Reynolds Tobacco placed its share of the 2007 NPM Adjustment, 2008 NPM Adjustment and 2009 NPM Adjustment, respectively, into the Disputed Payments Account (with the last two of such payments being reduced to adjust for a downward revision by the MSA Auditor to Reynolds Tobacco's share of the 2007 NPM Adjustment and 2008 NPM Adjustment). In connection with its MSA payment due in April 2013, Reynolds Tobacco placed its share of the 2010 NPM Adjustment (net of certain small adjustments to reflect revised MSA Auditor calculations of Reynolds Tobacco's share of the 2008 and 2009 NPM Adjustments) into the Disputed Payments Account. Reynolds Tobacco's 2013 payment into the Disputed Payments Account was reduced by approximately $1.2 million to adjust for a downward revision by the MSA Auditor to its share of the 2008 NPM Adjustment, and by approximately $319,000 to adjust for a downward revision to its share of the 2009 NPM Adjustment. In addition, Reynolds Tobacco placed approximately $419 million into the Disputed Payments Account in April 2013 to reflect its share of the 2006 NPM Adjustment that it previously retained.

In addition to the NPM Adjustment claims described above, Reynolds Tobacco has reported that it has filed dispute notices with respect to its 2011 and 2012 Annual Payments relating to the NPM Adjustments potentially applicable to those years. The amount at issue for those two years is approximately $841 million.

The approximate maximum principal amounts of the PMs' aggregate share of the disputed NPM Adjustment for the sales years 2003 through 2012 (payment years 2004 through 2013), as reported by NAAG, and without regard to the effects of the NPM Adjustment Term Sheet, are as follows:

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OPM and SPM Maximum Potential NPM Adjustment Amounts

Sales Years 2003-2012 (Payment Years 2004-2013) [1]

Sale Year for which NPM Adjustment was calculated	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
MSA Payment Year for which NPM Adjustment was calculated	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
MSA Payment Year by which deduction for NPM Adjustment may be asserted by OPMs [2]	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Potential OPM NPM Adjustment*	$1,061,158,548	$1,061,288,734	$702,715,077	$646,394,781	$702,104,158[3]	$821,644,318[3]	$779,388,450[3]	$779,818,190[3]	$663,895,464[3]	$715,833,950[3]
Potential SPM NPM Adjustment*	86,407,516	76,107,191	50,630,561	53,949,637	47,254,505[3]	66,765,407[3]	68,573,096[3]	63,143,527[3]	50,767,997[3]	53,091,832[3]
Total*	**$1,147,566,065**	**$1,137,395,925**	**$753,345,638**	**$700,344,418**	**$749,358,662**	**$888,409,725**	**$847,961,547**	**$842,961,718**	**$714,663,460**	**$768,925,782**

[1] Payments are subject to adjustments from disputes for up to four years following the payment due date under the MSA under the Offset for Miscalculated or Disputed Payment provisions.
[2] For SPMs the times vary and may be as short as one year after the sales year.
[3] Includes MSA Annual Payment and Strategic Contribution Payment.
* Rounded.

The foregoing amounts may be recalculated by the MSA Auditor if it receives information that is different from or in addition to the information on which it based these calculations, including, among other things, if it receives revised sales volumes from any PM. Disputes among the manufacturers could also reduce the foregoing amounts.

Philip Morris has reported its expectation of receiving, outside of the ambit of the NPM Adjustment Settlement Term Sheet discussed below, its share of any adjustments for 2003 - 2007 in the form of a credit against future MSA payments and its share of any adjustment for 2008 - 2010 in the form of a withdrawal from the Disputed Payments Account. Any adjustments made in the form of a credit against future MSA payments could lead to material reductions in the Pledged TSRs. However, Altria, Philip Morris's parent company, noted in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that there is no certainty that the PMs would ultimately receive any adjustment from the Term Sheet Non-Signatories (as defined below) as a result of the NPM Adjustment proceedings described herein.

NPM Adjustment Settlement and Award. On December 17, 2012, terms of a settlement agreement (the "**NPM Adjustment Settlement Term Sheet**") were agreed to by 19 jurisdictions (excluding the State), the OPMs and certain SPMs regarding claims related to the 2003 through 2012 NPM Adjustments and the determination of future NPM Adjustments. The 19 jurisdictions (which do not include the State) that signed the NPM Adjustment Settlement Term Sheet on December 17, 2012 are Alabama, Arizona, Arkansas, California, the District of Columbia, Georgia, Kansas, Louisiana, Michigan, Nebraska, Nevada, New Hampshire, New Jersey, North Carolina, Puerto Rico, Tennessee, Virginia, West Virginia and Wyoming. On April 12, 2013, Oklahoma joined the NPM Adjustment Settlement Term Sheet and on May 24, 2013, Connecticut and South Carolina joined the NPM Adjustment Settlement Term Sheet, bringing the total number of jurisdictions that have joined the settlement to 22, representing approximately 46% Allocable Share. Such jurisdictions that joined the NPM Adjustment Settlement Term Sheet are collectively referred to herein as the "**Term Sheet Signatories**," which term, where appropriate, includes any additional jurisdictions that subsequently sign the NPM Adjustment Settlement Term Sheet. Additional jurisdictions were permitted to join the settlement up to the end date of the last individual state-specific diligent enforcement hearings (the last diligent enforcement hearing for the jurisdictions that did not sign on to the NPM Adjustment Settlement Term Sheet occurred in May 2013), although they have different and potentially less favorable payment obligations as detailed in the NPM Adjustment Settlement Term Sheet. After such time, additional jurisdictions may join the settlement only if the signatory PMs, in their sole discretion, agree.

The NPM Adjustment Settlement Term Sheet was subject to approval by the Arbitration Panel. On March 12, 2013, the Arbitration Panel issued its Stipulated Partial Settlement and Award (the "**NPM Adjustment Stipulated Partial Settlement and Award**"). As described herein, the NPM Adjustment Stipulated Partial Settlement and Award was implemented by the MSA Auditor as it relates to the April 2013 MSA payment, in particular, effecting certain reductions to the April 2013 MSA payment due by the PMs and releasing certain funds from the Disputed Payments Account to the Term Sheet Signatories at the time (the original 19 jurisdictions plus Oklahoma), as specified below. The MSA Auditor issued revised payment calculations reflecting the financial impact of Oklahoma's decision to join the settlement. The MSA Auditor has stated that, by implementing such reductions to the PM payments and releases from the Disputed Payments Account to the Term Sheet Signatories with respect to the MSA payments due in April 2013, it was not committing to implement any provision of the NPM Adjustment Settlement Term Sheet other than those provisions relating to such distributions and credits with respect to the MSA payments due in April 2013.

In the NPM Adjustment Stipulated Partial Settlement and Award, the Arbitration Panel, as a threshold matter, ruled that it has jurisdiction (i) to enter the NPM Adjustment Stipulated Partial

Settlement and Award, (ii) to rule on the objections of those jurisdictions that did not join the settlement, including the State (the "**Term Sheet Non-Signatories**"), (iii) to determine how the 2003 NPM Adjustment Settlement will be allocated among the Term Sheet Non-Signatories in light of the settlement and (iv) to incorporate and direct the MSA Auditor to implement the provisions of the NPM Adjustment Settlement Term Sheet, including as they pertain to years beyond 2003. The Arbitration Panel noted that it was neither "approving" the NPM Adjustment Settlement Term Sheet nor assessing the merits of any NPM Adjustment dispute, but rendering the NPM Adjustment Settlement Term Sheet binding on the Term Sheet Signatories and directing the MSA Auditor to implement the settlement provisions contained therein.

In the NPM Adjustment Stipulated Partial Settlement and Award, the Arbitration Panel specifically directed the MSA Auditor (i) to release approximately $1.76 billion (plus accumulated earnings thereon) from the Disputed Payments Account to the Term Sheet Signatories, allocating such released amount among the Term Sheet Signatories as they direct in connection with the April 15, 2013 MSA payment and (ii) to apply a credit in the aggregate amount of approximately $1.65 billion to the OPMs' MSA payments, allocating such credit among the OPMs as they direct with 50% of the credit applied against the April 15, 2013 MSA payment and 12.5% to be applied against each of the April 15, 2014 through 2017 MSA payments. Under the NPM Adjustment Settlement Term Sheet, parallel provisions exist for SPMs, which stipulated a credit of approximately $31 million to the SPMs' April 2013 MSA payments.

In addition, while not ruling on years subsequent to the 2003 NPM Adjustment, the Arbitration Panel ruled that the reduction of the 2003 NPM Adjustment, in light of the NPM Adjustment Stipulated Partial Settlement and Award (for purposes of allocating the 2003 NPM Adjustment to the Term Sheet Non-Signatories), will be on a *pro rata* basis: the dollar amount of the 2003 NPM Adjustment will be reduced by a percentage equal to the aggregate allocable share of the Term Sheet Signatories. In addition, the Arbitration Panel directed the MSA Auditor to treat the Term Sheet Signatories as not being subject to the 2003 NPM Adjustment, resulting in a reallocation of the Term Sheet Signatories' share of the 2003 NPM Adjustment among those Term Sheet Non-Signatories that are found not to have diligently enforced their Qualifying Statutes during 2003. This framework creates an incentive for Term Sheet Non-Signatories to contest the diligent enforcement of Term Sheet Signatories for years 2004 onward. The Arbitration Panel concluded that the NPM Adjustment Settlement Term Sheet and the NPM Adjustment Stipulated Partial Settlement and Award do not legally prejudice or adversely affect the Term Sheet Non-Signatories, but that, should a Term Sheet Non-Signatory found by the Arbitration Panel to be non-diligent have a good faith belief that the *pro rata* reduction method did not adequately compensate it for a Term Sheet Signatory's removal from the reallocation pool, its relief, if any, is by appeal to its individual MSA state court. The Arbitration Panel further concluded that neither the NPM Adjustment Stipulated Partial Settlement and Award nor the NPM Adjustment Settlement Term Sheet constitutes an amendment to the MSA that would require the consent of any Term Sheet Non-Signatory.

Pursuant to the NPM Adjustment Settlement Term Sheet, including as implemented in April 2013 following the NPM Adjustment Stipulated Partial Settlement and Award, the OPMs and certain SPMs have received certain reductions in 2013 and will receive reductions to future MSA payments to reflect a percentage of the Term Sheet Signatories' aggregate share of the OPMs' and certain SPMs' aggregate 2003 through 2012 NPM Adjustment claims. The amount of such percentages is dependent on the number of jurisdictions that eventually join the final settlement. According to a Form 10-Q filed with the SEC by Altria (the parent company of Philip Morris) for the six-month period ended June 30, 2013, the OPMs have agreed that, subject to certain conditions, Philip Morris will receive approximately 28% of the reductions, Reynolds Tobacco will receive approximately 60% of the reductions, and Lorillard will receive approximately 12% of the reductions. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, Philip Morris reported that, based on the Term Sheet Signatories as of April

15, 2013, Philip Morris received all of its reduction under the NPM Adjustment Settlement Term Sheet through a credit of approximately $483 million against its MSA payment made in April 2013. Philip Morris also reports that it expects to receive an additional credit of $36 million to be applied to its MSA payment obligation in April 2014 as a result of the two additional states joining the NPM Adjustment Settlement Term Sheet after the date of the 2013 MSA payment. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, Reynolds Tobacco reported that, based on the jurisdictions bound by the NPM Adjustment Settlement Term Sheet, Reynolds Tobacco will receive approximately $1.1 billion as credits with respect to their NPM Adjustment claims for the period from 2003 through 2012, to be applied against annual payments under the MSA over a five-year period, commencing with the MSA payment due in April 2013. In its Form 10-Q for the six-month period ended June 30, 2013, Lorillard reported that it expects to receive credits over five years of at least $220 million on its outstanding claims, with $164 million having occurred in April 2013 and the remainder occurring over the following four years.

In addition, as part of the NPM Adjustment Settlement Term Sheet, in April 2013, the 20 Term Sheet Signatories that had signed the Term Sheet by that time received their aggregate Allocable Share of over $4.7 billion from the Disputed Payments Account under the MSA in April 2013.

The NPM Adjustment Settlement Term Sheet provides that the Term Sheet Signatories will allocate the settlement amount for the 2003 NPM Adjustment among themselves (through the application of the credits to PMs or the receipt by the Term Sheet Signatories of amounts released from the Disputed Payments Account, or both) so as to fully compensate those Term Sheet Signatories whose diligent enforcement for 2003 was non-contested.

The NPM Adjustment Settlement Term Sheet also sets forth the terms by which NPM Adjustments for 2013 onward will be determined. For the two-year transition period of sales years 2013¬2014, the revised adjustment for SET-Paid NPM Sales, as described in the next succeeding paragraph, will apply (with certain exceptions). The revised adjustment for Non-SET-Paid NPM Sales, described in the second next succeeding paragraph, will not apply during this transition period. In addition, for each of those years, signatory PM payments will be adjusted based on a comparison of the Market Share Losses (as defined in the MSA) in 2013 or 2014 to the 2011 Market Share Loss. If the Market Share Loss is below the 2011 level, the adjustment is 25%, using the original NPM Adjustment formula. For Market Share Loss above the 2011 level, the adjustment is indexed upwards based on the number of cigarettes above the 2011 Market Share Loss starting at 30% and increasing to 50%.

Beginning in 2013, there will be a state-specific adjustment that applies to sales of SET-paid NPM cigarettes ("**SET-Paid NPM Sales**"). "**SET**" consists of state cigarette excise tax or other state tax on the distribution or sale of cigarettes (other than a state or local sales tax that is applicable to consumer products generally and is not in lieu of an excise tax) and, after 2014, any excise or other tax imposed by a state or federally recognized tribe on the distribution or sale of cigarettes. For SET-Paid NPM Sales of "**non-compliant NPM cigarettes**" (defined in the NPM Adjustment Settlement Term Sheet, with certain exceptions, as any cigarette sale for which escrow is not deposited, either by payment by the NPM or by collection upon a bond), the adjustment of PM payments due from signatory PMs will be three times the per-cigarette escrow deposit rate contained in the Model Statute for the year of the sale, including the inflation adjustment in the statute. There will be a proportional adjustment for each signatory SPM in proportion to the size of its MSA payment for that year. A Term Sheet Signatory will not be subject to this revised adjustment if (i) escrow was deposited on 96% of all NPM cigarettes sold in the Term Sheet Signatory jurisdiction during that year on which SET was paid, or (ii) the number of SET-paid NPM cigarettes sold in the Term Sheet Signatory jurisdiction during that year on which escrow was not deposited did not exceed 2 million cigarettes.

A data clearinghouse that will be established (the "**Data Clearinghouse**") will calculate the total FET-paid NPM volume in the Settling States and nationwide. "**FET**" means the federal excise tax. Beginning in 2015, for non-SET-Paid NPM Sales ("**Non-SET-Paid NPM Sales**"), the total NPM Adjustment liability, if any, of each Term Sheet Signatory for a year would be reduced by a percentage equal to the percentage represented by the fraction of the total SET-paid NPM volume in the Settling States divided by nationwide FET-paid NPM volume for that year.

In addition, the NPM Adjustment Settlement Term Sheet provides that, except in certain cases (primarily, if the dispute was noticed for arbitration by the PM over one year prior to the payment date and the arbitration has not begun despite good faith efforts by the PM), the PMs will not withhold payments or pay into the Disputed Payments Account based on a dispute arising out of the revised NPM Adjustment as set forth in the NPM Adjustment Settlement Term Sheet.

On September 11, 2013, as described above, the Arbitration Panel released its decisions with respect to fifteen of the Term Sheet Non-Signatories (including the State) regarding the 2003 NPM Adjustment. The arbitration process will continue with respect to sales years 2004 through 2012. As previously noted, the NPM Adjustment Stipulated Partial Settlement and Award created incentives for Term Sheet Non-Signatories to contest the diligent enforcement of Term Sheet Signatories for sales years 2004 onward. The OPMs have previously reported that they continue to reserve all rights regarding the NPM Adjustment with respect to the Term Sheet Non-Signatories and pursue the disputed NPM Adjustments against the Term Sheet Non-Signatories. Altria has stated in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that, except with respect to the Term Sheet Signatories, and except with respect to the non-contested states in regard to the 2003 NPM Adjustment (which did not include the State), Philip Morris intends to pursue vigorously the disputed NPM Adjustments for sales years 2004 – 2012 against the Term Sheet Non-Signatories (including the State) through the arbitration proceedings described herein. As noted above, proceedings with respect to diligent enforcement claims for the sales years 2004 through 2012 have not yet been scheduled.

Disputes Concerning the NPM Adjustment Settlement Term Sheet and Stipulated Partial Settlement and Award

Several states (including the State) have disputed the NPM Adjustment Settlement Term Sheet and Stipulated Partial Settlement and Award. On March 13, 2013, the Office of the Attorney General of the State of Illinois sent a letter, on behalf of itself and 23 other Term Sheet Non-Signatories, including the State (to which letter several additional Term Sheet Non-Signatories later joined), to the MSA Auditor, affirming their position that the Arbitration Panel lacked jurisdiction and that the NPM Adjustment Stipulated Partial Settlement and Award was inconsistent with the terms of the MSA, and informing the MSA Auditor that they object to and will contest any action by the MSA Auditor to release funds from the Disputed Payments Account or to reallocate the 2003 NPM Adjustment under the terms of the NPM Adjustment Stipulated Partial Settlement and Award.

Motions are pending in eight Term Sheet Non-Signatory states including Colorado (*State v. R.J. Reynolds Tobacco Co.,* Case No 1997CV3432), Connecticut (*State v. Philip Morris Inc.*, UWY-CV-96-0148414-S), Maryland (*State v. Philip Morris Inc.*, Case No. 24C96122017), Massachusetts (*Commonwealth of Massachusetts v. Philip Morris*, No. 95-7378), New York (*State v. Philip Morris*, 400361/1997), Ohio (*State v. R.J. Reynolds Tobacco Co.*, Case No. 97CVH-05-5114), Pennsylvania (*Commonwealth of Pennsylvania v. Philip Morris, Inc.*, No. 2443), and South Carolina (*State v. Brown & Williamson Tobacco Corp.*, 97CP4001686) to vacate and/or modify the NPM Adjustment Stipulated Partial Settlement and Award. Connecticut and South Carolina subsequently became Term Sheet Signatories in May 2013. In addition, two states, Colorado (*State v. R.J. Reynolds Tobacco Co.*, Case No 1997CV3432) and Ohio (*State v. R.J. Reynolds Tobacco Co.*, Case No. 97CVH-05-5114) filed for

preliminary injunctions. These motions for preliminary injunctions against the implementation of the NPM Adjustment Stipulated Partial Settlement and Award in connection with the April 2013 MSA payment were denied, and the MSA Auditor carried out such implementation over the objections of the Term Sheet Non-Signatories. The outcomes of the pending claims filed by the Term Sheet Non-Signatories cannot be predicted. No assurance can be given that other challenges to the NPM Adjustment Stipulated Partial Settlement and Award will not be commenced in other MSA courts.

No assurance can be given as to the impact or the magnitude of the effect of the NPM Adjustment Stipulated Partial Settlement and Award on Term Sheet Non-Signatories such as the State, as to whether or not the NPM Adjustment Stipulated Partial Settlement and Award will be revised or reversed and any consequences thereto, or as to any final settlement or resolution of disputes concerning the NPM Adjustment Stipulated Partial Settlement and Award and the effect of such factors on the amount and/or timing of Pledged TSRs available to the Authority to pay debt service on the Series 2013 Bonds.

Disputed or Recalculated Payments and Other Disputes under the Terms of the MSA

Disputes concerning Annual Payments and Strategic Contribution Payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments may result in the application of an offset against subsequent Annual Payments or Strategic Contribution Payments. The diversion of disputed payments to the Disputed Payments Account, the withholding of all or a portion of any disputed amounts or the application of offsets against future payments could also have a material adverse effect on the amount and/or timing of Pledged TSRs available to the Authority. Furthermore, miscalculations or recalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA, such as those described above under "—*NPM Adjustment*", have resulted and could in the future result in offsets to, or delays in disbursements of, payments to the Settling States pending resolution of the disputed item in accordance with the provisions of the MSA. Amounts held in the Disputed Payments Account could be released to those Settling States which, in the future, are found to have diligently enforced their Qualifying Statutes, or pursuant to a settlement of the disputes among the Settling States and the PMs. The models used in the Collection Methodology and Assumptions and debt service coverage tables for the Series 2013 Bonds do not factor in an offset for miscalculated or disputed payments or any release of funds currently held in the Disputed Payments Account other than pursuant to the NPM Adjustment Stipulated Partial Settlement and Award. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—Offset for Miscalculated or Disputed Payments," "—Potential Payment Decreases Under the Terms of the MSA—*NPM Adjustment*—Application of the NPM Adjustment" and "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

California, Kentucky and Iowa have had disputes and have filed suit against Bekenton USA, Inc. ("**Bekenton**"), to among other things, compel Bekenton to comply with its full payment obligations under the MSA. In June 2005, the State of California filed an application in San Diego County Superior Court seeking an enforcement order against Bekenton. Bekenton was allowed by the court to file a suit that argued, among other things, that the State of California breached the "most favored nation" ("**MFN**") provisions of the MSA by allowing three other SPMs to join the MSA under more favorable terms, and that it was entitled to similar relief under another clause of the MSA (the "**Relief Clause**"), which requires that if any PM is relieved of a payment obligation, such relief becomes applicable to all of the PMs. In a November 2005 tentative ruling (which subsequently became a final order on March 15, 2006), the court denied Bekenton's MFN claim and its motion to file suit under the Relief Clause. In 2005, Bekenton also filed for bankruptcy relief. In the Kentucky case, Bekenton failed to make its full MSA payment of approximately \$7.7 million in April 2005, and, instead, paid only \$198,000, less than 3% of the total payment due. The Commonwealth of Kentucky commenced an action against Bekenton in which Bekenton claimed that under the Relief Clause it was entitled to reduce its payment. In April 2006,

the court dismissed Bekenton's claim for a reduction, holding that the Relief Clause was not applicable since the agreement with another PM did not relieve the PM of any payment obligations. In the Iowa case, the State of Iowa sought to de-list Bekenton as a PM for failing to comply with the MSA payment provisions and to prohibit Bekenton from doing business in Iowa for failing to comply with the escrow payment provisions of the Iowa Qualifying Statute. In August 2005, an Iowa state court enjoined Iowa from "de-listing" Bekenton, permitting Bekenton to continue selling cigarettes in Iowa. The court found that the MSA itself provides procedures for the resolution of disputes regarding MSA payments and that such procedures should be followed in this case.

For a discussion of litigation presenting challenges to the MSA and Settling States' Qualifying Statutes and Complementary Legislation, see "—Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" above.

Other Disputes Related to MSA Payments

Certain PMs were in dispute regarding (i) whether a "roll-your-own" tobacco conversion of 0.0325 ounces for one individual cigarette should be used for purposes of calculating the downward Volume Adjustments to the MSA payments (as is currently the case), or, rather, a 0.09 ounce conversion; and (ii) whether the total domestic cigarette market and certain other calculations related to the PMs' MSA payments should be determined based on the "net" number of cigarettes on which federal excise tax is paid (as is currently the case), or, rather, the "adjusted gross" number of cigarettes.

In the "roll-your-own" dispute, the PMs contended that the 0.09 ounce conversion should be used, whereas the Settling States contended that the 0.0325 ounce conversion is required under the MSA. Altria, Philip Morris's parent company, had reported in its SEC filings that it believes that, for the years 2004-2012, the use of the 0.0325 ounce conversion method resulted in excess MSA payments by Philip Morris in those years of approximately $92 million in the aggregate. In the "net vs. gross" dispute, PMs contended that the MSA requires calculations based on a gross approach, while the Settling States contend that a net approach is required by the MSA.

Forty-three jurisdictions (including the State) entered into arbitration involving these two disputes. In an award dated January 21, 2013, the Arbitration Panel held that (i) the MSA Auditor is to use the market share for Liggett Group LLC (an SPM) on a net basis, but increase that calculation by a specified factor to avoid unfairness given the gross basis used for Liggett Group LLC in the MSA Auditor's March 30, 2000 calculation, and (ii) the MSA Auditor is to use the 0.0325 ounce conversion method for purposes of roll-your-own tobacco. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that it is unclear precisely which past and future MSA payments may be affected by this ruling.

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 will 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.

CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY

The following description of the domestic tobacco industry has been compiled from certain publicly available documents of the tobacco companies and their current or former parent companies, certain publicly available analyses of the tobacco industry and other public sources. Certain of those companies file annual, quarterly and certain other reports with the SEC. Such reports are available on the SEC's website (www.sec.gov) and upon request from the SEC's Investor Information Service, 100 F Street, NE, Washington, D.C. 20549 (phone: (800) SEC-0330 or (202) 551-5450; fax: (202) 343-1028; 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 the participants therein, 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 2013 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2013 Bonds is consistent with their investment objectives.

It is anticipated that certain of the tobacco companies will release their third quarter results in the near future. Such results may differ materially from the information provided herein. When released, those reports will also be available on the SEC's website (www.sec.gov) and upon request from the SEC's Investor Information Service, 100 F Street, NE, Washington, D.C. 20549 (phone: (800) SEC-0330 or (202) 551-5450; fax: (202) 343-1028; e-mail: publicinfo@sec.gov).

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 quantities of cigarettes shipped and cigarettes consumed within the 50 states of the United States, the District of Columbia and Puerto Rico may not match at any given point in time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

Retail market share information, based upon shipments or sales as reported by the OPMs for purposes of their filings with the SEC, may be different from Relative Market Share for purposes of the MSA and the respective obligations of the PMs to contribute to Annual Payments and Strategic Contribution Payments. The Relative Market Share information reported is confidential under the MSA, except to the extent reported by NAAG. See "SUMMARY OF THE MASTER SETTLEMENT

AGREEMENT—Overview of Payments by the Participating Manufacturers; MSA Escrow Agent", "—Annual Payments" and "—Strategic Contribution Payments." Additionally, aggregate market share information, based upon shipments as reported by Lorillard, Inc. (the parent company of Lorillard), Reynolds American Inc. (the parent company of Reynolds Tobacco) and the Altria Group, Inc. (the parent company of Philip Morris) and reflected in the chart below entitled "Manufacturers' Domestic market share of Cigarettes" is different from that utilized in the bond structuring assumptions. See "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

Industry Overview

As reported by NAAG, based upon OPM shipments reported to MSAI, the OPMs accounted for approximately 84.81% of the U.S. domestic cigarette market in sales year 2012 measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate and approximately 84.52% measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate. However, according to publicly available documents of the OPMs, at June 30, 2013, the OPMs collectively accounted for approximately 91.5% of the domestic cigarette retail industry (with Philip Morris and Reynolds Tobacco measuring by sales, and Lorillard measuring by shipments). The market for cigarettes in the U.S. divides generally into premium and discount sales. As reported by Lorillard, at June 30, 2013, the discount segment of the domestic tobacco industry represented approximately 26.5% of domestic tobacco sales.

Philip Morris USA Inc. ("**Philip Morris**"), a wholly-owned subsidiary of Altria Group, Inc. ("**Altria**"), is the largest tobacco company in the U.S. Prior to a name change on January 27, 2003, Altria was named Philip Morris Companies Inc. In its Form 10-K filed with the SEC for the calendar year 2012, Altria reported that Philip Morris's domestic cigarette market share for calendar year 2012 was 49.8% (based on retail sales) which represents an increase of 0.8 share points from its reported domestic market share (based on retail sales) of 49.0% for calendar year 2011. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, Altria reported that Philip Morris's domestic cigarette market share in the six months ended June 30, 2013 was 50.6%, which represents an increase of 0.4 share points from its reported domestic market share of 50.2% in the six months ended June 30, 2012. Philip Morris's major premium brands are Marlboro, Virginia Slims and Parliament (with Marlboro representing approximately 86% of Philip Morris's domestic cigarette shipment volume during the six months ended June 30, 2013, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2013). Marlboro is the largest selling cigarette brand in the U.S., with approximately 43.6% of the U.S. domestic retail share at June 30, 2013, up from 43.5% at June 30, 2012, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, and has been the world's largest-selling cigarette brand since 1972. Philip Morris's principal discount brands are Basic and L&M. In 2009, Altria acquired UST LLC, whose subsidiary, U.S. Smokeless Tobacco LLC ("**UST**"), is the largest producer of smokeless tobacco in the U.S. Effective in the first quarter of 2013, Philip Morris's market share results for cigarettes are based on a new tracking service, IRI/Management Science Associate Inc., which measures retail share in stores representing trade classes selling a significant majority of the volume of the product being measured. For other trade classes selling cigarettes, retail share is based on shipments from wholesalers to retailers reported through the Store Tracking Analytical Reporting System. According to Altria, retail market share results reported using the new services cannot be meaningfully compared to retail market shares previously reported by Altria's tobacco companies under the previous services. Altria has restated its retail share results for 2012 to reflect these new services. In its Form 10-Q filed with the SEC for the three-month period ended March 31, 2013, Altria reported that Philip Morris's restated domestic cigarette market share for calendar year 2012 was 50.3%.

Reynolds American Inc. ("**Reynolds American**") is the second largest tobacco company in the U.S. Reynolds American became the parent company of R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") on July 30, 2004, following a transaction that combined Reynolds Tobacco and the U.S.

operations of Brown & Williamson Tobacco Corporation ("**B&W**"), previously the third largest tobacco company in the U.S., under the Reynolds Tobacco name. In connection with this merger, Reynolds American assumed all pre-merger liabilities, costs and expenses of B&W, including those related to the MSA and related agreements and with respect to pre-merger litigation of B&W. Reynolds American is also the parent company of American Snuff Co., owner of smokeless tobacco brands, and Santa Fe Natural Tobacco Company, Inc., both of which are SPMs.

In its Form 10-K filed with the SEC for the calendar year 2012, Reynolds American reported that Reynolds Tobacco's domestic retail cigarette market share at December 31, 2012 was 26.5% (measured by sales volume), which represents an approximately 4% decrease from the 27.6% market share at December 31, 2011. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, Reynolds American reported that Reynolds Tobacco's domestic retail market share in the three months ended June 30, 2013 was 26.0%, which represents a decrease from its reported domestic retail market share of 26.3% in the three months ended June 30, 2012. Reynolds Tobacco's major premium brands are Camel, Kool, Winston and Salem. Its discount brands include Doral and Pall Mall. Reynolds Tobacco's market share information is based on data from the IRI/Capstone Total Retail Panel ("**IRI/Capstone**"), which was designed to measure market share in retail stores selling cigarettes, but was not designed to capture Internet, direct mail and some illicitly tax-advantaged outlets.

Lorillard, Inc., formerly a wholly-owned subsidiary of Loews Corporation prior to June 2008, is the parent company of Lorillard Tobacco Company ("**Lorillard**"), the third largest tobacco company in the U.S. In its Form 10-K filed with the SEC for the calendar year 2012, Lorillard, Inc. reported that its domestic retail cigarette market share in 2012 was 14.4% (measured by wholesale shipment volume), which represents an increase of 0.3 share points from calendar year 2011. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, Lorillard, Inc. reported that its domestic cigarette market share for the six months ended June 30, 2013 was 14.9% (measured by wholesale shipment volume), an increase of 0.5 share points from its reported domestic market share of 14.4% for the six months ended June 30, 2012. Lorillard's principal brands are Newport, Kent, True, Maverick and Old Gold. Its largest selling brand is Newport, which accounted for approximately 88.3% of Lorillard's cigarette segment net sales for the six months ended June 30, 2013, an increase from 88.0% of Lorillard's cigarette segment net sales for the six months ended June 30, 2012. On November 1, 2010, Lorillard began shipping its new non-menthol varieties of Newport, called Newport Non-Menthol Box and Newport Non-Menthol Box 100s. Market share data reported by Lorillard is based on Lorillard's proprietary retail shipment data "EXCEL," which reflects shipments from wholesalers to retailers.

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market for the six-month period ended June 30, 2013 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, LLC ("**Liggett**") (the operating successor to the Liggett & Myers Tobacco Company) and Vector Tobacco Inc. ("**Vector Tobacco**"), each wholly-owned subsidiaries of Vector Group Ltd. ("**Vector Group Ltd.**"), and Commonwealth Brands, Inc. ("**CBI**"), a wholly-owned subsidiary of Imperial Tobacco Group PLC ("**Imperial Tobacco**"), which markets deep discount brands. Liggett, Vector Tobacco and CBI are SPMs under the MSA.

Imperial Tobacco is listed on the London Stock Exchange and does not file quarterly or annual reports with the SEC. However, Imperial Tobacco reported in its half year results for the six months ended March 31, 2013 that it held a 3.3% market share of the U.S. cigarette market, a decrease from its 3.5% market share of the U.S. cigarette market in the six months ended March 31, 2012. CBI's brands include USA Gold, Sonoma and Fortuna.

In its Form 10-K filed with the SEC for the year ended December 31, 2012, Vector Group Ltd. reported that Liggett's domestic market share in calendar year 2012 was 3.5%, measured by shipment

volume (which percentage Vector Group Ltd. also reported in its Form 10-Q filed with the SEC for the six months ended June 30, 2013 as that represented by Liggett's and Vector Tobacco's combined domestic market share). Such market share represents a decrease from the 2011 domestic market share of 3.8%. Vector Group Ltd. reports in its SEC filings that Liggett is required to make payments under the MSA only to the extent of the incremental market share above a base market share of approximately 1.65% of the U.S. cigarette market, and that Vector Tobacco is required to make payments under the MSA only to the extent of the incremental market share above a base market share of approximately 0.28% of the U.S. cigarette market. All of Liggett's unit sales volume for the calendar year 2012 (and all years since 2004) and for the first six months of 2013 were in the discount segment. Its brands include Liggett Select, Grand Prix, Eve, Pyramid, Eagle 20's (relaunched as a deep discount brand in January 2013) and USA. Vector Tobacco is focused on developing reduced risk cigarette products. Vector Tobacco announced that it has introduced three varieties of a low nicotine cigarette in eight states, one of which is reported to be virtually nicotine free, under the brand name QUEST. However, Vector Tobacco has postponed the national launch of QUEST indefinitely. In February 2008, Liggett announced that it would begin selling "snus", a smokeless tobacco product, under its Grand Prix brand, but its presence in this market appears to be limited, as there is no mention of it in Vector Group Ltd.'s recent SEC filings.

Industry Market Share

The following table sets forth the approximate comparative positions of the leading producers of cigarettes in the U.S. tobacco industry, each of which is an OPM under the MSA. Individual and total domestic OPM market shares presented below are derived from the publicly available documents of the OPMs and, as a result of varying methodologies used by the OPMs to calculate market share, may not be comparable and may be inaccurate when combined as presented.

Manufacturers' Domestic Market Share of Cigarettes*

	Calendar Year			
Manufacturer	2009	2010	2011	2012
Philip Morris	49.9%	49.8%	49.0%	49.8%
Reynolds Tobacco	28.3	28.1	27.6	26.5
Lorillard**	11.8	12.9	14.1	14.4
Other***	10.0	9.2	9.3	9.3

*Aggregate market share as reported above is different from that utilized in the Collection Methodology and Assumptions.

** Lorillard utilizes MSAI market share data in its SEC reports. MSAI divides the cigarette market into two price segments, the premium price segment and the discount or reduced price segment. MSAI's information relating to unit sales volume and market share of certain of the smaller, primarily deep discount, cigarette manufacturers is based on estimates derived by MSAI. Lorillard management has indicated that it believes that volume and market share information for the deep discount manufacturers may be understated (and, correspondingly, volume and market share information for the larger manufacturers may be overstated).

*** The market share, other than the OPMs, has been determined by subtracting the total market share percentages of the OPMs as reported in their publicly available documents from 100%. Results may not be accurate and may not total 100% due to rounding and the differing sources and methodologies utilized to calculate market share.

Cigarette Shipment Trends

The following table sets forth the industry's approximate cigarette shipments in the U.S. for the six years ended December 31, 2012. The MSA payments are calculated in part on shipments by the OPMs in or to the U.S. rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)*	Percent Change From Prior Year
2012	286.5	(2.3)%
2011	293.1	(3.5)
2010	303.7	(3.8)
2009	315.7	(8.6)
2008	345.3	(3.3)
2007	357.2	(5.0)

* As reported in SEC filings of Lorillard and Reynolds Tobacco, based on MSAI data.

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

According to data from NAAG, overall shipments dropped approximately 2.0% to 290.102 billion cigarettes in sales year 2012 from 295.956 billion cigarettes in sales year 2011 measuring roll-your-own tobacco sales at 0.0325 ounces per cigarette conversion rate (or approximately 1.9% to 288.670 billion cigarettes in sales year 2012 from 294.281 billion cigarettes in sales year 2011 measuring roll-your-own tobacco sales at 0.09 ounces per cigarette conversion rate). According to NAAG data, domestic U.S. cigarette consumption over the past 10 sales years was approximately as follows:

Sales Year	No. of Cigarettes (in billions) (with 0.0325 oz. RYO conversion)	% Change From Prior Year (with 0.0325 oz. RYO conversion)	No. of Cigarettes (in billions) (with 0.09 oz. RYO conversion)	% Change From Prior Year (with 0.09 oz. RYO conversion)
2012	290.102	(1.98)%	288.670	(1.91)%
2011	295.956	(2.67)	294.281	(2.55)
2010	304.079	(6.45)	301.989	(5.92)
2009	325.043	(9.14)	320.997	(8.47)
2008	357.738	(3.79)	350.711	(4.14)
2007	371.833	(4.96)	365.875	(5.14)
2006	391.256	0.26	385.711	0.25
2005	390.250	(3.51)	384.766	(3.86)
2004	404.439	0.09	400.224	0.07
2003	404.071	(3.30)	399.934	(3.44)

According to data from the Department of Treasury, Alcohol and Tobacco Tax and Trade Bureau (the "**TTB**"), the overall quantity of cigarettes shipped domestically (not including a conversion for roll-your-own tobacco) dropped approximately 1.91% to 287.187 billion cigarettes in 2012 from 292.769 billion cigarettes in 2011. According to the TTB, the quantity of cigarettes shipped domestically for the past 10 calendar years was approximately as follows:

Calendar Year	No. of Cigarettes (in billions)	Percent Change From Prior Year
2012	287.187	(1.91)%
2011	292.769	(2.57)
2010	300.489	(5.52)
2009	318.029	(8.20)
2008	346.419	(4.22)
2007	361.665	(5.01)
2006	380.726	(0.10)
2005	381.107	(4.31)
2004	398.285	(0.37)
2003	399.768	(3.92)

According to data from MSAI, the overall quantity of cigarettes shipped domestically (not including a conversion for roll-your-own tobacco) dropped approximately 6.1% to 134.2 billion cigarettes in the six months ended June 30, 2013 from 143.0 billion cigarettes in the six months ended June 30, 2012.

Physical Plant, Distribution, Competition and Raw Materials

The production facilities of the OPMs tend to be highly concentrated. For instance, all of the cigarette production of Lorillard comes from a single facility in North Carolina. The other OPMs also have limited production facilities and have announced plans to continue to consolidate their production facilities. Material damage to these facilities could materially impact overall cigarette production. A prolonged interruption in the manufacturing operations of the cigarette manufacturers could have a material adverse effect on the ability of the cigarette manufacturers to effectively operate their respective businesses.

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 domestic market for cigarettes is highly competitive. Competition is primarily based on a brand's price, including the level of discounting and other promotional activities, positioning, consumer loyalty, retail display, quality and taste. Promotional activities include, in certain instances, allowances, the distribution of incentive items, price reductions and other discounts. Considerable marketing support, merchandising display and competitive pricing are generally necessary to maintain or improve a brand's market position. Increased selling prices and taxes on cigarettes have resulted in additional price sensitivity of cigarettes at the consumer level and in a proliferation of discounts and of brands in the discount segment of the market. Generally, sales of cigarettes in the discount segment are not as profitable as those in the premium segment.

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

Smokeless Tobacco Products

Smokeless tobacco products have been available for centuries. Chewing tobacco and snuff are the most significant components of this market segment. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and potentially spit-free. As cigarette consumption expanded in the last century, the use of smokeless products declined. Recently, however, the industry has expanded its smokeless tobacco products in response to the general decline in cigarette consumption, the proliferation of smoking bans and the perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. Snuff, for example, is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco (and a subsidiary of Altria, Philip Morris's parent company), which manufactures Copenhagen and Skoal smokeless products, among others, is explicitly targeting adult smoker conversion in its growth strategy. In 2006, the three largest U.S. cigarette manufacturers entered the market of smokeless tobacco products. Philip Morris introduced a snuff product, Taboka. Reynolds American acquired Conwood Company, L.P., the nation's second largest smokeless-tobacco manufacturer, and introduced Camel Snus, a snuff product. Lorillard entered into an agreement with Swedish Match North America to develop smokeless products in the United States, which has since been discontinued. In addition, Lorillard announced in 2010 that it intends to enter certain test markets with a traditional moist snuff product to assess opportunities to broaden its product offerings, but it makes no mention of such in its recent SEC filings. Product development has continued, however, with the introduction by Philip Morris of Marlboro snus (a smokeless, spitless tobacco product that originated in Sweden) and snuff products. In October 2007, Altria announced that it would accelerate the development of snuff and less-harmful cigarettes to counter a decline in smoking. In January 2012, Altria announced that it entered into an agreement with Okono, an affiliate of Fertin Pharma, a Danish maker of nicotine chewing gum, to develop non-combustible tobacco products. In May 2012, Altria announced that its subsidiary Nu Mark LLC introduced Verve nicotine discs, a mint-flavored, chewable, disposable tobacco product that contains tobacco-derived nicotine, and on June 11, 2013, Altria announced that it intends to expand distribution of its Verve discs from 60 stores to about 1,200 stores throughout Virginia in the second half of the year. Liggett, in 2008, announced it would introduce Grand Prix snus, which has yet to be marketed based on a review of Vector Group Ltd.'s recent SEC filings.

Advocates of the use of snuff as part of a tobacco harm reduction strategy point to Sweden, where use of "snus", a moist snuff manufactured by Swedish Match, has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men. The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. A May 2008 study using data from the 2000 National Health Interview Survey reports that U.S. men who used smokeless tobacco as a smoking cessation method achieved significantly higher quit rates than those who used other cessation aids. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

In 2008, Fuisz Technologies formed a new firm, Fuisz Tobacco, to commercialize a film-based smokeless tobacco product. No developments have been reported on this product. The thin film strip would be spitless and would dissolve entirely in the cheek. Reynolds American has developed and is marketing Camel Sticks, a twisted, dissolvable stick made of tobacco, Camel Orbs, dissolvable tobacco tablets, and Camel Strips, dissolvable tobacco strips, each of which may be produced as flavored items.

As a result of these efforts, smokeless tobacco products have been increasing market share of tobacco products overall at the expense of the market share captured by cigarettes. According to Reynolds Tobacco's parent company, Reynolds American, as reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, U.S. moist snuff retail volumes grew approximately 5% in the first six months of 2013, and in its Form 10-K filed with the SEC for the calendar year 2012, Reynolds American reported that U.S. moist snuff retail volumes grew approximately 5% in 2012 and 5% in 2011. Reynolds American reports that moist snuff's growth is partially attributable to cigarette smokers switching from cigarettes to smokeless tobacco products or using both. According to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, smokeless tobacco products accounted for approximately 7.38% of Altria's tobacco product net revenues for the six months ended June 30, 2013, compared with approximately 6.83% for the six months ended June 30, 2012.

E-Cigarettes

Numerous manufacturers have developed and are marketing "electronic cigarettes" (or "**e-cigarettes**"), which, while not tobacco products, are battery powered devices that vaporize liquid nicotine, which is then inhaled by the consumer. There are currently over 250 e-cigarette brands on the market. Because electronic cigarettes are not tobacco products, they are not subject to the advertising restrictions to which tobacco products are subject. Furthermore, electronic cigarettes are generally not subject to federal, state or local excise taxes; however, according to Lorillard, Inc. in its Form 10-K filed with the SEC for the calendar year 2012, one state has imposed an excise tax on electronic cigarettes and certain other jurisdictions are considering imposing excise taxes and other restrictions on electronic cigarettes. For example, a bill passed by the Oklahoma Senate in March 2013 would ban sales of electronic cigarettes to people under age 18 and would impose a five cent tax on electronic cigarettes (while limiting the maximum tax on electronic cigarettes to 10% of the tax levied on a pack of cigarettes). The Oklahoma House of Representatives has not yet voted on the bill. In addition, three U.S. states have banned the use of e-cigarettes in enclosed spaces.

Lorillard's parent company has reported in its SEC filings that on April 24, 2012, it acquired, through its subsidiaries, blu eCigs and other assets used in the manufacture, distribution, development, research, marketing, advertising and sale of electronic cigarettes. The acquisition provides Lorillard, Inc. with the blu eCigs brand and an e-cigarette product line. Lorillard, Inc. reported in its Form 10-K filed with the SEC for the calendar year 2012 that it sells the blu eCigs electronic cigarettes to distributors as well as directly to consumers over the internet. It has been reported that Lorillard has boosted distribution of its blue Cigs to more than 80,000 stores since acquiring the brand in 2012. Reynolds American reported in October 2012 that it introduced an electronic cigarette, VUSE, in limited distribution. Reynolds American launched a revamped version of its e-cigarette, VUSE, in Colorado retail outlets in July 2013, with a plan to quickly expand sales nationwide, including print and television ads for VUSE starting in August 2013. Reynolds American has stated that it is targeting existing smokers with VUSE and expects some smokers to give up cigarettes in favor of VUSE. Altria's subsidiary Nu Mark LLC introduced an electronic cigarette under the "MarkTen" brand with distribution in Indiana starting in August 2013. MarkTen is a disposable e-cigarette that can be reused with a separate battery recharging kit and additional cartridges in both tobacco and menthol flavors. Altria stated that the MarkTen's "Four Draw" technology is designed to give users a "more consistent experience" that closely resembles the draw of a traditional cigarette. The NJOY, Vapor, Logic and blu eCigs electronic cigarette brands have recently been marketing and advertising extensively across the U.S. Lorillard reported in its Form 10-K filed with the SEC for the calendar year 2012 that the predominant forms of advertising and promotion in the electronic cigarette industry are television, print and web-based advertising, and sampling events. During 2012, the FDA indicated that it intends to regulate electronic cigarettes under the FSPTCA. It has been reported that the FDA may announce its plan for regulation in October 2013; see "—Regulatory Issues" below. According to news reports, sales of e-cigarettes in 2012 have been estimated to be $300

million, which was double the amount during the prior two years, and are projected to reach as much as $2 billion in 2013. The CDC in February 2013 reported results of a survey that indicated that 6.2% of the adult population, and 12% of smokers, had tried e-cigarettes at some time, which results were approximately double the estimates in 2010. A report released by the CDC and the FDA in September 2013 showed a doubling, to 10%, of the number of high school students who have tried e-cigarettes. In addition, it has been reported that increases in cigarette taxes have caused an increase in the sale of e-cigarettes. Certain reports have predicted that sales of e-cigarettes could outpace traditional cigarettes before 2050. No assurance can be given that regulation of e-cigarettes by the FDA will stop their growth trend. Growth in the electronic cigarette market may have an adverse effect on the tobacco-cigarette market.

Smoking Cessation Products

A variety of smoking cessation products and services have developed to assist individuals to quit smoking. While some studies have shown that smokers who use a smoking cessation product to help them quit smoking are more likely to relapse, other studies have shown that these products and programs are effective, and that excise taxes and smoking restrictions and related tobacco regulation drive additional expenditures to the smoking cessation market. The smoking cessation industry is broadly divided into two segments, counseling services (e.g., individual, group, or telephone), and pharmacological treatments (both prescription and over-the-counter). Several large pharmaceutical companies, including GlaxoSmithKline, Johnson & Johnson, Novartis and Pfizer are significant participants in the smoking cessation market. The FDA has approved a variety of smoking cessation products and these products include prescription medicine, such as Nicotrol, Chantix, and Zyban, as well as over-the-counter products such as skin patches, lozenges and chewing gum. Electronic cigarettes and snus are viewed by some as alternatives to smoking that may lead to cigarette smoking cessation. Alternative therapies, such as psychotherapy and hypnosis, are also in use and available to individuals. The smoking cessation industry is a competitive market and new products, including sublingual wafers and bottled water containing nicotine, have been introduced in the last few years.

Private health insurance carriers are increasing premiums on smokers, which often are passed on by the employer to the smoker-employee. Certain of these and other health insurance policies, including Medicaid and Medicare, cover various forms of smoking cessation treatments, making smoking cessation treatments more affordable for covered smokers. Results of a study by the CDC, released in November 2011, found that in 2010 68.8% of smokers wanted to stop smoking, 52.4% had made a quit attempt in the past year, 6.2% had recently quit, 48.3% had been advised by a health professional to quit, and 31.7% had used counseling and/or medications when they tried to quit.

Gray Market

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

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives

The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products (including New York City, New York State and New Jersey proposals to raise the minimum age from 18 to 21), ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, and restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet. Several states charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. The Affordable Care Act will allow insurance companies to charge smokers up to 50% higher remiums than non-smokers, and several large corporations are now charging smokers higher premiums. Most recently, in January 2013, a state congressman from Oregon proposed legislation that would make cigarettes a Schedule III controlled substance in Oregon and therefore illegal to possess or distribute without a doctor's prescription.

Federal Regulation

In 1964, the Report of the Advisory Committee to the Surgeon General of the U.S. Public Health Service concluded that cigarette smoking was a health hazard of sufficient importance to warrant appropriate remedial action. Since this initial report in 1964, the Secretary of Health, Education and Welfare (now the Secretary of Health and Human Services) and the Surgeon General have issued a number of other reports that find the nicotine in cigarettes addictive and that link cigarette smoking and exposure to cigarette smoke with certain health hazards, including various types of cancer, coronary heart disease and chronic obstructive lung disease. These reports have recommended various governmental measures to reduce the incidence of smoking. Most recently, in March 2012, the Surgeon General released a report on preventing tobacco use among youth and young adults.

During the past four decades, various laws affecting the cigarette industry have been enacted. Since 1966, federal law has required a warning statement on cigarette packaging. Since 1971, television and radio advertising of cigarettes has been prohibited in the U.S. Cigarette advertising in other media in the U.S. is required to include information with respect to the "tar" and nicotine yield of cigarettes, as well as a warning statement. In 1984, Congress enacted the Comprehensive Smoking Education Act. Among other things, the Smoking Education Act established an interagency committee on smoking and health that is charged with carrying out a program to inform the public of any dangers to human health presented by cigarette smoking; required a series of four health warnings to be printed on cigarette packages and advertising on a rotating basis; increased type size and area of the warning required in cigarette advertisements; and required that cigarette manufacturers provide annually, on a confidential basis, a list of ingredients added to tobacco in the manufacture of cigarettes to the Secretary of Health and Human Services.

In 1992, the federal Alcohol, Drug Abuse and Mental Health Act was signed into law. This act required states to adopt a minimum age of 18 for purchases of tobacco products and to establish a system to monitor, report and reduce the illegal sale of tobacco products to minors in order to continue receiving federal funding for mental health and drug abuse programs. Federal law prohibits smoking in scheduled passenger aircraft, and the U.S. Interstate Commerce Commission has banned smoking on buses

transporting passengers interstate. Certain common carriers have imposed additional restrictions on passenger smoking. On March 31, 2010, President Obama signed into law the PACT Act. This legislation, among other things, restricts the sale of tobacco products directly to consumers or unlicensed recipients, including over the Internet, through expanded reporting requirements, requirements for delivery and sales, and penalties. On November 4, 2011 a bill, the Smoke-Free Federal Buildings Act, was introduced in the U.S. House of Representatives to ban smoking in and 25 feet around all facilities owned or leased by the federal government, but was never enacted. A similar bill may be introduced in the future.

FSPTCA

The FSPTCA grants the FDA authority to regulate tobacco products. Among other provisions, the FSPTCA:

- establishes a Tobacco Products Scientific Advisory Committee ("**TPSAC**") to, among other things, evaluate the issues surrounding the use of menthol as a flavoring or ingredient in cigarettes within one year of such committee's establishment;
- grants the FDA the regulatory authority to consider and impose broad additional restrictions through a rule making process, including a ban on the use of menthol in cigarettes upon a finding that such a prohibition would be appropriate for the public health;
- requires larger and more severe health warnings on cigarette packs and cartons;
- bans the use of descriptors on tobacco products, such as "low tar" and "light";
- requires the disclosure of ingredients and additives to consumers;
- requires pre-market approval by the FDA for claims made with respect to reduced risk or reduced exposure products;
- allows the FDA to require the reduction of nicotine or any other compound in cigarettes;
- allows the FDA to mandate the use of reduced risk technologies in conventional cigarettes;
- permits inconsistent state regulation of the advertising or promotion of cigarettes and eliminates the existing federal preemption of such regulation; and
- allows the FDA to subject tobacco products that are modified or first introduced into the market after March 22, 2011 to application and premarket review and authorization requirements (the "**new product application process**") if the FDA does not find them to be "substantially equivalent" to products commercially marketed as of February 15, 2007, and to deny any such new product application thus preventing the distribution and sale of any product affected by such denial.

Since the passage of the FSPTCA, the FDA has taken the following actions:

- established the collection of user fees from the tobacco industry;

- created and staffed the TPSAC;
- selected the Director of the Center for Tobacco Products;
- announced and began enforcing a ban on fruit, candy or clove flavored cigarettes (menthol is currently exempted from this ban);
- issued guidance on registration and product listing;
- issued final rules restricting access and marketing of cigarettes and smokeless tobacco products to youth;
- issued a prohibition on misleading marketing terms ("Light," "Low," and "Mild") for tobacco products;
- required warning labels for smokeless tobacco products; and
- authorized the sale and marketing of new tobacco products and rejected applications to introduce certain new tobacco products into the market.

Pursuant to requirements of the FSPTCA, the FDA issued a proposed rule in November 2010 to modify the required warnings that appear on cigarette packages and in cigarette advertisements. The new required warnings consist of nine new textual warning statements accompanied by color pictures depicting the negative health consequences of smoking. The warnings would appear on the upper portion of the front and rear panels of each cigarette package and comprise at least the top 50 percent of these panels, and would also appear in each cigarette advertisement and occupy at least 20 percent of the advertisement. The FDA took public comments on the proposed rule through January 2011, and in June 2011, the FDA unveiled nine new graphic health warnings that were required to appear on cigarette packages and advertisements no later than September 2012. As discussed below under "*FSPTCA Litigation*," five tobacco companies in August 2011 filed a complaint against the FDA in the U.S. District Court for the District of Columbia challenging the FDA's rule requiring new textual and graphic warning labels on cigarette packaging and advertisements. The FDA is currently enjoined from enforcing the rule.

In July 2010, the TPSAC conducted hearings on the impact of dissolvable tobacco products and the use of menthol in cigarettes on public health. A report on these hearings was submitted to the FDA in 2011 and remains subject to continuing TPSAC hearings. Written comments regarding dissolvable tobacco products were submitted to the TPSAC ahead of its January 2012 meeting, at which the TPSAC continued its discussions of issues related to the nature and impact of dissolvable tobacco products on public health. The TPSAC's final report released to the FDA in March 2012 found that dissolvable tobacco products would reduce health risks compared to smoking cigarettes, but also have the potential to increase the number of tobacco users. The TPSAC could not reach any overall judgment as to whether or not the consequence of dissolvable tobacco products would be an increase or decrease in the number of people who successfully quit smoking. The FDA will consider the report and recommendations and determine what future action, if any, is warranted with respect to dissolvable tobacco products. There is no timeline or statutory requirement for the FDA to act on the TPSAC's recommendations.

The TPSAC or the Menthol Report Subcommittee held meetings throughout 2010 and 2011 to consider the issues surrounding the use of menthol in cigarettes. At its March 18, 2011 meeting, TPSAC presented its report and recommendations on menthol. The report's findings included that menthol likely increases experimentation and regular smoking, menthol likely increases the likelihood and degree of addiction for youth smokers, non-white menthol smokers (particularly African-Americans) are less likely

to quit smoking and are less responsive to certain cessation medications, and consumers continue to believe that smoking menthol cigarettes is less harmful than smoking nonmenthol cigarettes as a result of the cigarette industry's historical marketing. TPSAC's overall recommendation to the FDA was that "removal of menthol cigarettes from the marketplace would benefit public health in the United States." The FDA submitted a draft report on its independent review of research related to the effects of menthol in cigarettes on public health, if any, to an external peer review panel in July 2011. The FDA stated that, after peer review, the results and the preliminary scientific assessment will be available for public comment in the Federal Register. At the July 21, 2011 meeting, TPSAC considered revisions to its report, and the voting members unanimously approved the final report for submission to the FDA with no change in its recommendation. On January 26, 2012, the FDA provided a second progress report on its review of the science related to menthol cigarettes. In its January 2012 update, the FDA stated that the "FDA submitted its report to external scientists for peer review, and the agency is revising its report based on their feedback." The FDA stated its intent to make the final report, along with the peer review scientists' feedback and the FDA's response to the feedback, available for public comment in the Federal Register. The FDA also indicated that it would consider any public comments to the final report, which "may provide additional evidence or emerging data." Based on those comments, together with the TPSAC report, the industry's perspective report and prior public comments, the FDA stated that it will consider the collective evidence and "possible actions related to the public health impact of menthol in cigarettes." On July 23, 2013, the FDA released its Independent Preliminary Scientific Evaluation of the Public Health Effects of Menthol Versus Non-menthol Cigarettes (the "**Preliminary Evaluation**") and peer comments for 60 days of public comment (such public comment period was subsequently extended for an additional 60 days to November 22, 2013), and issued an Advance Notice of Proposed Rulemaking seeking additional information to help the FDA make informed decisions about menthol in cigarettes. The Preliminary Evaluation found that although there is little evidence to suggest menthol cigarettes are more toxic than regular cigarettes, the mint flavor of menthol masks the harshness of tobacco, which makes it easier to become addicted and harder to quit, and increases smoking initiation among youth. The FDA concluded that menthol cigarettes likely pose a public health risk above that seen with non-menthol cigarettes. During the public comment period, the FDA will consider all comments, data and research submitted to determine what regulatory action, if any, with respect to menthol cigarettes is appropriate, including the establishment of product standards. In the meantime it will conduct and support research on the differences between menthol and non-menthol cigarettes as they relate to menthol's likely impact on smoking cessation. The FDA is not required to follow the TPSAC's recommendations, and the FDA has not yet taken any action with respect to menthol use. Any ban or material limitation on the use of menthol in cigarettes could materially adversely affect the results of operations, cash flow and financial condition of the PMs, especially Lorillard, which is heavily dependent on sales of its *Newport* brand mentholated cigarettes. According to Lorillard, mentholated cigarettes are reported to have comprised 31.4% and 31.0% of the U.S. cigarette market for the six-month periods ended June 30, 2013 and 2012, respectively. Menthol smoking rates have also increased among young adults during the past decade.

In January 2011, the FDA issued guidance concerning reports that manufacturers must submit for certain FDA-regulated tobacco products that the manufacturer modified or introduced for the first time into the market after February 15, 2007. These reports must be reviewed by the FDA to determine if such tobacco products are "substantially equivalent" to products commercially available as of February 15, 2007. In general, in order to continue marketing these products sold before March 22, 2011, manufacturers of FDA-regulated tobacco products were required to send to the FDA a report demonstrating substantial equivalence by March 22, 2011. If the FDA ultimately makes such a determination, it could require the removal of such products or subject them to the new product application process and, if any such applications are denied, prevent the continued distribution and sale of such products. Manufacturers intending to introduce new products and certain modified products into the market after March 22, 2011 must submit a report to the FDA and obtain a "substantial equivalence order" from the FDA before introducing the products into the market. If the FDA declines to issue a so-

called “substantial equivalence order” for a product or if the manufacturer itself determines that the product does not meet the substantial equivalence requirements, the product would need to undergo the new product application process.

The FDA announced on June 25, 2013 that it authorized the sale of two new Newport cigarettes made by Lorillard and rejected four other new tobacco products. Since the FSPTCA’s enactment, the FDA has received approximately 4,000 applications for products that tobacco companies claimed were “substantially equivalent” to ones already on the market. The FDA approved the applications for two types of non-menthol cigarettes after determining that the cigarettes, while slightly different than previous products, would not pose new health issues. The four other applications were rejected based on new health concerns raised by some ingredients and a lack of detail about product design. It was the first instance of a federal agency rejecting an application by a tobacco manufacturer to bring a new tobacco product to the market based on the product’s threat to public health. Four additional tobacco products were rejected by the FDA on August 28, 2013 because they were found to be “not substantially equivalent” to the predicate products to which they were compared, and in September 2013 four roll-your-own products were approved for marketing and sale by the FDA because the products were determined to be “substantially equivalent” to the predicate products to which they were compared. Approximately 500 products submitted for review after March 2011 cannot be sold until the FDA approves them.

On March 30, 2012 the FDA issued draft guidance on: (i) the reporting of harmful and potentially harmful constituents in tobacco products and tobacco smoke pursuant to the FSPTCA, and (ii) preparing and submitting applications for modified risk tobacco products pursuant to the FSPTCA.

According to Lorillard, during 2012, the FDA indicated that it intends to regulate electronic cigarettes under the FSPTCA through the issuance of deeming regulations that would include electronic cigarettes under the definition of a “tobacco product” under the FSPTCA subject to the FDA’s jurisdiction. Lorillard reports that the FDA has not yet taken such action. In a letter to the Commissioner of the FDA dated September 24, 2013, the attorneys general of 41 states requested that the FDA “take all available measures” to issue proposed regulations that will address the advertising, ingredients, and sale to minors of electronic cigarettes by the FDA’s previously stated deadline of October 31, 2013. The letter asked the FDA to regulate electronic cigarettes like other tobacco products, and to move quickly to ensure that all tobacco products are tested and regulated to ensure that tobacco companies do not continue to sell or advertise to young people. In addition, fifteen public health organizations sent a letter to President Obama, dated September 19, 2013, asking for his leadership in ensuring that the FDA moves forward promptly with rules that would assert the FDA’s authority over all tobacco products, including e-cigarettes.

On a going-forward basis, various provisions under the FSPTCA and regulations to be issued thereunder will become effective and will:

- require manufacturers to test ingredients and constituents identified by the FDA and disclose this information to the public;
- prohibit use of tobacco containing a pesticide chemical residue at a level greater than allowed under Federal law;
- establish “good manufacturing practices” to be followed at tobacco manufacturing facilities;
- authorize the FDA to place more severe restrictions on the advertising, marketing and sale of tobacco products;

- permit inconsistent state regulation of labeling and advertising and eliminate the existing federal preemption of such regulation;
- authorize the FDA to require the reduction of nicotine (though not to zero) and the reduction or elimination of other constituents; and
- grant the FDA the regulatory authority to impose broad additional restrictions.

The FDA reported in November 2011 that it issued approximately 1,200 warning letters to retailers in 15 states for violating Federal tobacco regulations since the FDA's Center for Tobacco Products began conducting retail inspections under the FSPTCA. Most of the letters were issued for selling tobacco products to minors. The FDA also reported that it had contracted with 37 states and the District of Columbia to conduct compliance checks in at least 20% of the stores in each state to ensure that the retailers are acting in compliance with the FDA's regulations concerning the sale of tobacco products.

FSPTCA Litigation

In August 2009, a group of tobacco manufacturers (including Reynolds Tobacco and Lorillard) and a tobacco retailer filed a complaint against the United States of America in the United States District Court for the Western District of Kentucky, *Commonwealth Brands, Inc. v. U.S.*, 678 F.Supp.2d 512, in which they asserted that various provisions of the FSPTCA violate their free speech rights under the First Amendment, constitute an unlawful taking under the Fifth Amendment, and are an infringement on their Fifth Amendment due process rights. Plaintiffs sought a preliminary injunction and a judgment declaring the challenged provisions unconstitutional. Both plaintiffs and the government filed motions for summary judgment and on November 5, 2009, the district court denied certain plaintiffs' motion for preliminary injunction as to the modified risk tobacco products provision of the FSPTCA and in January 2010 granted partial summary judgment to plaintiffs on their claims that the ban on color and graphics in advertising and the ban on statements implying that tobacco products are safer due to FDA regulation violated their First Amendment speech rights. The district court granted partial summary judgment to the government on all other claims. Both parties appealed from the district court's order and on March 19, 2012, the United States Court of Appeals for the Sixth Circuit affirmed the district court's decision upholding the FSPTCA's restrictions on the marketing of modified-risk tobacco products, the FSPTCA's bans on event sponsorship, branding non-tobacco merchandise, and free sampling, and the requirement that tobacco manufacturers reserve significant packaging space for textual health warnings. The Sixth Circuit further affirmed the district court's grant of summary judgment to plaintiffs on the FSPTCA's restriction of tobacco advertising to black and white text, as well as the district court's decision to uphold the constitutionality of the color graphic and non-graphic warning label requirement. The Sixth Circuit reversed the district court's determination that the FSPTCA's restriction on statements regarding the relative safety of tobacco products based on FDA regulation is unconstitutional and its determination that the FSPTCA's ban on tobacco continuity programs is permissible under the First Amendment. On May 31, 2012, the Sixth Circuit denied the plaintiffs' motion for rehearing en banc. On October 30, 2012, the plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court. The government declined to seek a petition for certiorari to the U.S. Supreme Court. The government did not appeal the part of the Court of Appeals ruling striking the FSPTCA's restriction of tobacco advertising to black and white text. On April 22, 2013, the U.S. Supreme Court denied plaintiffs' petition for certiorari.

In February 2011, Lorillard, along with Reynolds Tobacco, filed a lawsuit in the U.S. District Court for the District of Columbia, *Lorillard, Inc. v. U.S. Food and Drug Administration*, against the FDA challenging the composition of the TPSAC because of the FDA's appointment of certain voting members with significant financial conflicts of interest. Lorillard believes these members are financially

biased because they regularly testify as expert witnesses against tobacco-product manufacturers, and because they are paid consultants for pharmaceutical companies that develop and market smoking-cessation products. The suit similarly challenges the presence of certain conflicted individuals on the Constituents Subcommittee of the TPSAC. The complaint sought a judgment (i) declaring that, among other things, the appointment of the conflicted individuals to the TPSAC (and its Constituents Subcommittee) was arbitrary, capricious, an abuse of discretion, and otherwise not in compliance with the law because it prevented the TPSAC from preparing a report that was unbiased and untainted by conflicts of interest, and (ii) enjoining the FDA from, among other things, relying on the TPSAC's report. The FDA filed a motion to dismiss this action, and on August 1, 2012, the court denied the FDA's motion to dismiss. The FDA filed its answer to the amended complaint on October 12, 2012, and the case will proceed before the U.S. District Court for the District of Columbia. On April 25, 2013, the court granted plaintiffs' unopposed motion for leave to file the third amended complaint, and plaintiffs filed same. The FDA filed its answer to plaintiff's third amended complaint on May 9, 2013. One June 21, 2013, the FDA filed a motion for summary judgment against Lorillard. The motions are subject to further briefing in the third quarter of 2013.

On August 16, 2011, five tobacco companies (including OPMs Reynolds Tobacco and Lorillard as well as Commonwealth Brands, Inc., Liggett Group LLC, and Santa Fe Natural Tobacco Company, Inc.) filed a complaint against the FDA in the U.S. District Court for the District of Columbia, *R.J. Reynolds Tobacco Co. v. U.S. Food and Drug Administration*, challenging the FDA's rule requiring new textual and graphic warning labels on cigarette packaging and advertisements. The tobacco companies sought a declaratory judgment that the FDA's final rule violates the First Amendment and the APA, and declarative and injunctive relief that the new textual and graphic warnings will not become effective until 15 months after FDA issues regulations "that are permissible under the United States Constitution and federal laws." The plaintiffs allege that the FDA's final rule regarding textual and graphic warnings requires them "to become a mouthpiece for the Government's emotionally-charged anti-smoking message." The plaintiffs also contend that the FDA's warnings are unjustified and unduly burdensome, as they do not further any compelling governmental purpose and are "unlikely to have any material impact on consumer understanding of smoking risks, consumer intentions regarding smoking, or actual consumer smoking decisions." The FDA's final rule, according to the plaintiffs, "violates the First Amendment under any standard of review." In addition, the plaintiffs argue that the FDA acted arbitrarily and capriciously "by attempting to justify the Rule...on grounds that were illogical, contradictory, and without support in the regulatory record, and by employing different standards of analysis to comments supporting the rule than to comments opposing the rule." As a result, the plaintiffs allege that the FDA's final rule "contravenes core requirements" of the APA. Furthermore, the plaintiffs assert that the FDA has not issued a legally valid rule and, therefore, the 15-month effective date for the new textual and graphic warnings cannot come into effect until the FDA complies accordingly. On September 9, 2011, the FDA asked the court to reject the plaintiffs' request for a preliminary injunction against the labeling regulation. On November 7, 2011, the U.S. District Court granted the plaintiffs' request to postpone the September 22, 2012 deadline for the regulations to take effect while the court reviews the rule's constitutionality. The FDA appealed the ruling. In December 2011, 24 state attorneys general filed a friend of the court brief with the U.S. Court of Appeals in support of the FDA's challenge of the ruling. Plaintiffs also moved in the district court for summary judgment in their favor. The FDA opposed plaintiffs' motion and has cross moved for summary judgment in its favor. The district court granted a motion to expedite consideration of the cross summary judgment motions. Oral argument on those motions was held on February 1, 2012, at which the U.S. District Court stated that the government had failed to show how graphic images met legal precedents requiring federally-imposed labeling to be factual and uncontroversial, and said the federal rule that requires such warnings may violate the free speech rights of tobacco companies. On February 29, 2012, the district court granted the plaintiffs' motion for summary judgment and entered an order permanently enjoining the FDA, until 15 months following the issuance of new regulations implementing Section 201(a) of the FSPTCA that are substantively and procedurally

valid and permissible under the United States Constitution and federal law, from enforcing against plaintiffs the new textual and graphic warnings required by Section 201(a) of the FSPTCA. The district court ruled that the mandatory graphic warnings violated the First Amendment by unconstitutionally compelling speech, and that the FDA had failed to carry both its burden of demonstrating a compelling interest for its rule requiring the textual and graphic warning labels and its burden of demonstrating that the rule is narrowly tailored to achieve a constitutionally permissible form of compelled commercial speech. The FDA filed an appeal with the U.S. Court of Appeals for the District of Columbia Circuit on March 4, 2012, and moved the appellate court to consolidate this appeal with the FDA's appeal of the preliminary injunction decision. The Court of Appeals granted the FDA's motion and heard argument on both appeals on April 10, 2012. On August 24, 2012, the Court of Appeals affirmed the district court's decision invalidating the graphic warning rule. On October 9, 2012, the FDA filed a motion for rehearing en banc with the Court of Appeals, and on December 5, 2012, the Court of Appeals denied the FDA's petition for a rehearing en banc. The FDA, on December 5, 2012, issued a notice announcing its intention to collect information from consumers to determine the effectiveness of graphic warning labels, in apparent response to the Court of Appeal's August 2012 affirmation of the invalidation of the graphic warning rule, in which it cited the absence of evidence that the chosen labels furthered the FDA's stated goal of encouraging cessation and discouraging initiation of smoking. On March 19, 2013, the FDA announced that it would not file a petition for writ of certiorari with the U.S. Supreme Court, but instead would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA. The FDA has not provided a timeline for the revised labels.

Other Federal Regulation

In October 2011, the FDA and the National Institutes of Health (the "**NIH**") announced a joint national study called the "Tobacco Control Act National Longitudinal Study of Tobacco Users" to monitor and assess the behavioral and health impacts of new government tobacco regulations by following 40,000 users of tobacco products and those who are 12 and over who are at risk of using tobacco products. The study is being coordinated by researchers at the NIH's National Institute on Drug Abuse and the FDA's Center for Tobacco Products. According to the NIH, data is expected to be collected between 2013 and 2016. The results of the study will be used to guide the FDA in targeting effective actions to reduce the effects of smoking on public health.

In November 2011, the FDA issued two requests for proposals for an integrated anti-smoking campaign that targets teenagers, with a combined budget of up to $600 million over five years. The first request for proposal related to an up to $390 million campaign to prevent tobacco use among teenagers thirteen to seventeen years old. After a year-long review, the FDA in September 2012 selected six agencies to support this anti-smoking educational effort. The FDA's new campaign will strive to inform teens about the benefits of a tobacco-free lifestyle via science-based messages. The second request for proposals was a solicitation for agencies that qualify as small businesses relating to a $210 million campaign to reduce tobacco use among a "minority youth" audience of intermittent smokers in the same age range. The FDA has not announced any developments regarding this campaign.

In March 2012, the CDC announced a 12-week graphic advertising campaign intended to shock smokers into quitting with stories of people damaged by tobacco products. It has been reported that the $54 million campaign is the largest and starkest anti-smoking push by the CDC and its first national advertising effort. The campaign's goal was to convince 500,000 people to try quitting smoking and 50,000 to quit long-term. The CDC reported in August 2012 that its graphic ad campaign has been successful and that the CDC is planning more ads for 2013. The CDC's fiscal year 2013 budget request of $197,117,000 includes an increase of $6.040 million from the prior fiscal year for tobacco prevention and control. The CDC plans to use this increase in resources to expand the reach of a national tobacco education campaign and its tobacco cessation quitline capacity support.

In November 2008, the FTC rescinded guidance it issued in 1966 which provided that tobacco manufacturers were allowed to make factual public statements concerning the tar, nicotine and carbon monoxide yields of their cigarettes without violating the Federal Trade Commission Act if they were based on the "**Cambridge Filter Method**." The Cambridge Filter Method is a machine-based test that "smokes" cigarettes according to a standard protocol and measures tar, nicotine and carbon monoxide yields. The FTC has determined that machine-based yields determined by the Cambridge Filter Method are relatively poor indicators of actual tar, nicotine and carbon monoxide exposure and may be misleading to individual consumers who rely on such information as indicators of the amount of tar, nicotine and carbon monoxide they will actually receive from smoking a particular cigarette and therefore do not provide a good basis for comparison among cigarettes. According to the FTC, this is primarily due to "smoker compensation," which is the tendency of smokers of lower nicotine rated cigarettes to alter their smoking behavior in order to obtain higher doses of nicotine. Now that the FTC has withdrawn its guidance, tobacco manufacturers may no longer make public statements that state or imply that the FTC has endorsed or approved the Cambridge Filter Method or other machine-based testing methods in determining the tar, nicotine and carbon monoxide yields of their cigarettes. Factual statements concerning cigarette yields are allowed by the FTC if they are truthful, non-misleading and adequately substantiated, which is the same basis on which the FTC evaluates other advertising or marketing claims that are subject to the FTC's jurisdiction. It is possible that the FTC's rescission of its guidance regarding the Cambridge Filter Method could be cited as support for allegations by plaintiffs in pending or future litigation, or could encourage additional litigation against cigarette manufacturers.

Tobacco Quota Payments

A federal law enacted in October 2004 repealed the federal supply management program for tobacco growers and compensated tobacco quota holders and growers with payments to be funded by an assessment on tobacco manufacturers and importers. Cigarette manufacturers and importers are responsible for paying 91.6% of a $10.14 billion payment to tobacco quota holders and growers over a ten-year period that will expire in 2014. The law provides that payments will be based on shipments for domestic consumption.

Excise Taxes

Cigarettes are subject to substantial excise taxes in the U.S. On February 4, 2009, President Obama signed into law, effective April 1, 2009, an increase of $0.62 in the excise tax per pack of cigarettes, bringing the total federal excise tax to $1.01 per pack, and significant tax increases on other tobacco products. The federal excise tax rate for snuff increased $0.925 per pound to $1.51 per pound. The federal excise tax on small cigars, defined as those weighing three pounds or less per thousand, increased $48.502 per thousand to $50.33 per thousand. In addition, the federal excise tax rate for roll-your-own tobacco increased from $1.097 per pound to $24.78 per pound. Press reports have noted that many consumers who previously purchased roll-your-own tobacco began using pipe tobacco to roll their own cigarettes in order to avoid the new excise tax, as pipe tobacco excise taxes were unaffected, and using new, mechanized rolling machines to process cigarettes in bulk. Press reports have also noted that increased excise taxes have led to an increase in cigarette smuggling. According to Reynolds American, as a result of the tax disparity between cigarettes and loose tobacco created by the 2009 federal excise tax increase, the number of retailers selling loose tobacco and operating roll-your-own machines, allowing consumers to convert the loose tobacco into finished cigarettes, greatly increased. On July 6, 2012, President Obama signed into law a provision classifying retailers that operate roll-your-own machines as cigarette manufacturers, thus requiring those retailers to pay the same tax rate as other cigarette manufacturers.

Legislation introduced by Senator Tom Harkin on January 22, 2013, the Healthy Lifestyles and Prevention America Act (or the HeLP America Act), would, among other things, increase the Federal excise tax on cigarettes from $1.01 to $2.01 per pack, on roll-your-own tobacco from $24.78 to $49.55 per pound, on snuff from $1.51 to $26.79 per pound and on chewing tobacco from approximately $0.50 to $10.72 per pound, and set the Federal excise taxes on smokeless tobacco sold in discrete single-use units at $100.50 per 1,000 units (which would make the excise taxes on smokeless tobacco products comparable to those on cigarettes). Legislation introduced by Senator Richard Durbin on January 31, 2013, the Tobacco Tax Equity Act, would similarly equalize Federal excise tax rates on all tobacco products, including pipe tobacco, cigars and smokeless tobacco, so that the tax rates on such products would approximate those of cigarettes. Similar bills have not been introduced in the U.S. House of Representatives. On April 10, 2013, President Obama released a proposed budget which, if approved by the U.S. Congress, would increase the federal excise tax: on a pack of cigarettes from $1.01 to $1.95; for snuff from $1.51 per pound to $2.93 per pound; and for chewing tobacco from $0.5033 per pound to $0.98 per pound.

All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2012 ranged from $0.17 per pack in Missouri to $4.35 per pack in New York. Since January 1, 2002, 47 states, the District of Columbia and several U.S. territories have raised their cigarette taxes, many of them more than once. According to a report by the American Lung Association, in 2009, 14 states turned to cigarette taxes to increase revenue in response to record state deficits. As reported by Reynolds American and the American Lung Association's Tobacco Policy Project/State Legislated Actions on Tobacco Issues ("**SLATI**"), six states passed cigarette excise tax increases during 2010, two states (Connecticut and Vermont) passed cigarette excise tax increases during 2011, and in 2012, Illinois and Rhode Island enacted legislation to increase their cigarette excise taxes. According to the IHS Global Report, in July 2013 Minnesota increased its cigarette excise tax by $1.60 per pack. Massachusetts raised its excise tax by $1.00 per pack, effective July 31, 2013, bringing its tax to $3.51 per pack, the second highest in the country after New York. New Hampshire's cigarette tax increased by $0.10 on August 1, 2013 due to legislation enacted in 2011. Puerto Rico has also enacted legislation to increase their taxes in 2013. The legislatures in Florida, Maryland, New Hampshire, Oregon and Rhode Island are also considering cigarette excise tax increases. In addition, the Texas state legislature passed a cigarette tax increase in 2013. According to SLATI, the current nationwide average state cigarette tax is $1.51 per pack. Lorillard reports that for the six months ended June 30, 2013, combined state and local excise taxes ranged from $0.17 to $5.85 per pack. According to Reynolds American, as of June 30, 2013 and December 31, 2012, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.26. Philip Morris reports that between the end of 1998 (the year in which the MSA was executed) and July 22, 2013, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.45 per pack. It is expected that states will continue to raise excise taxes on cigarettes in 2013 and future years. Forty-nine states and the District of Columbia also subject smokeless tobacco to excise taxes, and the Commonwealth of Pennsylvania, the singular exception, may consider such a tax during its 2013 legislative session, according to Reynolds American. In May 2013, Minnesota approved an increase in its excise tax on smokeless tobacco to take effect on January 1, 2014.

In 2004, Michigan imposed an equity assessment on NPMs selling cigarettes in the state. The purpose of the equity assessment is to fund enforcement and administration of Michigan's Qualifying Statute and Complementary Legislation. The assessment is required to be prepaid by March 1 of each year for all cigarettes that are anticipated to be sold in Michigan in the current calendar year. For each NPM, the prepayment amount is equal to the greater of (i) $10,000 or (2) the number of cigarettes that the Department of Treasury reasonably determines that the NPM will sell in Michigan in the current calendar year multiplied by 17.5 mills. According to Reynolds American's SEC filings, Alaska, Minnesota, Mississippi and Utah also impose equity assessments on tobacco manufacturers not participating in the

MSA. For example, an extra $0.35 and $0.25, respectively, is added to each pack of cigarettes sold by an NPM in Utah and Alaska, in addition to other applicable taxes on tobacco. See "BONDHOLDERS' RISKS — Potential Payment Decreases Under the Terms of the MSA."

At least one state, Minnesota (a Previously-Settled State), currently imposes a 75-cent "health impact fee" on tobacco manufacturers for each pack of cigarettes sold. The purpose of this fee is to recover Minnesota's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld by the Minnesota Supreme Court as not in violation of Minnesota's settlement with the tobacco companies. On February 20, 2007, the U.S. Supreme Court denied Philip Morris' petition for writ of certiorari.

In June 2013, Texas (a Previously Settled State) enacted legislation to apply cigarette taxes ($0.55 per pack) for future health costs to tobacco manufacturers that did not join the Texas' State Settlement Agreement. The tax took effect on September 1, 2013.

State and Local Regulation

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

The FSPTCA substantially expanded federal tobacco regulation, but state regulation of tobacco is not necessarily preempted by federal law in this instance. Importantly, the FSPTCA specifically allows states and localities to impose restrictions on the time, place and manner, but not content, of advertising and promotion of tobacco products. The FSPTCA also eliminated the prior federal preemption of state regulation that, in certain circumstances, had been upheld by the U.S. Supreme Court.

In addition to the FSPTCA disclosure requirements and marketing and labeling restrictions, several states have enacted or proposed legislation or regulations that would require cigarette manufacturers to disclose the ingredients used in the manufacture of cigarettes to state health authorities. According to SLATI, as of March 1, 2013, six states require tobacco product disclosure information: Massachusetts and Texas require tobacco manufacturers to disclose any added constituent of tobacco products other than tobacco, water and reconstituted tobacco sheet made wholly from tobacco; Massachusetts, Texas and Utah require disclosure of the nicotine yield for each brand of cigarettes; Minnesota and Utah require tobacco manufacturers to disclose the presence of ammonia, any compound of ammonia, arsenic, cadmium, formaldehyde or lead in their unburned or burned states; New Hampshire requires its state Department of Health and Human Services to obtain from the Massachusetts Department of Public Health a list of additives for each brand of tobacco products sold; and Connecticut required its Commissioner of Public Health to issue regulations concerning how the commissioner will obtain nicotine yield ratings for each brand of tobacco product.

In 2003, New York was the first state to pass legislation requiring the introduction of cigarettes with a lower likelihood of starting a fire. Cigarette manufacturers responded by designing cigarettes that would extinguish quicker when left unattended. Since then, according to SLATI, fire-safety standards for cigarettes identical to those of New York are in effect in all 50 states and the District of Columbia.

According to the American Nonsmokers' Rights Foundation ("**ANRF**"), as of October 1, 2013, 27 states and territories have laws that require 100% smoke-free non-hospitality workplaces and restaurants and bars: Arizona, Delaware, the District of Columbia, Hawaii, Illinois, Iowa, Kansas, Maine,

Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, New Jersey, New York, North Dakota, Ohio, Oregon, Puerto Rico, Rhode Island, South Dakota, the U.S. Virgin Islands, Utah, Vermont, Washington and Wisconsin. According to ANRF, as of October 1, 2013, only 15 states and territories do not have laws that require either 100% smoke-free non-hospitality workplaces or restaurants or bars (being Alabama, Alaska, Arkansas, Georgia, Guam, Kentucky, Mississippi, Missouri, Oklahoma, South Carolina, Tennessee, Texas, Virginia, West Virginia and Wyoming). Restrictions in Arizona, Hawaii, Illinois, New Mexico, North Dakota, Oregon and Washington are stronger than those in other states as they include a ban on outdoor smoking within at least 10 feet of the entrances of restaurants and other public places. ANRF also tracks clean indoor air ordinances by local governments throughout the U.S. As of October 1, 2013, there were 1,078 municipalities with local laws that require 100% smoke-free non-hospitality workplaces or restaurants or bars. Most states without a statewide smoking ban have some local municipalities that have enacted smoking regulations. It is expected that these restrictions will continue to proliferate.

Smoking bans have also extended outdoors. According to ANRF, as of October 1, 2013:

- Puerto Rico prohibits smoking on beaches, Maine prohibits smoking on beaches in its state parks, 178 municipalities specified that all city beaches and/or specifically named city beaches are smokefree, and in January 2014 a smoking ban will go in effect on Hawaii's beaches;

- Iowa, New York, Wisconsin, Guam and the U.S. Virgin Islands prohibit smoking in outdoor public transit waiting areas, and there are 313 municipalities with smokefree outdoor public transit waiting area laws;

- Hawaii, Maine, Michigan, Washington and Puerto Rico laws prohibit smoking in outdoor dining and bar patios, Iowa prohibits smoking in outdoor dining areas, and 266 municipalities have enacted laws for 100% smokefree outdoor dining, while 126 municipalities have enacted laws both for 100% smokefree outdoor dining and bar patios; and

- Oklahoma and Puerto Rico prohibit smoking in all parks, and 875 municipalities specified that all city parks and/or specifically named city parks are smokefree.

Smoking bans have also been enacted for smaller governmental and private entities. According to the ANRF, as of July 8, 2013, there are at least 1,178 100% smokefree university and college campuses with no exemptions, including dormitory housing, and of these, 793 have a 100% tobacco-free policy. In January 2012, the president of the University of California system requested the entire University of California system to become smoke-free by 2014. ANRF reports that, as of July 8, 2013, complete smoking bans, indoor and outdoor, have also been implemented on the campuses of four national and at least 3,777 local and/or state health providers. In addition, ANRF reports that all federal correctional facilities are completely smoke-free (indoor and outdoor), as well as those in 21 states plus Puerto Rico. Twenty-eight other states allow smoking in correctional facilities but only in outdoors areas. Finally, ANRF reports that as of October 1, 2013, four states and 92 municipalities have laws requiring that all hotel and motel rooms be 100% smokefree.

According to the IHS Global Report, in March 2013 California Assembly Bill 746 was introduced, which would prohibit smoking in, and within 20 feet of entrances of, condominiums, duplexes and apartment units throughout California. A similar bill has also been introduced in Massachusetts.

In June 2006, the Office of the Surgeon General released a report, "The Health Consequences of Involuntary Exposure to Tobacco Smoke." It is a comprehensive review of health effects of involuntary exposure to tobacco smoke. It concludes definitively that secondhand smoke causes disease and adverse respiratory effects. It also concludes that policies creating completely smoke-free environments are the most economical and efficient approaches to providing protection to non-smokers. On September 18, 2007, the Office of the Surgeon General released the report, "Children and Secondhand Smoke Exposure", which concludes that many children are exposed to secondhand smoke in the home and that establishing a completely smoke-free home is the only way to eliminate secondhand smoke exposure in that setting. The Surgeon General also addressed the health risks of second-hand smoke in its 2010 report entitled "How Tobacco Smoke Can Cause Disease: The Biology and Behavioral Basis for Smoking-Attributable Disease." These reports are expected to strengthen arguments in favor of further smoking restrictions across the country. Further, the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant in 2006.

Voluntary Private Sector Regulation

In recent years, many employers have initiated programs restricting or eliminating smoking in the workplace and providing incentives to employees who do not smoke, including charging higher health insurance premiums to employees who smoke, and many common carriers have imposed restrictions on passenger smoking more stringent than those required by governmental regulations. Similarly, many restaurants, hotels and other public facilities have imposed smoking restrictions or prohibitions more stringent than those required by governmental regulations, including outright bans. According to the IHS Global Report, New York City's first non-smoking apartment building opened in 2009, and many landlords and condominium associations in California and New York City have also established smoke-free apartment policies, including Related Companies, which manages 40,000 rental units and recently announced a ban on smoking for all new tenants.

International Agreements

On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force on February 27, 2005 for the first forty countries, including the U.S., that had ratified the treaty prior to November 30, 2004 (there is no deadline for ratification). According to the World Health Organization, as of June 2013, 177 countries were party to the FCTC. In November 2012, parties to the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products, which opened for signature in January 2013.

Civil Litigation

Overview

Legal proceedings or claims covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions against the tobacco industry. Several types of claims are raised in these proceedings including, but not limited to, claims for product liability, consumer protection, antitrust, and reimbursement. Litigation is subject to many uncertainties and it is possible that there could be material adverse developments in pending or future cases. Damages claimed in some tobacco-related and other litigation are or can be significant and, in certain cases, range in the billions of dollars. 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 materially adversely affect the business of the PMs and the

market for or prices of securities such as the Series 2013 Bonds payable from tobacco settlement payments made under the MSA. Lorillard's parent company reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that, as of July 23, 2013, 7,888 product liability cases are pending against cigarette manufacturers in the United States. Many of these cases are "*Engle* Progeny Cases", described below (although many arose from one Florida federal court in 2009 severing the claims of approximately 4,400 *Engle* Progeny plaintiffs). Reynolds American reports in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that 5,296 *Engle* Progeny cases are pending against Reynolds Tobacco or its affiliates or indemnitees as of June 30, 2013, and Lorillard, Inc. reports in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that 4,271 *Engle* Progeny cases are pending against Lorillard or Lorillard, Inc. as of July 23, 2013.

Altria, Philip Morris's parent company, reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, that after exhausting all appeals in cases resulting in adverse verdicts associated with tobacco-related litigation, Philip Morris has paid in the aggregate judgments (and related costs and fees) totaling approximately $245 million and interest totaling approximately $139 million as of July 22, 2013. In its Form 10-K filed with the SEC for the calendar year 2012, Altria further reported that it recorded pre-tax charges related to certain tobacco and health judgments in the amounts of $4 million, $98 million and $16 million (excluding accrued interest of $1 million, $64 million and $5 million), for the calendar years 2012, 2011 and 2010, respectively. Reynolds American reported in its Form 10-K filed with the SEC for the calendar year 2012 that for calendar years 2010, 2011 and 2012, it had paid approximately $118 million related to unfavorable smoking and health litigation judgments.

Plaintiffs assert a broad range of legal theories in these cases, including, among others, theories of negligence, fraud, misrepresentation, strict liability in tort, design defect, breach of warranty, enterprise liability (including claims asserted under RICO), civil conspiracy, intentional infliction of harm, injunctive relief, indemnity, restitution, unjust enrichment, public nuisance, unfair trade practices, claims based on antitrust laws and state consumer protection acts, and claims based on failure to warn of the harmful or addictive nature of tobacco products.

The MSA does not release the PMs from liability in individual plaintiffs' cases or in class action lawsuits. Plaintiffs in most of the cases seek unspecified amounts of compensatory damages and punitive damages that may range into the billions of dollars. Plaintiffs in some of the cases have sought treble damages, statutory damages, disgorgement of profits, equitable and injunctive relief, and medical monitoring, among other damages.

The list below specifies categories of tobacco-related cases pending against the tobacco industry. A summary description of each type of case follows the list.

Type of Case

Conventional Product Liability Cases
Engle Progeny Cases
West Virginia Individual Personal Injury Cases
Flight Attendant Cases
Class Action Cases
Reimbursement Cases
Tobacco-Related Antitrust Cases

"**Conventional Product Liability Cases**" are brought by individuals who allege cancer or other health effects caused by smoking cigarettes, by using smokeless tobacco products, by addiction to tobacco, or by exposure to environmental tobacco smoke.

"***Engle*** **Progeny Cases**" are brought by individuals who purport to be members of the decertified *Engle* class. These cases are pending in a number of Florida courts. The time period for filing *Engle* Progeny Cases expired in January 2008 and no additional cases may be filed. Some of the *Engle* Progeny cases were filed on behalf of multiple class members. Some of the courts hearing the cases filed by multiple class members severed these suits into separate individual cases. It is possible the remaining suits filed by multiple class members may also be severed into separate individual cases.

In a 1999 administrative order, the West Virginia Supreme Court of Appeals transferred to a single West Virginia court a group of cases brought by individuals who allege cancer or other health effects caused by smoking cigarettes, smoking cigars, or using smokeless tobacco products (the "**West Virginia Cases**"). The plaintiffs' claims alleging injury from smoking cigarettes were consolidated for trial. On May 15, 2013, a jury returned a verdict for tobacco company defendants with the sole exception of a defective design claim regarding cigarette filters. The plaintiffs' claims alleging injury from the use of other tobacco products have been severed from the consolidated cigarette claims and have not been consolidated for trial. The time for filing a case that could be consolidated for trial with the West Virginia Cases expired in 2000.

"**Flight Attendant Cases**" are brought by non-smoking flight attendants alleging injury from exposure to environmental smoke in the cabins of aircraft. Plaintiffs in these cases may not seek punitive damages for injuries that arose prior to January 15, 1997. The time for filing Flight Attendant Cases expired in 2000 and no additional cases in this category may be filed.

"**Class Action Cases**" are purported to be brought on behalf of large numbers of individuals for damages allegedly caused by smoking, including "lights" Class Action Cases and Class Action Cases that seek court-supervised medical monitoring programs.

"**Reimbursement Cases**" are brought by or on behalf of entities seeking equitable relief and reimbursement of expenses incurred in providing health care to individuals who allegedly were injured by smoking. Plaintiffs in these cases have included the U.S. federal government, U.S. state and local governments, foreign governmental entities, hospitals or hospital districts, American Indian tribes, labor unions, private companies and private citizens. Included in this category is the suit filed by the federal government, *United States of America v. Philip Morris USA, Inc., et al*. (the "**DOJ Case**"), that sought to recover profits earned by the defendants and other equitable relief.

In 2000 and 2001, a number of cases were brought against cigarette manufacturers alleging that defendants conspired to set the price of cigarettes in violation of federal and state antitrust and unfair business practices statutes ("**Tobacco-Related Antitrust Cases**"). Plaintiffs sought class certification on behalf of persons who purchased cigarettes directly or indirectly from one or more of the defendant cigarette manufacturers.

Conventional Product Liability Cases

According to Lorillard, since January 1, 2010, verdicts have been returned in ten Conventional Product Liability Cases against cigarette manufacturers. In one such case, *Evans v. Lorillard Tobacco Co.,* (Superior Court, Suffolk County, Massachusetts), the jury awarded in December 2010 $50 million in compensatory damages to the estate of a deceased smoker, $21 million in damages to the deceased smoker's son, and $81 million in punitive damages. In September 2011, the court granted in part Lorillard's motion to reduce the jury's damages awards and reduced the verdicts to the deceased smoker to $25 million and to the deceased smoker's son to $10 million. The court did not reduce the punitive damages verdict, and it denied the other motions Lorillard filed following trial that contested the jury's verdict. In September 2011, the court also issued an order that addressed the single claim that was not

submitted to the jury. While the court made certain findings that were favorable to the plaintiffs, it did not award additional damages to the plaintiffs on this final claim. The court has denied the various motions filed by Lorillard following the entry of the order on the claim that was not submitted to the jury. In September 2011, the court entered a judgment that reflected the jury's damages awards and the court's reductions following trial. The judgment awarded plaintiffs interest on each of the three damages awards at the rate of 12% per year from the date the case was filed in 2004. Interest on the three awards will continue to accrue until either the judgment is paid or is vacated on appeal. In November 2011, the court granted in part plaintiffs' counsel's application for attorneys' fees and costs and has awarded approximately $2.4 million in fees and approximately $225,000 in costs. Lorillard has noticed an appeal from the final judgment to the Massachusetts Appeals Court. In March 2012, plaintiffs' application for direct appellate review was granted, transferring the appeal to the Massachusetts Supreme Judicial Court. On June 11, 2013, the Massachusetts Supreme Judicial Court allowed the $35 million in compensatory damages but vacated the punitive damages of $81 million, and ordered a new trial on that part of the case. Lorillard filed a petition for rehearing, which was denied on July 26, 2013.

According to Lorillard, juries found in favor of the plaintiffs and awarded compensatory damages in three of the other nine Conventional Product Liability Case trial verdicts rendered since January 1, 2010. In one of these three trials, the jury also awarded $4.0 million in punitive damages.

Defendants appealed the verdicts in two of the nine trials, and those appeals remain pending. In one case, according to Lorillard, the plaintiff was awarded $25 million in punitive damages in a retrial ordered by an appellate court in which the jury was permitted to consider only the amount of punitive damages to award. Defendants appealed that verdict, which was affirmed on appeal in July 2013. In the other case, *Schwarz v. Philip Morris Inc.*, (Circuit Court, Multnomah County, Oregon), the jury awarded $168,500 in compensatory damages and $150 million in punitive damages in March 2002 to plaintiffs. In May 2002, the trial court reduced the punitive damages award to $100 million. In May 2006, the Oregon Court of Appeals affirmed the compensatory damages verdict, vacated the award of punitive damages and remanded the case to the trial court for a new trial limited to the determination of the amount of punitive damages, if any. In June 2006, the plaintiff petitioned the Oregon Supreme Court to review the portion of the court of appeals' decision reversing and remanding the case for a new trial on punitive damages. In June 2010, the Oregon Supreme Court affirmed the court of appeals' decision and remanded the case to the trial court for a new trial limited to the question of punitive damages. In February 2012, the jury awarded plaintiffs $25 million in punitive damages. In March 2012, Philip Morris filed motions to set aside the verdict, for a new trial or, in the alternative, for a remittitur. The trial court denied these motions in May 2012, and on September 4, 2012, Philip Morris filed a notice of appeal from the trial court's judgment with the Oregon Court of Appeals. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, Altria, Philip Morris's parent company, reported no developments in this case.

Juries found in favor of the defendants in the five other Conventional Product Liability Cases. Two of these five cases have concluded because the plaintiffs did not pursue appeals. The plaintiff in the third case noticed an appeal, and in February 2013 the appellate Court affirmed the verdict. In the fourth case, *Hunter v. Philip Morris USA*, the court granted in December 2012 a post-trial motion for a new trial filed by the plaintiff, but withdrew the order at Philip Morris's motion for reconsideration. The plaintiff filed a petition for review of this decision with the Alaska Supreme Court, which denied the petition on April 30, 2013. The plaintiff in the fifth case has filed a notice for a new trial. The court has not yet ruled on the motion.

In rulings addressing cases tried in earlier years, some appellate courts have reversed verdicts returned in favor of the plaintiffs while other judgments that awarded damages to smokers have been affirmed on appeal. Manufacturers have exhausted their appeals and have been required to pay damages

to plaintiffs in 13 individual cases since 2001. Punitive damages were paid to the smokers in 6 of these cases. Lorillard reports that some Conventional Product Liability Cases are scheduled for trial in 2013.

Engle Progeny Cases

The case of *Engle v. R.J. Reynolds Tobacco Co., et al.* (Circuit Court, Dade County, Florida, filed May 5, 1994) was certified in 1996 as a class action on behalf of Florida residents, and survivors of Florida residents, who were injured or died from medical conditions allegedly caused by addiction to smoking, and a multi-phase trial resulted in verdicts in favor of the class. During the three-phase trial, a Florida jury awarded compensatory damages to three individuals and approximately $145 billion in punitive damages to the certified class. In *Engle v. Liggett Group, Inc.*, 945 So.2d 1246 (Fla. 2006), the Florida Supreme Court vacated the punitive damages award, determined that the case could not proceed further as a class action and ordered decertification of the class. The Florida Supreme Court also reinstated the compensatory damages awards to two of the three individuals whose claims were heard during the first phase of the *Engle* trial. These two awards totaled approximately $7 million, and according to Lorillard both verdicts were paid in February 2008.

The Florida Supreme Court's 2006 ruling also permitted *Engle* class members to file individual actions, including claims for punitive damages. The court further held that these individuals are entitled to rely on a number of the jury's findings in favor of the plaintiffs in the first phase of the *Engle* trial. These findings included that smoking cigarettes causes a number of diseases; that cigarettes are addictive or dependence-producing; and that the defendants were negligent, breached express and implied warranties, placed cigarettes on the market that were defective and unreasonably dangerous, and concealed or conspired to conceal the risks of smoking. The time period for filing *Engle* Progeny Cases expired in January 2008 and no additional cases may be filed. In 2009, the Florida Supreme Court rejected a petition that sought to extend the time for purported class members to file an additional lawsuit.

Engle Progeny Cases are pending in various Florida state and federal courts. Some of the *Engle* Progeny Cases were filed on behalf of multiple plaintiffs. Various courts have entered orders severing the cases filed by multiple plaintiffs into separate actions. In 2009, one Florida federal court entered orders that severed the claims of approximately 4,400 *Engle* Progeny plaintiffs, initially asserted in a small number of multi-plaintiff actions, into separate lawsuits. In some cases, spouses or children of alleged former class members have also brought derivative claims. In 2011, approximately 500 cases that were among the 4,400 cases severed into separate lawsuits in 2009, filed by family members of alleged former class members, were combined with the cases filed by the smoker from which the family members' claims purportedly derived. In August 2012, the United States District Court for the Middle District of Florida ordered the parties to submit approximately 600 *Engle* Progeny Cases (*In re: Engle Progeny Cases* Case No. 3:09-CV-10000- TJC-JBT) to mediation. These cases were scheduled to be mediated in groups starting in November 2012 through May 2013. According to Lorillard, the first group of mediations has concluded. On January 30, 2013, the court issued an order changing the mediation process. Instead of conducting individual plaintiff mediations, the court ordered the parties to participate in a mediation process for the federal *Engle* Progeny Cases globally. Defendants filed a motion for reconsideration of this mediation order. On March 4, 2013, the Court entered a new order which provides that: (1) plaintiffs will participate in a confidential mediation session without the defendants by March 15, 2013; (2) defendants will participate along with a high-level corporate officer from each defendant in a confidential mediation session without the plaintiffs by April 15, 2013; and (3) each side will disclose to the mediators a confidential offer for global resolution of the federal *Engle* Progeny Cases. The mediators conducted the ordered mediation sessions. On April 9, 2013, the mediators issued a report stating that "there are practical and procedural impediments which act to prevent a meaningful discussion of settlements at this time," and that the mediators are prepared to discuss the mediation process further

with the Court at the Court's convenience. On April 22, 2013, the Court met with only the mediators to discuss in further detail the mediation process. The Court has taken no further action.

On December 14, 2012, plaintiffs' counsel filed a motion to remand the majority of the federal *Engle* Progeny Cases to state court. On January 25, 2013, the United States District Court for the Middle District of Florida denied the motion. Plaintiffs petitioned the United States Court of Appeals for the Eleventh Circuit for permission to appeal the district court's order denying the motion to remand. On April 2, 2013, the United States Court of Appeals for the Eleventh Circuit granted the petition for permission to appeal and simultaneously affirmed the District Court's order denying remand.

Lorillard reports that since January 2010 and through July 23, 2013, the United States District Court for the Middle District of Florida has dismissed a total of approximately 3,176 cases. In some instances, the plaintiffs whose cases were dismissed also were pursuing cases pending in other courts. In other instances, the attorneys who represented the plaintiffs asked the court to enter dismissal orders because they were no longer able to contact their clients. In September 2012, the court dismissed approximately 589 cases for failure to comply with court deadlines and granted a motion that dismissed 211 additional cases for a variety of reasons. In November 2012, the court granted a motion by defendants and dismissed an additional 36 cases as barred by the statute of limitations. In January 2013, the court dismissed approximately 520 cases in which the plaintiffs were deceased at the time their personal injury lawsuits were filed. Plaintiffs appealed the dismissals to the United States Court of Appeal for the Eleventh Circuit, and the appeal remains pending. In June 2013, the Court dismissed an additional approximately 440 cases for a variety of reasons. Plaintiffs have appealed the dismissal of approximately 70 of these cases, in which the plaintiffs were deceased at the time their personal injury lawsuits were filed or where the cases were barred by the statute of limitations. The Court granted plaintiffs' motion to consolidate the appeals from the January and June 2013 orders dismissing these groups of federal cases. Other courts, including state courts, have entered orders dismissing additional cases.

Reynolds American reports in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that as of June 30, 2013, 2,014 *Engle* Progeny Cases were pending in federal court and 3,282 cases were pending in state court, together including approximately 6,423 plaintiffs.

Various intermediate state and federal Florida appellate courts have issued rulings that address the scope of the preclusive effect of the findings from the first phase of the *Engle* trial, including whether those findings relieve plaintiffs from the burden of proving certain legal elements of their claims. In July 2010, the United States Court of Appeals for the Eleventh Circuit in *Brown v. R. J. Reynolds Tobacco Co.*, 611 F.3d 1324 (2010) ("***Bernice Brown***"), vacated the decision of the trial court, finding that it was premature to address the extent of any preclusive effect of the findings of the first phase of the *Engle* trial until the scope of the factual issues decided in first phase of the *Engle* trial was determined by the trial court. In two other cases, *Duke v. R.J. Reynolds Tobacco Co.* and *Walker v. R.J. Reynolds Tobacco Co.*, the due process issue was appealed to the United States Court of Appeals for the Eleventh Circuit. On May 8, 2012, a group of plaintiffs firms submitted an amicus brief in both cases contending that finding for the tobacco companies, and undoing the over 100 verdicts decided under the Florida Supreme Court's 2006 decision, would be unfair to their clients. On September 6, 2013, the United States Court of Appeals for the Eleventh Circuit ruled that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. It has been reported that R.J. Reynolds is seeking a rehearing en banc before the Eleventh Circuit and will seek Supreme Court review if necessary.

In December 2010, the Florida First District Court of Appeal in *R.J. Reynolds Tobacco Co. v. Martin*, 53 So.3d 1060 (2010) refused to adopt the Eleventh Circuit's ruling in *Brown*, finding that the trial court correctly construed the Florida Supreme Court's 2006 *Engle* decision and had properly instructed the jury on the preclusive effect of certain of the *Engle* jury's findings. In September 2011, the

Florida Fourth District Court of Appeal in *R.J. Reynolds Tobacco Co. v. Brown*, 70 So.3d 707 (2011) ("***Jimmie Lee Brown***") had a different interpretation of the effect of the 2006 *Engle* decision on plaintiff's claims than both the *Bernice Brown* and *Martin* courts, holding that while the conduct elements of strict liability and negligence claims were preclusively established, the remaining elements of the underlying claims must be proven in the second phase of trial. In May 2013, however, the Florida Supreme Court accepted discretionary jurisdiction in *Jimmie Lee Brown* and the appeal is currently pending. In December 2011, the U.S. District Court for the Middle District of Florida, in *Waggoner v. R.J. Reynolds Tobacco Co.*, 835 F.Supp.2d 1244 (2011), held that the first phase of the *Engle* trial may be given the preclusive effect afforded them by the 2006 Florida Supreme Court decision, as well as the *Martin* and *Jimmie Lee Brown* decisions without violating the Due Process Clause. In *Philip Morris v. Douglas* (No. 12-617), the Florida Supreme Court ruled on March 14, 2013 that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. In order to prevail on either strict liability or negligence claims, the Court found that an *Engle* plaintiff must establish (1) membership in the *Engle* class; (2) that addiction to smoking the *Engle* defendants' cigarettes containing nicotine was a legal cause of the injuries the plaintiff alleged; and (3) damages. Defendants filed a petition for review of the Florida Supreme Court's decision in *Douglas* with the U.S. Supreme on August 9, 2013.

Various courts, including appellate courts, have issued rulings that have addressed the conduct of the cases prior to trial. One intermediate state appellate court ruled in 2011 that plaintiffs are permitted to assert a claim against a cigarette manufacturer even if the smoker did not smoke a brand sold by that manufacturer. Defendants' petition for review of this decision by the Florida Supreme Court was denied in August 2012. In March 2012, another intermediate state appellate court agreed with the 2011 ruling and reversed dismissals in a group of cases. Defendants in these cases are also seeking review by the Florida Supreme Court. The Florida Supreme Court had announced that it would defer decision on whether to accept review of these cases until it decided whether to review the 2011 decision. In June and July 2013, the Florida Supreme Court denied defendants' petitions for review of the intermediate appellate court's decision in these cases. These rulings may limit the ability of the defendants to be dismissed from cases in which smokers did not use a cigarette manufactured by such defendant. In October 2012, the Florida First District Court of Appeal in *Soffer v. R.J. Reynolds Tobacco Co.* affirmed the judgment awarding damages in one case, however the appeals court certified to the Florida Supreme Court the question of whether *Engle* class members may pursue an award of punitive damages based on claims of negligence or strict liability. On May 17, 2013, the Florida Supreme Court issued an order directing the parties to show cause why the Court's decision in *Philip Morris v. Douglas,* dated March 14, 2013, is not controlling in this case and why the Court should not decline jurisdiction in this case. The parties filed their responses to the Court's order on June 3, 2013. The Florida Supreme Court has not announced whether it would grant review of this case. In June 2013, in *Capone v. Philip Morris*, the Florida Supreme Court reversed an intermediate state appellate court and held that a plaintiff's representative may continue to litigate an existing lawsuit after the original plaintiff has died.

According to Lorillard, tobacco manufacturing defendants face various other legal issues in connection with the *Engle* Progeny Cases that could materially affect the outcome of the *Engle* Progeny Cases. These legal issues include, but are not limited to, the application of the statute of limitations and statute of repose, the constitutionality of a cap on the amount of a bond necessary to obtain an automatic stay of a post-trial judgment, and whether a plaintiff's representative may continue an existing lawsuit or file a new lawsuit after the original plaintiff has died. Lorillard reports that various intermediate Florida appellate courts and Florida federal courts have issued rulings on these issues.

Lorillard reports that as of July 23, 2013, verdicts have been returned in thirteen *Engle* Progeny Cases in which Lorillard was a defendant and 85 *Engle* Progeny Cases in which neither Lorillard nor Lorillard Inc. was a defendant at trial. Of the thirteen *Engle* Progeny Cases in which Lorillard was a

defendant, juries awarded compensatory damages to the plaintiffs in ten of these cases (and in three of these ten cases, juries also awarded punitive damages), and in another case, the court entered an order that awarded plaintiff compensatory damages. According to Lorillard, of the 85 *Engle* Progeny Cases in which neither Lorillard nor Lorillard Inc. was a defendant at trial, juries awarded compensatory damages and punitive damages in 27 of the trials; the 27 punitive damages awards have totaled approximately $676 million and have ranged from $20,000 to $244 million. In 27 of the trials, juries' awards were limited to compensatory damages. In the 31 remaining trials, juries found in favor of the defendants. Post-trial motions challenging the verdicts in some cases and appeals from final judgments in some cases are pending before various Florida circuit and intermediate appellate courts. Lorillard reports in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that as of July 23, 2013, one verdict in favor of the defendants and three verdicts in favor of the plaintiff have been reversed on appeal and returned to the trial court for a new trial on all issues, and in seven cases, the appellate courts have ruled that the issue of damages awarded must be revisited by the trial court. Motions for rehearing of these appellate court rulings are pending in some cases. According to Altria, as of July 22, 2013, 44 *Engle* Progeny Cases involving Philip Morris have resulted in verdicts since the Florida Supreme Court's *Engle* decision, 23 of which were returned in favor of plaintiffs and 21 of which were returned in favor of Philip Morris.

In one of the *Engle* Progeny Cases in which all 3 OPMs are defendants, *Calloway v. R.J. Reynolds Tobacco Company, et al.* (Circuit Court, Seventeenth Judicial Circuit, Broward County, Florida), the jury awarded plaintiff and a daughter of the decedent a total of $20,500,000 in compensatory damages. The jury apportioned 20.5% of the fault for the smoker's injuries to the smoker, 27% to R.J. Reynolds, 25% to Philip Morris, 18% to Lorillard, and 9.5% to Liggett. The jury awarded a total punitive damages award from the defendants of $54,850,000. In August 2012, the court granted a post-trial motion by the defendants and lowered the compensatory damages award to $16,100,000. The court also ruled that the jury's finding on the plaintiff's percentage of comparative fault would not be applied to reduce the compensatory damage award because the jury found in favor of the plaintiff on her claims alleging intentional conduct. In August 2012, the court entered final judgment against defendants in the amount of $16,100,000 in compensatory damages and $54,850,000 in punitive damages, plus the statutory rate of interest, which is currently 4.75%. In September 2012, the defendants filed a notice of appeal to the Florida Fourth District Court of Appeal, and Reynolds Tobacco posted a supersedeas bond in the amount of $1.5 million. The plaintiff filed a notice of cross-appeal. Briefing with the Florida Fourth District Court of Appeal was underway as of the date hereof and a request for oral arguments was filed on June 28, 2013.

In another *Engle* Progeny case, *Naugle v. Philip Morris*, a jury returned a verdict in November 2009 in favor of the plaintiff and against Philip Morris. The jury awarded approximately $56.6 million in compensatory damages and $244 million in punitive damages, allocating 90% of the fault to Philip Morris. In August 2010, the trial court entered an amended final judgment of approximately $12.3 million in compensatory damages and approximately $24.5 million in punitive damages. In June 2012, the Fourth District Court of Appeal affirmed the amended final judgment, and in July 2012, Philip Morris filed a motion for rehearing. On December 12, 2012, the Fourth District Court of Appeal withdrew its prior decision, reversed the verdict as to compensatory and punitive damages and returned the case to the trial court for a new trial on the question of damages. On December 26, 2012, the plaintiff filed a motion for rehearing *en banc* or for certification to the Florida Supreme Court, which was denied on January 25, 2013. The jurisdiction of the Florida Supreme Court was invoked through the filing of a Notice to Invoke Discretionary Jurisdiction in February 2013. The Fourth District Court of Appeal issued its mandate in March 2013. On May 17, 2013, the Florida Supreme Court consolidated the parties' petitions and ordered the parties to show cause as to why the Florida Supreme Court's decision in *Philip Morris USA, Inc v. Douglas* was not controlling and the court should not decline jurisdiction. On June 3, 2013, the parties filed responses to the court's order to show cause.

Reynolds Tobacco reports that as of June 30, 2012, outstanding jury verdicts in favor of the *Engle* Progeny plaintiffs in *Engle* Progeny Cases had been entered against Reynolds Tobacco in the aggregate amount of $96,815,000 in compensatory damages (as adjusted) and in the aggregate amount of $156,495,000 in punitive damages, for a total of $253,310,000. Reynolds Tobacco reports that all of such verdicts are at various stages in the appellate process.

Various *Engle* Progeny Cases are discussed in detail in the SEC filings of the parent companies of Lorillard, Philip Morris and Reynolds Tobacco.

In June 2009, Florida amended the security requirements for a stay of execution of any judgment during the pendency of appeal in *Engle* Progeny Cases. The amended statute provides for the amount of security for individual *Engle* Progeny Cases to vary within prescribed limits based on the number of adverse judgments that are pending on appeal at a given time. The required security decreases as the number of appeals increases to ensure that the total security posted or deposited does not exceed $200 million in the aggregate. This amended statute applies to all judgments entered on or after June 16, 2009. The plaintiffs in some of the cases have challenged the constitutionality of the amended statute. Lorillard reports that as of July 23, 2013, none of these motions had been granted and courts either denied these challenges or declared them moot, or the motions were withdrawn.

A number of *Engle* Progeny Cases have been placed on courts' 2013/2014 trial calendars; according to Reynolds American, there are 54 set for trial through June 30, 2014. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2013 that as of July 22, 2013, 12 *Engle* Progeny Cases against Philip Morris were scheduled for trial through the end of 2013. Trial schedules are subject to change. It is not possible to predict whether some courts will implement procedures that consolidate multiple *Engle* Progeny Cases for trial.

West Virginia Cases

In September 2000, there were approximately 1,250 West Virginia Cases. Plaintiffs in most of the cases alleged injuries from smoking cigarettes, and the claims alleging injury from smoking cigarettes have been consolidated for a multi-phase trial. Approximately 645 West Virginia Cases have been dismissed in their entirety; however, some or all of the dismissals could be contested in subsequent appeals.

The West Virginia Cases pending were brought in a single West Virginia court by individuals who allege cancer or other health effects caused by smoking cigarettes, smoking cigars, or using smokeless tobacco products. More than 700 West Virginia Cases were consolidated for a multiphase trial, which began April 22, 2013 and concluded May 13, 2013. The order that consolidated the cases for trial, among other things, also limited the consolidation to those cases that were filed by September 2000. No additional West Virginia Cases may be consolidated for trial with this group. On May 15, 2013, the jury returned a verdict finding for the defendant tobacco companies on claims of failure to warn, negligence and fraudulent concealment but for the plaintiff smokers on the claim that manufacturers are liable for the defective design of ventilated filter cigarettes. No punitive damages were awarded. No judgment has yet been entered on the jury's verdict. Plaintiffs and defendants both filed post-trial motions on July 15, 2013. The trial court has set a briefing schedule requiring that any opposition to the post-trial motions be filed by August 5, 2013, and a hearing on all post-trial motions was scheduled for August 13, 2013.

The court has severed from the West Virginia Cases those claims alleging injury from the use of tobacco products other than cigarettes, including smokeless tobacco and cigars (the "**Severed West Virginia Claims**"). The Severed West Virginia Claims involve 30 plaintiffs. Twenty-eight of these

plaintiffs have asserted both claims alleging that their injuries were caused by smoking cigarettes as well as claims alleging that their injuries were caused by using other tobacco products. The former claims will be considered during the consolidated trial of the West Virginia Cases, while the latter claims are among the Severed West Virginia Claims. Two plaintiffs have asserted only claims alleging that injuries were caused by using tobacco products other than cigarettes, and no part of their cases will be considered in the consolidated trial of the West Virginia Cases. According to Lorillard, as of July 23, 2013, no cases were scheduled for trial.

Flight Attendant Cases

Four cigarette manufacturers are the defendants in the pending Flight Attendant Cases. These suits were filed as a result of a settlement agreement by the parties in *Broin v. Philip Morris Companies, Inc., et al*. (Circuit Court, Miami-Dade County, Florida, filed October 31, 1991), a class action brought on behalf of flight attendants claiming injury as a result of exposure to environmental tobacco smoke. The settlement agreement, among other things, permitted the plaintiff class members to file these individual suits. These individuals may not seek punitive damages for injuries that arose prior to January 15, 1997. The period for filing Flight Attendant Cases expired in 2000 and no additional cases in this category may be filed.

The judges who have presided over the cases that have been tried have relied upon an order entered in October 2000 by the Circuit Court of Miami-Dade County, Florida. The October 2000 order has been construed by these judges as holding that the flight attendants are not required to prove the substantive liability elements of their claims for negligence, strict liability and breach of implied warranty in order to recover damages. The court further ruled that the trials of these suits are to address whether the plaintiffs' alleged injuries were caused by their exposure to environmental tobacco smoke and, if so, the amount of damages to be awarded.

Defendants have prevailed in seven of the eight cases in which verdicts have been returned. In one of the seven cases in which a defense verdict was returned, the court granted plaintiff's motion for a new trial and, following appeal, the case has been returned to the trial court for a new trial. The six remaining cases in which defense verdicts were returned are concluded. In the single trial decided for the plaintiff, *French v. Philip Morris Incorporated, et al*., the jury awarded $5.5 million in damages. The court, however, reduced this award to $500,000. This verdict, as reduced by the trial court, was affirmed on appeal and the defendants have paid the award. According to Lorillard, as of July 23, 2013, none of the Flight Attendant Cases were scheduled for trial.

Class Action Cases

In most of the class action cases, plaintiffs seek class certification on behalf of groups of cigarette smokers, or the estates of deceased cigarette smokers, who reside in the state in which the case is filed. According to Lorillard, cigarette manufacturers have defeated motions for class certification in a number of cases. Motions for class certification have also been ruled upon in some of the "lights" cases or in other types of class actions. In some of these cases, courts have denied class certification to the plaintiffs, while classes have been certified in other matters.

The *Scott* Case. In one of the class actions, *Scott v. The American Tobacco Company, et al.* (District Court, Orleans Parish, Louisiana, filed May 24, 1996), a class was certified on behalf of certain cigarette smokers resident in the State of Louisiana who desired to participate in medical monitoring or smoking cessation programs and who began smoking prior to September 1, 1988, or who began smoking prior to May 24, 1996 and alleged that defendants undermined compliance with the warnings on cigarette packages. In *Scott*, trial was heard in two phases and at the conclusion of the first phase in July 2003, the

jury rejected medical monitoring, the primary relief requested by plaintiffs, and returned sufficient findings in favor of the class to proceed to a Phase II trial on plaintiffs' request for a statewide smoking cessation program. Phase II of the trial, which concluded in May 2004, resulted in an award of $591 million to fund cessation programs for Louisiana smokers. In February 2007, the Louisiana Court of Appeal reduced the amount of the award by approximately $312 million; struck an award of prejudgment interest, which totaled approximately $444 million as of December 31, 2006; and limited class membership to individuals who began smoking by September 1, 1988, and whose claims accrued by September 1, 1988. The case was returned to the trial court, which subsequently entered an amended final judgment that ordered the defendants to pay approximately $264 million to fund a ten year, court-supervised smoking cessation program for the members of the certified class. The Louisiana Court of Appeal, Fourth Circuit, issued a decision in April 2010 that modified the trial court's 2008 amended final judgment, reducing the judgment amount to approximately $242 million to fund the court-supervised smoking cessation program. Both the Louisiana Supreme Court and the U.S. Supreme Court declined to review the case. In August 2011, following the exhaustion of all appeals, the defendants paid a total of approximately $280 million to satisfy the final judgment and the interest that was due. In May 2012, the parties reached a settlement on the amount of fees and costs to be awarded to plaintiffs' counsel. Plaintiffs agreed that any recovery of fees and costs would come from the court-supervised fund, not the defendants, and indicated they would seek approximately $114 million from the fund. In exchange, defendants agreed to waive 50% of their right to a refund of any unspent money in the fund after the 10-year program is completed. The agreement is not contingent on the trial court's granting plaintiffs' request for additional costs and fees. In December 2012, the court ratified and approved the agreement.

The New York Court of Appeals on May 30, 2013, agreed to consider the following certified questions that it received from the United States Circuit Court of Appeals for the Second Circuit in a medical monitoring class action, *Caronia v. Philip Morris USA,* that is pending in the U.S. District Court for the Eastern District of New York: (1) under New York law, may a current or former longtime heavy smoker who has not been diagnosed with a smoking-related disease, and who is not under investigation by a physician for such a suspected disease, pursue an independent equitable cause of action for medical monitoring for such a disease; (2) and if so, what are the elements of that cause of action; and (3) what is the applicable statute of limitations, and when does that cause of action accrue. With regard to *Caronia* and other medical monitoring class action suits, evolving medical standards and practices could have an impact on the defense of medical monitoring claims. For example, the first publication of the findings of the National Cancer Institute's National Lung Screening Trial in June 2011 reported a 20% reduction in lung cancer deaths among certain long-term smokers receiving Low Dose CT Scanning for lung cancer. Since then, various public health organizations have begun to develop new lung cancer screening guidelines. Also, a number of hospitals have advertised the availability of screening programs. Other studies in this area are ongoing.

Other Class Action Cases. In another Class Action Case, *In Re Tobacco II Cases* (Superior Court, San Diego County, California, JCCP 4042), the California Supreme Court in 2009 vacated an order that had previously decertified a class and returned *In Re Tobacco II* to the trial court for further activity. The class in *In Re Tobacco II* is composed of residents of California who smoked at least one of defendants' cigarettes between June 10, 1993 and April 23, 2001 and who were exposed to defendants' marketing and advertising activities in California. The trial court has permitted plaintiffs to assert claims based on the alleged misrepresentation, concealment and fraudulent marketing of "light" or "ultra-light" cigarettes. In May 2012, the court issued rulings that decertified the class on false statements concerning additives, nicotine manipulation and conspiracy to mislead concerning health risks of smoking. However, the court found that the class action could proceed as to the "light" claims, but that only one of the currently named plaintiffs was suitable to represent the class. In September 2012, the court entered an order that dismissed Lorillard, Reynolds Tobacco and all other defendants except Philip Morris from this case. On October 18, 2012, the Court of Appeal denied the defendants' petition to issue a writ of

mandate. Trial began April 15, 2013. On June 3, 203, Philip Morris filed a motion to decertify the class. The trial concluded on July 10, 2013 and the court took the matter under consideration.

"Lights" Class Action Cases. According to Lorillard, there are approximately 16 Class Action Cases in which plaintiffs' claims are based on the allegedly fraudulent marketing of "light" or "ultra-light" cigarettes. Classes have been certified in some of these cases. In one of the "lights" Class Action Cases, *Good v. Altria Group, Inc., et al*., the U.S. Supreme Court ruled in December 2008 that neither the Federal Cigarette Labeling and Advertising Act nor the Federal Trade Commission's regulation of cigarettes' tar and nicotine disclosures preempts (or bars) certain of plaintiffs' claims. Although the Court rejected the argument that the Federal Trade Commission's actions were so extensive with respect to the descriptors that the state law claims were barred as a matter of federal law, the Court's decision was limited: it did not address the ultimate merits of plaintiffs' claim, the viability of the action as a class action, or other state law issues. The case was returned to the federal court in Maine and consolidated with other federal cases in a multidistrict litigation proceeding, discussed below. In June 2011, the plaintiffs voluntarily dismissed the case without prejudice after the district court denied plaintiffs' motion for class certification, concluding the litigation.

Since the December 2008 United States Supreme Court decision in *Good*, and through July 22, 2013, according to Philip Morris, 26 purported "Lights" class actions were served upon Philip Morris and, in certain cases, Altria. These cases were filed in 15 states, the U.S. Virgin Islands and the District of Columbia. All of these cases either were filed in federal court or were removed to federal court by Philip Morris and were transferred and consolidated by the Judicial Panel on Multidistrict Litigation ("**JPMDL**") before the United States District Court for the District of Maine for pretrial proceedings. In November 2010, the district court denied plaintiffs' motion for class certification in four cases, covering the jurisdictions of California, the District of Columbia, Illinois and Maine. These jurisdictions were selected by the parties as sample cases, with two selected by plaintiffs and two selected by defendants. Plaintiffs sought appellate review of this decision but, in February 2011, the United States Court of Appeals for the First Circuit denied plaintiffs' petition for leave to appeal. Later that year, plaintiffs in 13 cases voluntarily dismissed without prejudice their cases. In April 2012, the JPMDL remanded the remaining four cases back to the federal district courts in which the suits originated. In one of those cases, *Phillips v. Altria Group, Inc.*, which is now pending in the United States District Court for the Northern District of Ohio, defendants filed in June 2012 a motion for partial judgment on the pleadings on plaintiffs' class action consumer sales practices claims and a motion for judgment on the pleadings on plaintiffs' state deceptive trade practices claims. On March 21, 2013, the Court granted defendants' motions and accordingly dismissed plaintiffs' class action consumer sales practices and deceptive trade practices claims with prejudice. On April 18, 2013, defendants filed a motion for judgment on the pleadings on the class component of plaintiffs' common law fraud and unjust enrichment claims. A hearing on plaintiff's motion for class certification is currently set for October 30, 2013.

According to Philip Morris, as of July 22, 2013, in addition to the district court for the District of Maine proceeding, 15 courts in 16 "Lights" cases have refused to certify class actions, dismissed class action allegations, reversed prior class certification decisions or have entered judgment in favor of Philip Morris.

On June 19, 2013, the Oregon Court of Appeals in *Pearson et al. v. Philip Morris Inc.* et al. reversed a Multnomah County Circuit judge's October 2005 decision that had granted summary judgment to Philip Morris USA and dismissed a lawsuit filed against Philip Morris USA in 2002 by two Marlboro Lights smokers. In that case the Court of Appeals ruled that plaintiffs' claims were not preempted by federal law as the circuit court had concluded and were not subject to dismissal on that basis. The Court of Appeals also ruled that the circuit court had erred in not allowing the case to proceed as a class-action suit on behalf of an alleged 100,000 Oregon smokers. In this suit which has been remanded to the circuit

court for further proceedings, plaintiffs allege, among other things, that Philip Morris USA violated the Oregon Unlawful Trade Practices Act by misrepresenting the tar and nicotine characteristics of Marlboro Lights and that, as result of such misrepresentations, plaintiffs had suffered economic losses. On July 17, 2013, Philip Morris filed a petition for reconsideration with the Oregon Court of Appeals.

The *Price* Case. In *Price, et al v. Philip Morris Inc*. (Circuit Court, Madison County, Illinois, filed February 10, 2000) the trial judge found in favor of the plaintiff class and awarded $7.1 billion in compensatory damages and $3 billion in punitive damages against Philip Morris. In December 2005, the Illinois Supreme Court issued its judgment reversing the trial court's judgment in favor of the plaintiffs and directing the trial court to dismiss the case. In December 2006, the defendant's motion to dismiss and for entry of final judgment was granted, and the case was dismissed with prejudice. In December 2008, plaintiffs filed with the trial court a petition for relief from the final judgment and sought to vacate the 2005 Illinois Supreme Court judgment, contending that the U.S. Supreme Court's December 2008 decision in *Good* demonstrated that the Illinois Supreme Court's decision was "inaccurate." In February 2009, the trial court granted Philip Morris's motion to dismiss plaintiffs' petition. In March 2009, the plaintiffs filed a notice of appeal with the Illinois Appellate Court, Fifth Judicial District. In February 2011, the Illinois Appellate Court, Fifth Judicial District reversed the trial court's dismissal of plaintiffs' petition and remanded for further proceedings, and on September 28, 2011, the Illinois Supreme Court denied Philip Morris' petition for leave to appeal that ruling. As a result, the case returned to the trial court for proceedings on whether the court should grant the plaintiffs' petition to reopen the prior judgment. In February 2012, plaintiffs filed an amended petition, which Philip Morris opposed. Subsequently, in responding to Philip Morris's opposition to the amended petition, plaintiffs asked the trial court to reinstate the original judgment. On December 12, 2012, the trial court denied the plaintiffs' request to reopen the prior judgment, and the plaintiffs filed a notice of appeal to the Fifth District Appellate Court on January 8, 2013. On January 23, 2013 Philip Morris filed a motion requesting that the Illinois State Supreme Court directly hear plaintiffs' appeal. On February 15, 2013, the Illinois State Supreme Court denied Philip Morris' motion for direct appeal. It cannot be predicted if or when the Fifth District Appellate Court will hear plaintiffs' appeal over the trial court's December 12, 2012 ruling.

In another case, *Larsen v. Philip Morris Inc.* (formerly *Craft v. Philip Morris Inc.*), a Missouri Court of Appeals in August 2005 affirmed a class certification order for current and former smokers of Marlboro Lights. (The class period is 1995 through 2003.) In June 2011, Philip Morris filed various summary judgment motions challenging the plaintiffs' claims. In August 2011, the trial court granted Philip Morris's motion for partial summary judgment, ruling that plaintiffs could not present a damages claim based on allegations that Marlboro Lights are more dangerous than Marlboro Reds, and denied Philip Morris's remaining summary judgment motions. Trial began in September 2011, and in October 2011 the trial court declared a mistrial after the jury failed to reach a verdict. The court has continued the new trial through January 2014, with an exact date to be determined.

In early 2013, the U.S. District Court for Massachusetts in *Donovan v. Philip Morris* finalized the certified class and approved the notice plan for certain Massachusetts plaintiffs potentially affected by smoking Marlboro cigarettes. Plaintiffs seek compensation for medical monitoring of incipient and not yet detected or diagnosed cancers. In September 2010, the First Circuit U.S. Court of Appeals denied defendant Philip Morris' petition for interlocutory review of class certification. As of July 2013, the parties are in the process of satisfying the class action notice requirements and identifying potential class members.

In September 2013 a California Superior Court judge in *Brown v. The American Tobacco Co., Inc*. ruled in favor of defendant PM USA and rejected the class plaintiffs' claims for recovery of a portion of the money paid by California smokers who purchased Marlboro Lights between 1998 and 2001. The plaintiffs claimed that defendant PM USA violated California's Unfair Competition Law and False

Advertising Law by using the terms "Lights" and "Lowered Tar and Nicotine" on cigarette packages. In this ruling the court concluded that, based on the totality of the evidence presented, plaintiffs were not entitled to any restitution of the payments they made for defendant's cigarettes. The Court also ruled that plaintiffs' request for injunctive relief was moot because "the evidence established that the descriptors on which the Plaintiffs base their case have been removed and, because of changes in the law, these descriptors can never be used again."

Reimbursement Cases

Reimbursement Cases are brought by or on behalf of entities seeking equitable relief and reimbursement of expenses incurred in providing health care to individuals who allegedly were injured by smoking. Plaintiffs in these cases have included the U.S. federal government, U.S. state and local governments, foreign governmental entities, hospitals or hospital districts, American Indian tribes, labor unions, private companies and private citizens.

The *DOJ* Case. In August 2006, the U.S. District Court for the District of Columbia issued its final judgment and remedial order in the federal government's reimbursement suit, *United States of America v. Philip Morris*, which final judgment and remedial order concluded a bench trial that began in September 2004. The court determined in its final judgment and remedial order that the defendants violated certain provisions of the RICO statute, that there was a likelihood of present and future RICO violations, and that equitable relief was warranted. The government was not awarded monetary damages. The equitable relief included permanent injunctions that prohibit the defendants from engaging in any act of racketeering, as defined under RICO; from making any material false or deceptive statements concerning cigarettes; from making any express or implied statement about health on cigarette packaging or promotional materials (these prohibitions include a ban on using such descriptors as "low tar," "light," "ultra-light," "mild" or "natural"); from making any statements that "low tar," "light," "ultra-light," "mild" or "natural" or low-nicotine cigarettes may result in a reduced risk of disease; and from participating in the management or control of certain entities or their successors. The final judgment and remedial order also requires the defendants to make corrective statements on their websites, in certain media, in point-of-sale advertisements, and on cigarette package "inserts" (as described below). The final judgment and remedial order also requires defendants to make disclosures of disaggregated marketing data to the government, and to make document disclosures on a website and in a physical depository, and also prohibits each defendant that manufactures cigarettes from selling any of its cigarette brands or certain elements of its business unless certain conditions are met.

Following trial, the final judgment and remedial order was stayed because the defendants, the government and several intervenors noticed appeals to the Circuit Court of Appeals for the District of Columbia. In May 2009, a three judge panel upheld substantially all of the District Court's final judgment and remedial order. In September 2009, the Court of Appeals denied defendants' rehearing petitions as well as their motion to vacate those statements in the appellate ruling that address defendants' marketing of "low tar" or "lights" cigarettes, to vacate those parts of the trial court's judgment on that issue, and to remand the case with instructions to deny as moot the government's allegations and requested relief regarding "lights" cigarettes. In June 2010, the U.S. Supreme Court denied all of the petitions for review of the case. The case was returned to the trial court for implementation of the Court of Appeals' directions in its 2009 ruling and for entry of an amended final judgment. In March 2011, defendants filed a motion to vacate the court's factual findings and remedial order on alternative grounds, and on June 1, 2011, the trial court denied defendants' motion. Defendants filed a notice of appeal, and in July 2012 the appellate court affirmed the District Court's ruling, permitting the case to proceed. In response to the government's motion requesting clarification, the trial court held in April 2011 that the defendants must provide a broad range of data for the ten-year period beginning July 29, 2010, and that the Department of Justice may share that data with other governmental agencies, subject to the

confidentiality requirements previously imposed by the trial court. The defendants noticed an appeal from this order to the U.S. Court of Appeals for the District of Columbia Circuit. In July 2012, the appellate court dismissed the appeal for lack of jurisdiction, and the defendants have not sought further review of that decision.

On November 27, 2012 the U.S. District Court for the District of Columbia issued an order specifying the text of the corrective statements that the defendants must make on their websites. The court ordered that the corrective statements include statements to the effect that a federal court has ruled that the tobacco companies deliberately deceived the American public about the health effects of smoking and secondhand smoke and the addictiveness of smoking and nicotine, and deliberately deceived the American public by falsely selling and advertising low tar and light cigarettes as less harmful than regular cigarettes and by designing cigarettes to enhance the delivery of nicotine. In addition, the court ordered that the corrective statements contain statements including, among other things, that smoking kills on average 1,200 Americans every day, results in various detrimental health conditions and is highly addictive, that low tar and light cigarettes are not less harmful than regular cigarettes and cause some of the same detrimental health conditions that regular cigarettes cause, that tobacco companies intentionally designed cigarettes to make them more addictive, and that secondhand smoke causes lung cancer and coronary heart disease in adults who do not smoke. The court further ordered that the parties are to engage in discussions with the court, to conclude by March 1, 2013, regarding implementation of the corrective statements. The PMs have not reported any updates as to such discussions in their SEC filings. According to Reynolds American, proceedings are pending before the district court to determine whether the corrective statements will have to be displayed at retail points of sale. In January 2013, defendants appealed to the U.S. Court of Appeals for the District of Columbia Circuit the district court's November 2012 order on the text of the corrective statements. Defendants also filed a motion to hold the appeal in abeyance pending the completion of related proceedings in the district court regarding the implementation of the corrective statements. On February 15, 2013, the Court of Appeals granted the defendants' motion to hold the case in abeyance pending the District Court's resolution of corrective statement implementation issues. The District Court has not entered an amended final judgment. Reynolds American has stated in its Form 10-K filed with the SEC for the calendar year 2012 that if the corrective statements remedy is implemented, Reynolds Tobacco would incur significant compliance costs and there could be an adverse effect on product sales.

Tobacco-Related Antitrust Cases

Indirect Purchaser Suits. Approximately 30 antitrust suits were filed in 2000 and 2001 on behalf of putative classes of consumers in various state courts against cigarette manufacturers. The suits all alleged that the defendants entered into agreements to fix the wholesale prices of cigarettes in violation of state antitrust laws which permit indirect purchasers, such as retailers and consumers, to sue under price fixing or consumer fraud statutes. More than 20 states permit such suits. Four indirect purchaser suits, in New York, Florida, New Mexico and Michigan, thereafter were dismissed by courts in those states. The actions in all other states, except for Kansas, were either voluntarily dismissed or dismissed by the courts.

In the Kansas case, *Smith v. Philip Morris Cos., Inc.*, the District Court of Seward County, Kansas certified a class of Kansas indirect purchasers in 2002. In July 2006, the court issued an order confirming that fact discovery was closed, with the exception of privilege issues that the court determined, based on a court special master's report, justified further fact discovery. In October 2007, the court denied all of the defendants' privilege claims, and the Kansas Supreme Court thereafter denied a petition seeking to overturn that ruling. On March 23, 2012, the District Court of Seward County granted the defendants' motions for summary judgment dismissing the Kansas suit. Plaintiff's motion for reconsideration was denied. On July 18, 2012, plaintiff filed a notice of appeal to the Court of Appeals for the State of Kansas, and in August 2012 the defendants cross-appealed the trial court's class certification

decision. After various delays, appellate briefing is currently underway with the Court of Appeals of Kansas.

For a discussion of *VIBO* and other litigation involving claims of antitrust violations, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

Other Litigation

By way of example only, and not as an exclusive or complete list, the following are additional types of tobacco-related litigation which the tobacco industry is also the target of: (a) asbestos contribution cases, where asbestos manufacturers and related parties seek contribution or reimbursement where asbestos claims were allegedly caused in whole or in part by cigarette smoking, (b) patent infringement claims, (c) "ignition propensity cases" where wrongful death actions contend fires caused by cigarettes led to other individuals' deaths, (d) "filter cases" which mostly have been filed against Lorillard for alleged exposure to asbestos fibers there were incorporated into filter material used in one brand of cigarettes manufactured by Lorillard over 50 years ago, (e) claims related to smokeless tobacco products, (f) ERISA claims, and (g) employment litigation claims.

Defenses

The PMs believe that they have valid defenses to the cases pending against them as well as valid bases for appeal should any adverse verdicts be returned against them. While PMs have indicated their intent to defend vigorously all tobacco products liability litigation, it is not possible to predict the outcome of any litigation. Litigation is subject to many uncertainties. Plaintiffs have prevailed in several cases, as noted herein, and it is possible that one or more of the pending actions could be decided unfavorably as to the PMs or the other defendants. According to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, as of July 22, 2013, 12 *Engle* Progeny Cases against Philip Morris were scheduled for trial through the end of 2013 and 3 non-*Engle* Progeny Cases against Philip Morris were scheduled for trial through the end of 2013. The PMs may enter into discussions in an attempt to settle particular cases if the PMs believe it is appropriate to do so.

Some plaintiffs have been awarded damages from cigarette manufacturers at trial. While some of these awards have been overturned or reduced, other damages awards have been paid after the manufacturers have exhausted their appeals. These awards and other litigation activities against cigarette manufacturers and health issues related to tobacco products also continue to receive media attention. It is possible, for example, that the 2006 verdict in *United States of America v. Philip Morris*, which made many adverse findings regarding the conduct of the defendants, could form the basis of allegations by other plaintiffs or additional judicial findings against cigarette manufacturers. In addition, the U.S. Supreme Court ruling in *Good v. Altria* could result in further "lights" litigation. Any such developments could have material adverse effects on the ability of the PMs to prevail in smoking and health litigation and could influence the filing of new suits against the PMs.

The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon the examination or analysis by the Authority of the court records of the cases mentioned or of any other court records. It is based on SEC filings by the OPMs and on other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2013 Bonds are referred to the reports filed with the SEC by the OPMs and applicable court records for additional descriptions thereof.

Litigation is subject to many uncertainties. In its SEC filings, Reynolds American has stated that the possibility of material losses related to tobacco litigation is more than remote, but that generally, it is not possible to predict the outcome of the litigation or reasonably estimate the amount or range of any possible loss. This OPM has disclosed that notwithstanding the quality of defenses available to it and its affiliates in tobacco-related litigation matters, it is possible that its consolidated results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending or future litigation matters or difficulties in obtaining the bonds required to stay execution of judgments on appeal. 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 materially adversely affect the business of the PMs and the market for or prices of securities such as the Series 2013 Bonds payable from tobacco settlement payments made under the MSA.

SUMMARY OF IHS GLOBAL REPORT

The following is a brief summary of the IHS Global Report, a copy of which is attached hereto as Appendix D. This summary does not purport to be complete and the IHS Global Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The IHS Global Report forecasts future United States 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, but are substantially the same when compared over a period of time.

IHS Global 's forecasts, including, but not limited to, regarding future cigarette consumption, are estimates, which have been prepared by IHS Global 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 forecasts. The cigarette consumption forecast contained in the IHS Global Report is based upon assumptions as to future events and, accordingly, is subject to varying degrees of uncertainty. Some assumptions inevitably will not materialize and, additionally, unanticipated events and circumstances may occur. Therefore, for example, actual cigarette consumption inevitably will vary from the forecast included in the IHS Global Report and the variations may be material and adverse.

General

IHS Global Inc. ("**IHS Global**"), formerly known as DRI•WEFA, Inc., has prepared a report dated October 2, 2013 on the consumption of cigarettes in the United States from 2013 through 2033 entitled, "A Forecast of U.S. Cigarette Consumption (2013-2033) for the Tobacco Settlement Authority" (the **"IHS Global Report**"). IHS Global is an internationally recognized econometric and consulting firm of over 300 economists and is a part of IHS Inc., a global information company with over 1,000 researchers, analysts, and economists in more than 30 countries.

IHS Global developed a cigarette consumption model based on historical U.S. data between 1965 and 2012. IHS Global 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. IHS Global 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 workplace smoking restrictions first instituted widely in the 1980s, the stricter restrictions on smoking in public places instituted over the last decade, and the trend over time in individual behavior and preferences. The forecast is based on reasonable assumptions regarding the future paths of these factors. IHS Global's econometric model, coupled with their long term

forecast of the U.S. economy, has been used to project total U.S. cigarette consumption from 2013 through 2033. The forecast indicates that total consumption in 2033 will be approximately 149 billion cigarettes (or 150 billion including roll-your-own tobacco equivalents), a 48% decline from the 2012 level. From 2012 through 2033 the average annual rate of decline is projected to be 3.1%.

Cigarette Consumption in the United States

The U.S. Department of Agriculture, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion cigarettes in 1900 to a peak of 640 billion in 1981. Following the release of the Surgeon General's report in 1964, cigarette consumption continued to increase at an average annual rate of 1.2% between 1965 and 1981. Between 1981 and 1990, U.S. cigarette consumption declined at an average annual rate of 2.2%. From 1990 to 1998, the average annual rate of decline in cigarette consumption was 1.5%; the decline increased to 3.1% in 1998 (with a consumption level of 465 billion cigarettes in that year) and increased further to 6.5% in 1999. In 2000 and 2001, the rate of decline moderated to 1.2%, and then accelerated in 2002-2003 to an annual rate of 3.0% (with consumption of less than 400 billion cigarettes in 2003). The decline moderated for the next four years, through 2007, averaging 2.3%. The rate of decline accelerated dramatically beginning in 2008, with a 3.8% decline in the number of cigarettes (including roll-your-own equivalents to cigarettes as defined by the MSA at 0.0325 ounces of loose tobacco per cigarette) for that year, 9.1% in 2009, and 6.4% in 2010 before finally decelerating to 2.7% in 2011 and 2.0% in 2012. IHS Global correlates these declines with large price increases in 1998 and 1999 following the execution of the MSA and the Previously Settled State Settlements and a large number of state excise tax increases in the early part of the 2000s.

Factors Affecting Cigarette Consumption

The IHS Global Report notes that the following factors affect smoking in some manner and are variables that are relevant in building a model of cigarette demand: (i) general population growth, (ii) price increases, (iii) changes in disposable income, (iv) youth consumption, (v) trend over time, (vi) workplace smoking bans, (vii) smoking bans in public places, (viii) nicotine dependence and (ix) health warnings.

Price Elasticity of Demand. The IHS Global Report notes that according to economic research, the demand for cigarettes is price inelastic, with an elasticity generally found to be between -0.3 and -0.5. Pursuant to IHS Global's multivariate regression analysis using U.S. data from 1965 to 2012, the long-run price elasticity of consumption for the entire population is -0.33 (signifying that a 1.0% increase in the price of cigarettes decreases consumption by 0.33%).

Changes in Disposable Income. Pursuant to IHS Global's multivariate regression analysis, the income elasticity of consumption is 0.27 (signifying that a 1.0% increase in real disposable income per capita increases per capita cigarette consumption by 0.27%).

Youth Consumption. IHS Global compiled U.S. data from the CDC that measures the incidence of smoking in the 12-17 year 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 that decade. IHS Global assumes in its report that this recent trend peaked in the late 1990s and that youth smoking has resumed its longer term decline.

Trend Over Time and Health Warnings. The IHS Global Report notes that since 1964 there has been a significant decline in adult per capita cigarette consumption. The Surgeon General's health warning in 1964 and numerous subsequent mandatory health warnings, together with the increased health

awareness and knowledge of the population over the past thirty years, may have contributed to decreases in cigarette consumption levels. If, as IHS Global assumes, the awareness of the adult population continues to change in this way, IHS Global reports that overall consumption of cigarettes will decline gradually over time.

Smoking Bans in Public Places. The IHS Global Report notes that beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. In September 2003 Alabama joined the other 49 states and the District of Columbia in requiring smoke-free indoor air to some degree or in some public places. The most comprehensive bans, extending to restaurants and bars, have been enacted since 1998 in 39 states and a number of large cities. Restrictions to all workplaces, restaurants and bars cover 47.9% of the U.S. Based on its regression analysis using data from 1965 to 2012, IHS Global estimates that the restrictions on workplace smoking instituted beginning in the late 1970s have reduced smoking by about 2%.

Smokeless Tobacco Products. The IHS Global Report notes that chewing tobacco and snuff are the most significant components of the smokeless tobacco product market, and that snuff use is often criticized as a gateway to cigarette use.

Nicotine Dependence. The IHS Global Report notes that 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; and the American Medical Association Council on Scientific Affairs found that one-third to one-half of all people who experiment with smoking become smokers.

Regulation. The IHS Global Report notes that since June 22, 2009, when President Obama signed the FSPTCA, the FDA has had broad authority over the sale, distribution, and advertising of tobacco products. Such legislation significantly restricts tobacco marketing and sales to youth, requires the disclosure of cigarette ingredients, requires bigger and bolder health warnings, and bans labels thought to be deceptive, such as “light”, and “low tar” from cigarettes. A significant issue before the FDA is the role of menthol cigarettes. IHS Global reports that menthol cigarette sales represent almost 30% of total cigarette sales. Menthol smoking rates have also increased among young adults during the past decade. In September 2012 the American Journal of Public Health published the first peer-reviewed data on menthol smokers, showing that nearly 40% of menthol smokers say they would quit smoking if menthol cigarettes were no longer available. The IHS Global Report states that while an outright ban by the FDA would no doubt prompt a significant number of these smokers to switch to other brands, any significant amount of quitting as a result would have a large negative effect on total consumption and sales. The survey suggests that the effect might be as large as a 12% reduction in cigarette consumption. Another profound action the FDA is empowered to take is to mandate the reduction of nicotine levels in cigarettes, perhaps opting to phase out nicotine over some time period. IHS Global’s empirical model incorporates a negative impact on cigarette consumption due to tobacco tax increases, and a negative trend decline in levels of smoking since the Surgeon General’s 1964 warning, subsequent anti-smoking initiatives, and regulations which restrict smoking. Their model and forecast acknowledges the efficacy of these activities in reducing smoking and assumes that the effectiveness of such anti-smoking efforts will continue.

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 the case of the IHS Global Report, adult per capita cigarette consumption. IHS Global has 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; (2) the level of real disposable income per capita; (3) the impact of restrictions on smoking in public places; and (4) the trend over time in individual behavior and preferences.

IHS Global 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. Using that relationship, along with a standard population growth forecast, IHS Global projected actual cigarette consumption (in billions of cigarettes) out to 2033. The forecast also takes into account the effect of the Surgeon General's health warning in 1964 and the effect of nicotine dependence.

According to IHS Global's regression equation, cigarette consumption per capita displays a trend decline of 2.4% per year. The trend reflects the impact of a systematic change in public attitudes toward smoking and may also reflect the cumulative impact of health warnings, advertising restrictions, and other variables that are statistically insignificant when viewed in isolation.

IHS Global's 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 IHS Global forecasts. Annual population growth is projected to average 0.7%, and real per capita personal disposable income is projected to increase over the long term at just over 2.1% per year. The forecast assumptions have incorporated price increases in excess of general inflation to offset excise and other taxes. IHS Global projects that relative to other goods, cigarette prices will rise by an average of 1.9% per year over the long term. IHS Global also projects in its report that, if enacted, the increase in the federal excise tax to $1.95 per pack contained in President Obama's federal budget would reduce cigarette consumption by an additional 4.6%, resulting in a total decline of approximately 8.0% in the first year after enactment. In addition, IHS Global assumes in its report that the prevalence of indoor and outdoor restrictions on smoking will continue to increase, that by 2020 100% of states and municipalities will completely restrict smoking in workplaces, restaurants and bars, and that outdoor and residential restrictions will also proliferate over the following decades.

IHS Global projects the average annual rate of decline from 2012 through 2033 to be 3.1%, with total consumption in 2033 projected to be approximately 149 billion cigarettes, a 48% decline from the 2012 level.

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2013 Bonds will be as assumed, or that the other assumptions underlying the Collection Methodology and Assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. See "BONDHOLDERS' RISKS" herein.

SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS

Introduction

The following discussion describes the methodology and assumptions used to project the amount of Pledged TSRs to be received by the Authority (the **"Collection Methodology and Assumptions**"), as well as the methodology and assumptions used to structure the schedule of principal for the Series 2013 Bonds (the "**Bond Structuring Assumptions**"). The assumptions set forth herein are only assumptions and no guarantee can be made as to the ultimate outcome of certain events assumed herein. If actual results are different from those assumed, it could have a material effect on the receipt of Pledged TSRs.

In projecting Pledged TSRs to be received by the Authority, the forecast of cigarette consumption in the United States developed by IHS Global and described in the IHS Global Report (the "**IHS Global Forecast**") was applied to the Annual Payments and Strategic Contribution Payments to be made by the PMs pursuant to the MSA. The calculation of payments required to be made was performed in accordance with the terms of the MSA; however, as described below, certain assumptions were made with respect to consumption of cigarettes in the United States and the applicability of certain adjustments and offsets to such payments set forth in the MSA. In addition, it was assumed that the PMs make all payments required to be made by them pursuant to the MSA, and that the market share for each class of the PMs remains constant throughout the collection forecast period at 84.621% for the OPMs (based on sales year 2012 OPM cigarette shipments of 245,486,000,000 divided by total net market cigarette shipments of 290,102,238,941 as reported by NAAG, each measuring roll-your-own shipments at 0.0325 ounces per cigarette conversion rate) and 9.11% for the SPMs based on the NAAG reported market share for SPMs in sales year 2012 measuring roll-your-own at 0.09 ounces per cigarette conversion rate.[†] It was further assumed that each company that is currently a PM remains such throughout the term of the Series 2013 Bonds.

Collection Methodology and Assumptions

In applying the IHS Global Forecast, it was assumed that United States cigarette consumption was equal to the number of cigarettes shipped in and to the United States, the District of Columbia and Puerto Rico, which is the number that is applied to determine the Volume Adjustment. The IHS Global 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. The IHS Global Forecast for United States cigarette consumption is set forth herein under "SUMMARY OF THE IHS GLOBAL REPORT." See the copy of the IHS Global Report attached hereto as APPENDIX D for a discussion of the assumptions underlying the projections of cigarette consumption contained therein.

Annual Payments and Strategic Contribution Payments

The amount of Annual Payments and Strategic Contribution Payments to be made by the PMs was calculated by applying the adjustments applicable to the base amounts of such Annual Payments and Strategic Contribution Payments in the order, and in the amounts, set out in the MSA, as follows:

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Annual Payments and Strategic Contribution Payments set forth in the MSA. The inflation rate is compounded annually from 1999 at the greater of 3.0% or the percentage increase in the CPI in the prior year as published by the Bureau of Labor Statistics (released each January). The calculations of Annual Payments and Strategic Contribution Payments assume the minimum Inflation Adjustment provided in the MSA of 3.0% in every year except for calendar years 2000, 2004, 2005 and 2007, where actual CPI results of 3.387%, 3.256%, 3.416% and 4.081% respectively, were used. Thereafter, the Inflation Adjustment was assumed to be the minimum provided in the MSA, at a rate of 3.0% per year, compounded annually, for the rest of the collection forecast period.

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

Volume Adjustment. Next, 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 IHS Global Forecast for United States cigarette consumption to the OPM shipments as reported to MSAI. No add back or benefit was assumed from any Income Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – *Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

Previously-Settled States Reduction. Next, the Annual Payments 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 State Reduction does not apply to Strategic Contribution Payments. The Previously-Settled States Reduction is as follows for each year of the following period:

2013 through 2017	12.2373756%
2018 and after	11.0666667%

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

NPM Adjustment. The PMs have disputed Annual Payments attributable to sales years 2003 through 2012 and Strategic Contribution Payments attributable to sales years 2007 through 2012, and a portion of such payments have either been withheld or deposited in the Disputed Payments Account in each year since 2006. However, the Collection Methodology and Assumptions include an assumption that the State has diligently enforced and will diligently enforce a Qualifying Statute that is not held to be unenforceable. Therefore, the NPM Adjustment is assumed not to reduce Annual Payments and Strategic Contribution Payments throughout the period forecasted in the IHS Global Report. In addition, for payment year 2014, the Annual Payment is assumed to be increased pursuant to the resolution of the 2003 NPM Adjustment dispute by an amount equal to 29.2% of the State's share of the related principal amount on deposit in the Disputed Payments Account. For a discussion of the State's Qualifying Statute (which is a Model Statute), see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Relating to Model/Qualifying Statutes."

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

Litigating Releasing Parties Offset. The Collection Methodology and Assumptions include an assumption that the Litigating Releasing Parties Offset will not apply.

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

Subsequent Participating Manufacturers. The Collection Methodology and Assumptions treat the SPMs as a single manufacturer having executed the MSA on or prior to February 22, 1997 for purposes of calculating Annual Payments and Strategic Contribution Payments under Section IX(i) of the MSA. Further, the Market Share of the SPMs is determined assuming 0.09 ounces of roll-your-own tobacco constitute an individual Cigarette and is assumed to remain constant at 9.11% throughout the forecast period. Because the SPM Market Share exceeds the Base Share, the SPMs are assumed to make Annual Payments and Strategic Contribution Payments in each year in the same manner as the OPMs but

assuming a Market Share equal to (y) the SPM Market Share (9.11%) less the Base Share (3.539%) divided by (z) the aggregate Market Share of the OPMs based on measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate (84.81%).

Allocation Percentage for the State of Washington Under the MSA. The amounts of Annual Payments and Strategic Contribution Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled State Reduction (applicable only to Annual Payments) for each year were multiplied by the Allocation Percentage for the State (2.0532582% for Annual Payments and 5.7647432% for Strategic Contribution Payments under the MSA) 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 State.

Pledged TSRs. The amounts of Annual Payments and Strategic Contribution Payments in each year to be allocated to the State under the MSA calculated as described in the preceding paragraph, was multiplied by 29.2% as per the Sale Agreement.

Miscellaneous. The Collection Methodology and Assumptions further assume that no Lump Sum Payment or Partial Lump Sum Payment is received.

The following tables shows the projection of Annual Payments and Strategic Contribution Payments to be received by the Indenture Trustee through the year 2033, calculated in accordance with the Collection Methodology and Assumptions.

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Projection of Annual Payments to be Received by the Indenture Trustee

Payment Year	IHS Global Consumption Forecast[1]	Estimated OPM Consumption[1]	Base Annual Payments ($)	Inflation Adjustment ($)	Volume Adjustment ($)	Previously Settled States Reduction ($)	Subtotal ($)	Authority's Allocation[2]	2003 NPM Adjustment Recovery[3] ($)	OPM Annual Payments to Trustee ($)	SPM Annual Payments to Trustee ($)	Total Annual Payments to Trustee ($)
2014	279,295,119,986	236,342,323,483	8,139,000,000	4,806,475,055	(6,382,908,331)	(803,085,939)	5,759,480,785	0.5995513944%	4,340,016	34,531,047	2,584,558	41,455,621
2015	269,774,433,914	228,285,823,722	8,139,000,000	5,194,839,649	(6,795,722,916)	(800,093,902)	5,738,022,832	0.5995513944%		34,402,396	2,574,929	36,977,324
2016	260,485,395,316	220,425,346,370	8,139,000,000	5,594,855,221	(7,222,015,129)	(796,878,331)	5,714,961,762	0.5995513944%		34,264,133	2,564,580	36,828,713
2017	251,427,399,649	212,760,379,857	8,139,000,000	6,006,870,935	(7,662,070,407)	(793,447,024)	5,690,353,504	0.5995513944%		34,116,594	2,553,537	36,670,131
2018	242,414,080,963	205,133,219,452	9,000,000,000	7,111,589,400	(8,979,979,069)	(789,231,546)	6,342,378,785	0.5995513944%		38,025,820	2,808,666	40,834,487
2019	233,769,158,815	197,817,799,880	9,000,000,000	7,594,937,100	(9,499,498,179)	(785,228,576)	6,310,210,345	0.5995513944%		37,832,954	2,794,421	40,627,375
2020	225,599,306,356	190,904,389,031	9,000,000,000	8,092,785,600	(10,027,949,339)	(781,841,882)	6,282,994,379	0.5995513944%		37,669,780	2,782,368	40,452,149
2021	218,018,103,255	184,489,099,155	9,000,000,000	8,605,569,600	(10,561,489,722)	(779,544,842)	6,264,535,036	0.5995513944%		37,559,107	2,774,194	40,333,301
2022	210,863,510,392	178,434,811,129	9,000,000,000	9,133,736,400	(11,104,529,487)	(777,898,901)	6,251,308,012	0.5995513944%		37,479,804	2,768,336	40,248,141
2023	204,239,555,591	172,829,554,337	9,000,000,000	9,677,748,600	(11,653,366,923)	(777,364,908)	6,247,016,769	0.5995513944%		37,454,076	2,766,436	40,220,512
2024	198,079,466,308	167,616,825,184	9,000,000,000	10,238,081,400	(12,209,582,272)	(777,820,573)	6,250,678,556	0.5995513944%		37,476,030	2,768,058	40,244,088
2025	192,372,515,647	162,787,546,465	9,000,000,000	10,815,223,500	(12,773,027,495)	(779,336,360)	6,262,859,645	0.5995513944%		37,549,062	2,773,452	40,322,514
2026	187,032,210,914	158,268,527,198	9,000,000,000	11,409,679,800	(13,346,244,258)	(781,686,869)	6,281,748,673	0.5995513944%		37,662,312	2,781,817	40,444,128
2027	181,971,178,180	153,985,830,688	9,000,000,000	12,021,970,500	(13,932,123,202)	(784,609,770)	6,305,237,528	0.5995513944%		37,803,140	2,792,218	40,595,358
2028	177,120,507,606	149,881,144,741	9,000,000,000	12,652,629,300	(14,533,201,584)	(787,883,336)	6,331,544,380	0.5995513944%		37,960,863	2,803,868	40,764,731
2029	172,403,769,044	145,889,793,402	9,000,000,000	13,302,207,900	(15,152,598,113)	(791,223,485)	6,358,386,302	0.5995513944%		38,121,794	2,815,755	40,937,549
2030	167,788,108,886	141,983,975,620	9,000,000,000	13,971,274,200	(15,792,030,656)	(794,502,955)	6,384,740,590	0.5995513944%		38,279,801	2,827,426	41,107,227
2031	163,285,479,393	138,173,805,517	9,000,000,000	14,660,412,300	(16,451,529,063)	(797,783,081)	6,411,100,156	0.5995513944%		38,437,840	2,839,099	41,276,939
2032	158,907,396,419	134,469,027,924	9,000,000,000	15,370,224,300	(17,131,092,590)	(801,130,578)	6,438,001,132	0.5995513944%		38,599,126	2,851,012	41,450,137
2033	154,649,219,927	130,865,716,394	9,000,000,000	16,101,331,200	(17,831,376,460)	(804,541,660)	6,465,413,080	0.5995513944%		38,763,474	2,863,151	41,626,625

(1) Consumption amounts are for the previous sales year.
(2) The State of Washington is entitled to 2.0532582% of the Annual Payments under the MSA. The Pledged TSRs constitute 29.2% of the tobacco settlement revenues.
(3) 29.2% of the State's share of the related principal amount on deposit in the Disputed Payments Account.

Projection of Strategic Contribution Payments and Total Payments to be Received by the Indenture Trustee

			Total Payments										
Payment Year	IHS Global Consumption Forecast[(1)]	Estimated OPM Consumption[(1)]	Base Strategic Contribution Payments ($)	Inflation Adjustment ($)	Volume Adjustment ($)	Subtotal ($)	Authority's Allocation[(2)]	OPM Strategic Contribution Payments to Trustee ($)	SPM Strategic Contribution Payments to Trustee ($)	Total Strategic Contribution Payments to Trustee ($)	Total Annual Payments to Trustee ($)	Total Payments to Trustee ($)[(3)]
2014	279,295,119,986	236,342,323,483	861,000,000	508,462,345	(675,228,415)	694,233,929	1.6833050144%	11,686,075	767,635	12,453,710	41,455,621	53,909,330
2015	269,774,433,914	228,285,823,722	861,000,000	549,546,251	(718,898,812)	691,647,439	1.6833050144%	11,642,536	764,775	12,407,311	36,977,324	49,384,635
2016	260,485,395,316	220,425,346,370	861,000,000	591,862,679	(763,994,966)	688,867,713	1.6833050144%	11,595,745	761,701	12,357,446	36,828,713	49,186,159
2017	251,427,399,649	212,760,379,857	861,000,000	635,448,566	(810,547,072)	685,901,493	1.6833050144%	11,545,814	758,422	12,304,236	36,670,131	48,974,367
2018	242,414,080,963	205,133,219,452									40,834,487	40,834,487
2019	233,769,158,815	197,817,799,880									40,627,375	40,627,375
2020	225,599,306,356	190,904,389,031									40,452,149	40,452,149
2021	218,018,103,255	184,489,099,155									40,333,301	40,333,301
2022	210,863,510,392	178,434,811,129									40,248,141	40,248,141
2023	204,239,555,591	172,829,554,337									40,220,512	40,220,512
2024	198,079,466,308	167,616,825,184									40,244,088	40,244,088
2025	192,372,515,647	162,787,546,465									40,322,514	40,322,514
2026	187,032,210,914	158,268,527,198									40,444,128	40,444,128
2027	181,971,178,180	153,985,830,688									40,595,358	40,595,358
2028	177,120,507,606	149,881,144,741									40,764,731	40,764,731
2029	172,403,769,044	145,889,793,402									40,937,549	40,937,549
2030	167,788,108,886	141,983,975,620									41,107,227	41,107,227
2031	163,285,479,393	138,173,805,517									41,276,939	41,276,939
2032	158,907,396,419	134,469,027,924									41,450,137	41,450,137
2033	154,649,219,927	130,865,716,394									41,626,625	41,626,625

(1) Consumption amounts are for the previous sales year.
(2) The State of Washington is entitled to 5.7647432% of the Strategic Contribution Payments under the MSA. The Pledged TSRs constitute 29.2% of the tobacco settlement revenues.
(3) Totals may not add due to rounding.

Bond Structuring Assumptions

Issue Size. The objective in issuing the Series 2013 Bonds is to receive proceeds, after application of certain amounts available in the Debt Service Fund and the Liquidity Reserve Account, in an amount sufficient to: (i) refund all of the Outstanding Series 2002 Bonds in the aggregate principal amount of $369,900,000 and (ii) pay the costs of issuance of the Series 2013 Bonds.

Liquidity Reserve Account. The Liquidity Reserve Account will be funded in an amount equal to $31,997,719.44 and must be maintained, to the extent of available funds, at that level.

Interest Earnings. The Collection Methodology and Assumptions assume that the Indenture Trustee will receive ten days after April 15 its entitlement of the Annual Payments owed by the PMs in payment year 2014 and each year thereafter. It is further assumed that the Indenture Trustee will receive ten days after April 15 its entitlement of the Strategic Contribution Payments owed by the PMs in the payment years 2014 through 2017. Interest earnings are assumed at 0% per annum on the Annual Payments and Strategic Contribution Payments from the date of receipt by the Indenture Trustee until the applicable Distribution Date. No interest earnings have been assumed on the Annual Payments and Strategic Contribution Payments prior to the time they are received by the applicable Trustee.

Moneys deposited in the Liquidity Reserve Account are assumed to be invested at rates increasing from 0.03% per annum from December 1, 2013 to 0.75% per annum from December 1, 2018 and thereafter.

Operating Expense Assumptions. Operating expenses of the Authority have been assumed at the Operating Cap of $351,973.64 with respect to the period ending June 30, 2014, inflated at 3.00% per year thereafter. No arbitrage rebate expense was assumed.

Issuance Date. The Series 2013 Bonds are assumed to be issued on October 17, 2013.

Interest Rates. The Series 2013 Bonds are assumed to bear interest at the rates set forth on the inside front cover hereof.

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2013 Bonds will be as assumed, or that the other assumptions underlying the Collection Methodology and Assumptions and Bond Structuring Assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Collection Methodology and Assumptions or Bond Structuring Assumptions, the amount of Pledged TSRs available to the Authority to pay the principal of and interest on the Series 2013 Bonds could be adversely affected. See "BONDHOLDERS' RISKS" herein.

CONTINUING DISCLOSURE AGREEMENT

In order to assist the Underwriters in complying with the provisions of paragraph (b)(5) of Rule 15c2-12 (the "**Rule**"), promulgated by the SEC under the Securities Exchange Act of 1934, as amended (the "**1934 Act**") for the benefit of the holders and Beneficial Owners of the Series 2013 Bonds, the Authority and U.S. Bank National Association, as Dissemination Agent (the "**Dissemination Agent**") will enter into a Continuing Disclosure Agreement, dated the date of closing of the Series 2013 Bonds (the "**Disclosure Agreement**"). Pursuant to the Disclosure Agreement:

The Authority will provide, or cause to be provided, to the Electronic Municipal Market Access System ("**EMMA System**") implemented by the Municipal Securities Rulemaking Board (the "**MSRB**") established in accordance with the provisions of Section 15B(b)(1) of the 1934 Act, or any successor thereto or to the functions of the MSRB, the following:

(1) not later than 210 days after the end of the Authority's Fiscal Year (currently June 30), a copy of the Authority's "**Annual Report**" containing (i) audited financial statements of the Authority for the prior Fiscal Year, prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board, (ii) operating data including material historical quantitative data on the Authority's revenues, expenditures, financial operations and indebtedness, generally of the types described herein under the heading "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" under the last column in the table captioned "Projection of Strategic Contribution Payments and Total Payments to be Received by the Indenture Trustee," and (iii) debt service coverage for the Authority's most recent Fiscal Year for Outstanding Bonds, after giving credit for any redemptions that have been paid;

(2) in a timely manner, not in excess of ten (10) Business Days after the occurrence of the event, notice of the occurrence of any of the following events with respect to the Series 2013 Bonds:

(a) principal and interest payment delinquencies;

(b) non-payment related defaults, if material;

(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, the issuance by the Internal Revenue Service (the "**IRS**") of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB), or other material notices or determinations with respect to the tax status of the Series 2013 Bonds or other material events affecting the tax status of the Series 2013 Bonds;

(g) modifications to rights of Series 2013 Bondholders, if material;

(h) bond calls, if material, and tender offers;

(i) defeasances;

(j) release, substitution, or sale of property securing repayment of the Series 2013 Bonds, if material;

(k) rating changes;

(l) bankruptcy, insolvency, receivership or similar event of the Authority*;

(m) the consummation of a merger, consolidation, or acquisition involving the Authority or the sale of all or substantially all of the assets of the Authority, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; or

(n) appointment of a successor or additional trustee or the change of name of a trustee, if material.

The Dissemination Agent will, within two (2) Business Days of obtaining actual knowledge of the occurrence of any of the events listed in subparagraph 2 above (each, a "**Listed Event**"), contact the Authority's disclosure representative, inform such person of the event, and request that the Authority promptly provide instructions to the Dissemination Agent in writing for the purpose of reporting the event pursuant to the Disclosure Agreement.

If the Dissemination Agent has been instructed by the Authority to report the occurrence of a Listed Event, the Dissemination Agent will file a notice of such occurrence in the form and text provided by the Authority with the MSRB.

If the Authority's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to subparagraph (1) above, the Annual Report will contain unaudited financial statements in a format similar to the financial statements contained herein, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

If the Authority's fiscal year changes, it will give notice of such change in the same manner as for a Listed Event.

If the Dissemination Agent is unable to verify that an Annual Report has been provided to the MSRB by the date required in subparagraph (1) above, the Dissemination Agent will send a notice to the MSRB on such date.

Notwithstanding any other provision of the Disclosure Agreement, the Authority and the Dissemination Agent may amend the Disclosure Agreement (and the Dissemination Agent will agree to any amendment so requested by the Authority that does not affect its rights or immunities, or increase its duties under the Disclosure Agreement), and any provision of the Disclosure Agreement may be waived, provided that (a) if the amendment or waiver relates to the provisions described herein regarding the provision and contents of Annual Reports and the reporting of Listed Events, it may only be 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 an obligated person with respect to the Series 2013 Bonds, or the type of business conducted; (b) the undertaking, as amended or taking into account such waiver,

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* As noted in the Rule, this event is considered to occur when any of the following occur: (i) the appointment of a receiver, fiscal agent or similar officer for the Authority in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Authority, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or (ii) the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Authority.

would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Series 2013 Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and (c) the amendment or waiver either (i) is approved by the Bond holders in the same manner as provided in the Indenture for amendments to the Indenture with the consent of Bondholders, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Bondholders or Beneficial Owners of the Series 2013 Bonds.

In the event of any amendment or waiver of a provision of the Disclosure Agreement, the Authority will describe such amendment in the next Annual Report, and will include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the Authority. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change will be given in a filing with the MSRB in the same manner as with a Listed Event, and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

The Authority may appoint or engage a Dissemination Agent to assist the Authority in carrying out its obligations under the Disclosure Agreement, and may discharge any such agent, with or without appointing a successor Dissemination Agent. If at any time there is not any other designated Dissemination Agent, the Authority will be the Dissemination Agent. The sole remedy of any party against the Dissemination Agent shall be nonmonetary and specific performance. The Dissemination Agent will not be responsible for the form or content of any Annual Report, notice of a Listed Event, or other document furnished to the Dissemination Agent by the Authority. The Dissemination Agent may resign at any time by providing at least 60 days' notice to the Authority.

In the event of a failure of the Authority or the Dissemination Agent to comply with any provision of the Disclosure Agreement, the Dissemination Agent may (and, at the request of any Underwriter (as defined herein) or the Holders of at least 51% aggregate principal amount of Outstanding Bonds, will), or any Holder or Beneficial Owner of the Series 2013 Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Authority or Dissemination Agent, as the case may be, to comply with its obligations under the Disclosure Agreement. A default under the Disclosure Agreement will not be deemed an Event of Default under the Indenture, and the sole remedy under the Disclosure Agreement in the event of any failure of the Authority or the Dissemination Agent to comply with the Disclosure Agreement will be an action to compel performance.

The Authority's obligations under the Disclosure Agreement will terminate upon the legal defeasance, prior redemption or payment in full of all of the Series 2013 Bonds. If such termination occurs prior to the final maturity of the Series 2013 Bonds, the Authority will give notice of such termination in the same manner as for a Listed Event.

The Authority has not failed to comply, in any material respect, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of Rule 15c2-12 under the Securities Exchange Act of 1934, as amended.

TAX MATTERS

Opinions of Co-Bond Counsel

In the opinions of Hawkins Delafield & Wood LLP and Pacifica Law Group LLP, as Co-Bond Counsel to the Authority, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (1) interest on the Series 2013 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 2013 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, the State and others in connection with the Series 2013 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 2013 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 2013 Bonds. Co-Bond Counsel render their opinions under existing statutes and court decisions as of the issue date, and assume no obligation to update, revise or supplement their opinions to reflect any action thereafter taken or not taken, or any facts or circumstances that may thereafter come to their attention, or changes in law or interpretations thereof that may thereafter occur, or for any other reason. 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 2013 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 2013 Bonds in order that interest on the Series 2013 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 2013 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 2013 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 2013 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 2013 Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of a Series 2013 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 2013 Bonds.

Prospective owners of the Series 2013 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 2013 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.

Bond Premium

In general, if an owner acquires a Series 2013 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 2013 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 2013 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 (in certain cases involving a Premium Bond callable prior to its stated maturity date, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond). 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.

Information Reporting and Backup Withholding

Information reporting requirements apply to interest paid on tax-exempt obligations, including the Series 2013 Bonds. In general, such requirements are satisfied if the interest recipient completes, and provides the payor with, a Form W-9, "Request for Taxpayer Identification Number and Certification," or if the recipient is one of a limited class of exempt recipients. A recipient not otherwise exempt from information reporting who fails to satisfy the information reporting requirements will be subject to "backup withholding," which means that the payor is required to deduct and withhold a tax from the interest payment, calculated in the manner set forth in the Tax Code. For the foregoing purpose, a "payor" generally refers to the person or entity from whom a recipient receives its payments of interest or who collects such payments on behalf of the recipient.

If an owner purchasing a Series 2013 Bond through a brokerage account has executed a Form W-9 in connection with the establishment of such account, as generally can be expected, no backup withholding should occur. In any event, backup withholding does not affect the excludability of the interest on the Series 2013 Bonds from gross income for Federal income tax purposes. Any amounts withheld pursuant to backup withholding would be allowed as a refund or a credit against the owner's Federal income tax once the required information is furnished to the IRS.

Miscellaneous

Tax legislation, administrative actions taken by tax authorities, or court decisions, whether at the Federal or state level, may adversely affect the tax-exempt status of interest on the Series 2013 Bonds under Federal or state law or otherwise prevent Beneficial Owners of the Series 2013 Bonds from realizing the full current benefit of the tax status of such interest. In addition, such legislation or actions (whether currently proposed, proposed in the future, or enacted) and such decisions could affect the market price or marketability of the Series 2013 Bonds. For example, the Fiscal Year 2014 Budget proposed on April 10, 2013, by the Obama Administration recommends a 28% limitation on itemized deductions and "tax preferences," including "tax-exempt interest." The net effect of such proposal, if enacted into law, would be that an owner of a Series 2013 Bond with a marginal tax rate in excess of 28% would pay some amount of federal income tax with respect to the interest on such Series 2013 Bond.

Prospective purchasers of the Series 2013 Bonds should consult their own tax advisors regarding the foregoing matters.

RATINGS

It is expected that the Series 2013 Bonds maturing in the years 2014 through 2023 will be assigned a rating of "A" by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("**S&P**"), and the Series 2013 Bonds maturing in the years 2024 through 2033 will be assigned a rating of "A-" by S&P.

The ratings by S&P of the Series 2013 Bonds reflect only the views of such organization and any desired explanation of the significance of such ratings and any outlooks or other statements given by S&P with respect thereto should be obtained from S&P, at the following address: Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., 55 Water Street, New York, New York 10004.

A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to downward revision or withdrawal at any time. There is no assurance that the initial ratings assigned to the Series 2013 Bonds will continue for any given period of time or that the ratings will not be revised downward, suspended or withdrawn entirely by S&P. 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 2013 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 2013 Bonds from the Authority at an underwriters' discount of $1,973,690.19. The Underwriters will be obligated to purchase all of the Series 2013 Bonds if any are purchased. The initial public offering prices of the Series 2013 Bonds may be changed from time to time by the Underwriters.

Barclays Capital Inc. is acting as representative on behalf of the Underwriters.

The Series 2013 Bonds may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Series 2013 Bonds into investment trusts) at prices lower than such public offering prices.

The Underwriters have provided the statements below in this section of the Official Statement:

The Underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage activities. Certain of the Underwriters and their respective affiliates have, from time to time, performed, and may in the future, perform various investment banking services for the Authority, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the Underwriters and their respective affiliates may make or hold a broad array of investments and activity trade debt and equity securities (or related derivative securities) and financial instruments (which may include bank loans and/or credit default swaps) for their own account and for the accounts of their customers and may at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve the Series 2013 Bonds.

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 2013 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 2013 Bonds or the validity of the Series 2013 Bonds. For a discussion of other legal matters, including certain pending litigation involving the MSA and the PMs, see "BONDHOLDERS' RISKS," "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" and "LEGAL CONSIDERATIONS RELATING TO PLEDGED TSRS."

Hawkins Delafield & Wood LLP and Pacifica Law Group LLP, as Co-Bond Counsel to the Authority, will render opinions with respect to the validity of the Series 2013 Bonds in substantially the form set forth in Appendix F. Certain legal matters will be passed upon for the Authority by Pacifica Law Group, Seattle Washington, General Counsel to the Authority, and by Nixon Peabody LLP, as Disclosure Counsel to the Authority, for the State by the Attorney General of the State, and for the Underwriters by Orrick, Herrington & Sutcliffe LLP, as Underwriters' Counsel.

The Authority entered into a Reserve Fund Agreement dated November 5, 2002, between the Authority, U.S. Bank, N.A. (as Indenture Trustee), and Lehman Brothers Special Financing Inc. ("**LBSF**"), as amended by the Amendment Agreement, dated March 26, 2003, for the investment of amounts on deposit in the Liquidity Reserve Account securing the 2002 Bonds. The Reserve Fund Agreement provided generally that the Indenture Trustee would purchase Qualified Securities (as defined therein) from LBSF on a "delivery versus payment" basis over the term of the agreement at the Guaranteed Rate (as defined therein). Upon the bankruptcies on September 15, 2008 by Lehman Brothers Holding, Inc. (the guarantor of LBSF) and on October 3, 2008 by LBSF, the Authority terminated the Reserve Fund Agreement. The Authority has filed claims on October 12, 2009 in the amount of approximately $47,000,000 against the bankruptcy debtors for the lost value of future earnings on the Liquidity Reserve Account at the Guaranteed Rate pursuant to the Reserve Fund Agreement. The amount of such claims is under dispute and is the subject of litigation in the United States Bankruptcy Court for the Southern District of New York. It is not possible to predict the outcome of the pending litigation including the timing, the amount, if any, payable pursuant to the claims and the amount available for distribution to creditors for allowed claims. Any amounts received by the Indenture Trustee as a result of such litigation will be deposited in the Collections Account with respect to the 2013 Bonds upon receipt.

THE INDENTURE TRUSTEE

The Authority has appointed U.S. Bank National Association to serve as Indenture Trustee under the Indenture. The Indenture Trustee is to carry out those duties assignable to it under the Indenture, and the related financing documents. Except for the contents of this section, the Indenture Trustee has not reviewed or participated in the preparation of this Official Statement and assumes no responsibility for the contents, accuracy, fairness or completeness of the information set forth in this Official Statement or for the recitals contained in the Indenture or the Series 2013 Bonds, or for the validity, sufficiency, or legal effect of any of such documents.

Furthermore, the Indenture Trustee has no oversight responsibility, and is not accountable, for the use or application by the Authority of any of the Bonds authenticated or delivered pursuant to the Indenture or for the use or application of the proceeds of such Series 2013 Bonds by the Authority. The Indenture Trustee has not evaluated the risks, benefits, or propriety of any investment in the Series 2013 Bonds and make no representation, and have reached no conclusions, regarding the value or condition of any assets or revenues pledged or assigned as security for the Series 2013 Bonds, the technical or financial feasibility of the Issue, or the investment quality of the Series 2013 Bonds, about all of which the Indenture Trustee expresses no opinion and expressly disclaim the expertise to evaluate.

OTHER PARTIES

IHS Global

IHS Global has been retained on behalf of the Authority as an independent econometric consultant. IHS Global has announced that it intends to change its name to Global Insight (USA), Inc. The IHS Global Report attached as Appendix D hereto is included herein in reliance on IHS Global as experts in such matters. IHS Global's fees for acting as independent economic consultant are not contingent upon the issuance of the Series 2013 Bonds. The IHS Global Report should be read in its entirety before purchasing any Series 2013 Bonds.

Financial Advisor

Public Financial Management Inc. (the "**Financial Advisor**") has been retained to act as financial advisor to the Authority in connection with certain aspects of the issuance of the Series 2013 Bonds. Although the Financial Advisor assisted in the preparation of this Official Statement, the Financial Advisor is not obligated, and has not undertaken, to make an independent verification or assume responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement.

TOBACCO SETTLEMENT AUTHORITY

By: /s/ Carla M. DewBerry
Chair

APPENDIX A

MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

(AS AMENDED BY THE ADDENDUM OF CLARIFICATIONS)

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MASTER SETTLEMENT AGREEMENT

This Master Settlement Agreement is made by the undersigned Settling State officials (on behalf of their respective Settling States) and the undersigned Participating Manufacturers to settle and resolve with finality all Released Claims against the Participating Manufacturers and related entities as set forth herein. This Agreement constitutes the documentation effecting this settlement with respect to each Settling State, and is intended to and shall be binding upon each Settling State and each Participating Manufacturer in accordance with the terms hereof.

I. RECITALS

WHEREAS, more than 40 States have commenced litigation asserting various claims for monetary, equitable and injunctive relief against certain tobacco product manufacturers and others as defendants, and the States that have not filed suit can potentially assert similar claims;

WHEREAS, the Settling States that have commenced litigation have sought to obtain equitable relief and damages under state laws, including consumer protection and/or antitrust laws, in order to further the Settling States' policies regarding public health, including policies adopted to achieve a significant reduction in smoking by Youth;

WHEREAS, defendants have denied each and every one of the Settling States' allegations of unlawful conduct or wrongdoing and have asserted a number of defenses to the Settling States' claims, which defenses have been contested by the Settling States;

WHEREAS, the Settling States and the Participating Manufacturers are committed to reducing underage tobacco use by discouraging such use and by preventing Youth access to Tobacco Products;

WHEREAS, the Participating Manufacturers recognize the concern of the tobacco grower community that it may be adversely affected by the potential reduction in tobacco consumption resulting from this settlement, reaffirm their commitment to work cooperatively to address concerns about the potential adverse economic impact on such community, and will, within 30 days after the MSA Execution Date, meet with the political leadership of States with grower communities to address these economic concerns;

WHEREAS, the undersigned Settling State officials believe that entry into this Agreement and uniform consent decrees with the tobacco industry is necessary in order to further the Settling States' policies designed to reduce Youth smoking, to promote the public health and to secure monetary payments to the Settling States; and

WHEREAS, the Settling States and the Participating Manufacturers wish to avoid the further expense, delay, inconvenience, burden and uncertainty of continued litigation (including appeals from any verdicts), and, therefore, have agreed to settle their respective lawsuits and potential claims pursuant to terms which will achieve for the Settling States and their citizens significant funding for the advancement of public health, the implementation of important tobacco-related public health measures, including the enforcement of the mandates and restrictions related to such measures, as well as funding for a national Foundation dedicated to significantly reducing the use of Tobacco Products by Youth;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the implementation of tobacco-related health measures and the payments to be made by the Participating Manufacturers, the release and discharge of all claims by the Settling States, and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the Settling States and the Participating Manufacturers, acting by and through their authorized agents, memorialize and agree as follows:

II. DEFINITIONS

(a) "Account" has the meaning given in the Escrow Agreement.

(b) "Adult" means any person or persons who are not Underage.

(c) "Adult-Only Facility" means a facility or restricted area (whether open-air or enclosed) where the operator ensures or has a reasonable basis to believe (such as by checking identification as required under state law, or by checking the identification of any person appearing to be under the age of 27) that no Underage person is present. A facility or restricted area need not be permanently restricted to Adults in order to constitute an Adult-Only Facility, provided that the operator ensures or has a reasonable basis to believe that no Underage person is present during the event or time period in question.

(d) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of 10 percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(e) "Agreement" means this Master Settlement Agreement, together with the exhibits hereto, as it may be amended pursuant to subsection XVIII(j).

(f) "Allocable Share" means the percentage set forth for the State in question as listed in Exhibit A hereto, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States; or, solely for the purpose of calculating payments under subsection IX(c)(2) (and corresponding payments under subsection

IX(i)), the percentage disclosed for the State in question pursuant to subsection IX(c)(2)(A) prior to June 30, 1999, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States.

(g) "Allocated Payment" means a particular Settling State's Allocable Share of the sum of all of the payments to be made by the Original Participating Manufacturers in the year in question pursuant to subsections IX(c)(1) and IX(c)(2), as such payments have been adjusted, reduced and allocated pursuant to clause "First" through the first sentence of clause "Fifth" of subsection IX(j), but before application of the other offsets and adjustments described in clauses "Sixth" through "Thirteenth" of subsection IX(j).

(h) "Bankruptcy" means, with respect to any entity, the commencement of a case or other proceeding (whether voluntary or involuntary) seeking any of (1) liquidation, reorganization, rehabilitation, receivership, conservatorship, or other relief with respect to such entity or its debts under any bankruptcy, insolvency or similar law now or hereafter in effect; (2) the appointment of a trustee, receiver, liquidator, custodian or similar official of such entity or any substantial part of its business or property; (3) the consent of such entity to any of the relief described in (1) above or to the appointment of any official described in (2) above in any such case or other proceeding involuntarily commenced against such entity; or (4) the entry of an order for relief as to such entity under the federal bankruptcy laws as now or hereafter in effect. Provided, however, that an involuntary case or proceeding otherwise within the foregoing definition shall not be a "Bankruptcy" if it is or was dismissed within 60 days of its commencement.

(i) "Brand Name" means a brand name (alone or in conjunction with any other word), trademark, logo, symbol, motto, selling message, recognizable pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any domestic brand of Tobacco Products. Provided, however, that the term "Brand Name" shall not include the corporate name of any Tobacco Product Manufacturer that does not after the MSA Execution Date sell a brand of Tobacco Products in the States that includes such corporate name.

(j) "Brand Name Sponsorship" means an athletic, musical, artistic, or other social or cultural event as to which payment is made (or other consideration is provided) in exchange for use of a Brand Name or Names (1) as part of the name of the event or (2) to identify, advertise, or promote such event or an entrant, participant or team in such event in any other way. Sponsorship of a single national or multi-state series or tour (for example, NASCAR (including any number of NASCAR races)), or of one or more events within a single national or multi-state series or tour, or of an entrant, participant, or team taking part in events sanctioned by a single approving organization (e.g., NASCAR or CART), constitutes one Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in an event that is part of a series or tour that is sponsored by such Participating Manufacturer or that is part of a series or tour in which any one or more events are sponsored by such Participating Manufacturer does not constitute a separate Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in any event (or series of events) not sponsored by such Participating Manufacturer constitutes a Brand Name Sponsorship. The term "Brand Name Sponsorship" shall not include an event in an Adult-Only Facility.

(k) "Business Day" means a day which is not a Saturday or Sunday or legal holiday on which banks are authorized or required to close in New York, New York.

(l) "Cartoon" means any drawing or other depiction of an object, person, animal, creature or any similar caricature that satisfies any of the following criteria:

(1) the use of comically exaggerated features;

(2) the attribution of human characteristics to animals, plants or other objects, or the similar use of anthropomorphic technique; or

(3) the attribution of unnatural or extrahuman abilities, such as imperviousness to pain or injury, X-ray vision, tunneling at very high speeds or transformation.

The term "Cartoon" includes "Joe Camel," but does not include any drawing or other depiction that on July 1, 1998, was in use in any State in any Participating Manufacturer's corporate logo or in any Participating Manufacturer's Tobacco Product packaging.

(m) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "Cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). Except as provided in subsections II(z) and II(mm), 0.0325 ounces of "roll-your-own" tobacco shall constitute one individual "Cigarette."

(n) "Claims" means any and all manner of civil (i.e., non-criminal): claims, demands, actions, suits, causes of action, damages (whenever incurred), liabilities of any nature including civil penalties and punitive damages, as well as costs, expenses and attorneys' fees (except as to the Original Participating Manufacturers' obligations under section XVII), known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable, or statutory.

(o) "Consent Decree" means a state-specific consent decree as described in subsection XIII(b)(1)(B) of this Agreement.

(p) "Court" means the respective court in each Settling State to which this Agreement and the Consent Decree are presented for approval and/or entry as to that Settling State.

(q) "Escrow" has the meaning given in the Escrow Agreement.

(r) "Escrow Agent" means the escrow agent under the Escrow Agreement.

(s) "Escrow Agreement" means an escrow agreement substantially in the form of Exhibit B.

(t) "Federal Tobacco Legislation Offset" means the offset described in section X.

(u) "Final Approval" means the earlier of:

(1) the date by which State-Specific Finality in a sufficient number of Settling States has occurred; or

(2) June 30, 2000.

For the purposes of this subsection (u), "State-Specific Finality in a sufficient number of Settling States" means that State-Specific Finality has occurred in both:

(A) a number of Settling States equal to at least 80% of the total number of Settling States; and

(B) Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all Settling States.

Notwithstanding the foregoing, the Original Participating Manufacturers may, by unanimous written agreement, waive any requirement for Final Approval set forth in subsections (A) or (B) hereof.

(v) "Foundation" means the foundation described in section VI.

(w) "Independent Auditor" means the firm described in subsection XI(b).

(x) "Inflation Adjustment" means an adjustment in accordance with the formulas for inflation adjustments set forth in Exhibit C.

(y) "Litigating Releasing Parties Offset" means the offset described in subsection XII(b).

(z) "Market Share" means a Tobacco Product Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes sold in the fifty United States, the District of Columbia and Puerto Rico during the applicable calendar year, as measured by excise taxes collected by the federal government and, in the case of sales in Puerto Rico, arbitrios de cigarillos collected by the Puerto Rico taxing authority. For purposes of the definition and determination of "Market Share" with respect to calculations under subsection IX(i), 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette; for purposes of the definition and determination of "Market Share" with respect to all other calculations, 0.0325 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(aa) "MSA Execution Date" means November 23, 1998.

(bb) "NAAG" means the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement.

(cc) "Non-Participating Manufacturer" means any Tobacco Product Manufacturer that is not a Participating Manufacturer.

(dd) "Non-Settling States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by the aggregate Allocable Shares of those States that are not Settling States on the date 15 days before such payment is due.

(ee) "Notice Parties" means each Participating Manufacturer, each Settling State, the Escrow Agent, the Independent Auditor and NAAG.

(ff) "NPM Adjustment" means the adjustment specified in subsection IX(d).

(gg) "NPM Adjustment Percentage" means the percentage determined pursuant to subsection IX(d).

(hh) "Original Participating Manufacturers" means the following: Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company, and the respective successors of each of the foregoing. Except as expressly provided in this Agreement, once an entity becomes an Original Participating Manufacturer, such entity shall permanently retain the status of Original Participating Manufacturer.

(ii) "Outdoor Advertising" means (1) billboards, (2) signs and placards in arenas, stadiums, shopping malls and Video Game Arcades (whether any of the foregoing are open air or enclosed) (but not including any such sign or placard located in an Adult-Only Facility), and (3) any other advertisements placed (A) outdoors, or (B) on the inside surface of a window facing outward. Provided, however, that the term "Outdoor Advertising" does not mean (1) an advertisement on the outside of a Tobacco Product manufacturing facility; (2) an individual advertisement that does not occupy an area larger than 14 square feet (and that neither is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet, nor functions solely as a segment of a larger advertising unit or series), and that is placed (A) on the outside of any retail establishment that sells Tobacco Products (other than solely through a vending machine), (B) outside (but on the property of) any such establishment, or (C) on the inside surface of a window facing

outward in any such establishment; (3) an advertisement inside a retail establishment that sells Tobacco Products (other than solely through a vending machine) that is not placed on the inside surface of a window facing outward; or (4) an outdoor advertisement at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(jj) "Participating Manufacturer" means a Tobacco Product Manufacturer that is or becomes a signatory to this Agreement, provided that (1) in the case of a Tobacco Product Manufacturer that is not an Original Participating Manufacturer, such Tobacco Product Manufacturer is bound by this Agreement and the Consent Decree (or, in any Settling State that does not permit amendment of the Consent Decree, a consent decree containing terms identical to those set forth in the Consent Decree) in all Settling States in which this Agreement and the Consent Decree binds Original Participating Manufacturers (provided, however, that such Tobacco Product Manufacturer need only become bound by the Consent Decree in those Settling States in which the Settling State has filed a Released Claim against it), and (2) in the case of a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, such Tobacco Product Manufacturer, within a reasonable period of time after signing this Agreement, makes any payments (including interest thereon at the Prime Rate) that it would have been obligated to make in the intervening period had it been a signatory as of the MSA Execution Date. "Participating Manufacturer" shall also include the successor of a Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Participating Manufacturer such entity shall permanently retain the status of Participating Manufacturer. Each Participating Manufacturer shall regularly report its shipments of Cigarettes in or to the fifty United States, the District of Columbia and Puerto Rico to Management Science Associates, Inc. (or a successor entity as set forth in subsection (mm)). Solely for purposes of calculations pursuant to subsection IX(d), a Tobacco Product Manufacturer that is not a signatory to this Agreement shall be deemed to be a "Participating Manufacturer" if the Original Participating Manufacturers unanimously consent in writing.

(kk) "Previously Settled States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by 12.4500000%, in the case of payments due in or prior to 2007; 12.2373756%, in the case of payments due after 2007 but before 2018; and 11.0666667%, in the case of payments due in or after 2018.

(ll) "Prime Rate" shall mean the prime rate as published from time to time by the Wall Street Journal or, in the event the Wall Street Journal is no longer published or no longer publishes such rate, an equivalent successor reference rate determined by the Independent Auditor.

(mm) "Relative Market Share" means an Original Participating Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers during the calendar year immediately preceding the year in which the payment at issue is due (regardless of when such payment is made), as measured by the Original Participating Manufacturers' reports of shipments of Cigarettes to Management Science Associates, Inc. (or a successor entity acceptable to both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question). A Cigarette shipped by more than one Participating Manufacturer shall be deemed to have been shipped solely by the first Participating Manufacturer to do so. For purposes of the definition and determination of "Relative Market Share," 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(nn) "Released Claims" means:

(1) for past conduct, acts or omissions (including any damages incurred in the future arising from such past conduct, acts or omissions), those Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to (A) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (B) the exposure to, or (C) research, statements, or warnings regarding, Tobacco Products (including, but not limited to, the Claims asserted in the actions identified in Exhibit D, or any comparable Claims that were, could be or could have been asserted now or in the future in those actions or in any comparable action in federal, state or local court brought by a Settling State or a Releasing Party (whether or not such Settling State or Releasing Party has brought such action)), except for claims not asserted in the actions identified in Exhibit D for outstanding liability under existing licensing (or similar) fee laws or existing tax laws (but not excepting claims for any tax liability of the Tobacco-Related Organizations or of any Released Party with respect to such Tobacco-Related Organizations, which claims are covered by the release and covenants set forth in this Agreement);

(2) for future conduct, acts or omissions, only those monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future Claims for reimbursement of health care costs allegedly associated with the use of or exposure to Tobacco Products.

(oo) "Released Parties" means all Participating Manufacturers, their past, present and future Affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any Participating Manufacturer or of any such Affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). Provided, however, that "Released Parties" does not include any person or entity (including, but not limited to, an Affiliate) that is itself a Non-Participating Manufacturer at any time after the MSA Execution Date, unless such person or entity becomes a Participating Manufacturer.

(pp) "Releasing Parties" means each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions; and also means, to the full extent of the power of the signatories hereto to release past, present and future claims, the following: (1) any Settling State's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (2) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in this settlement, (A) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of the State, as opposed solely to private or individual relief for separate and distinct injuries, or (B) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State.

(qq) "Settling State" means any State that signs this Agreement on or before the MSA Execution Date. Provided, however, that the term "Settling State" shall not include (1) the States of Mississippi, Florida, Texas and Minnesota; and (2) any State as to which this Agreement has been terminated.

(rr) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas.

(ss) "State-Specific Finality" means, with respect to the Settling State in question:

(1) this Agreement and the Consent Decree have been approved and entered by the Court as to all Original Participating Manufacturers, or, in the event of an appeal from or review of a decision of the Court to withhold its approval and entry of this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review;

(2) entry by the Court has been made of an order dismissing with prejudice all claims against Released Parties in the action as provided herein; and

(3) the time for appeal or to seek review of or permission to appeal ("Appeal") from the approval and entry as described in subsection (1) hereof and entry of such order described in subsection (2) hereof has expired; or, in the event of an Appeal from such approval and entry, the Appeal has been dismissed, or the approval and entry described in (1) hereof and the order described in subsection (2) hereof have been affirmed in all material respects by the court of last resort to which such Appeal has been taken and such dismissal or affirmance has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court).

(tt) "Subsequent Participating Manufacturer" means a Tobacco Product Manufacturer (other than an Original Participating Manufacturer) that: (1) is a Participating Manufacturer, and (2) is a signatory to this Agreement, regardless of when such Tobacco Product Manufacturer became a signatory to this Agreement. "Subsequent Participating Manufacturer" shall also include the successors of a Subsequent Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Subsequent Participating Manufacturer such entity shall permanently retain the status of Subsequent Participating Manufacturer, unless it agrees to assume the obligations of an Original Participating Manufacturer as provided in subsection XVIII(c).

(uu) "Tobacco Product Manufacturer" means an entity that after the MSA Execution Date directly (and not exclusively through any Affiliate):

(1) manufactures Cigarettes anywhere that such manufacturer intends to be sold in the States, including Cigarettes intended to be sold in the States through an importer (except where such importer is an Original Participating Manufacturer that will be responsible for the payments under this Agreement with respect to such Cigarettes as a result of the provisions of subsections II(mm) and that pays the taxes specified in subsection II(z) on such Cigarettes, and provided that the manufacturer of such Cigarettes does not market or advertise such Cigarettes in the States);

(2) is the first purchaser anywhere for resale in the States of Cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the States; or

(3) becomes a successor of an entity described in subsection (1) or (2) above.

The term "Tobacco Product Manufacturer" shall not include an Affiliate of a Tobacco Product Manufacturer unless such Affiliate itself falls within any of subsections (1) - (3) above.

(vv) "Tobacco Products" means Cigarettes and smokeless tobacco products.

(ww) "Tobacco-Related Organizations" means the Council for Tobacco Research-U.S.A., Inc., The Tobacco Institute, Inc. ("TI"), and the Center for Indoor Air Research, Inc. ("CIAR") and the successors, if any, of TI or CIAR.

(xx) "Transit Advertisements" means advertising on or within private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, transportation waiting area, train station, airport or any similar location. Notwithstanding the foregoing, the term "Transit Advertisements" does not include (1) any advertisement placed in, on or outside the premises of any retail establishment that sells Tobacco Products (other than solely through a vending machine) (except if such individual advertisement (A) occupies an area larger than 14 square feet; (B) is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet; or (C) functions solely as a segment of a larger advertising unit or series); or (2) advertising at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no

event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(yy) "Underage" means younger than the minimum age at which it is legal to purchase or possess (whichever minimum age is older) Cigarettes in the applicable Settling State.

(zz) "Video Game Arcade" means an entertainment establishment primarily consisting of video games (other than video games intended primarily for use by persons 18 years of age or older) and/or pinball machines.

(aaa) "Volume Adjustment" means an upward or downward adjustment in accordance with the formula for volume adjustments set forth in Exhibit E.

(bbb) "Youth" means any person or persons under 18 years of age.

III. PERMANENT RELIEF

(a) Prohibition on Youth Targeting. No Participating Manufacturer may take any action, directly or indirectly, to target Youth within any Settling State in the advertising, promotion or marketing of Tobacco Products, or take any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within any Settling State.

(b) Ban on Use of Cartoons. Beginning 180 days after the MSA Execution Date, no Participating Manufacturer may use or cause to be used any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

(c) Limitation of Tobacco Brand Name Sponsorships.

(1) Prohibited Sponsorships. After the MSA Execution Date, no Participating Manufacturer may engage in any Brand Name Sponsorship in any State consisting of:

(A) concerts; or

(B) events in which the intended audience is comprised of a significant percentage of Youth; or

(C) events in which any paid participants or contestants are Youth; or

(D) any athletic event between opposing teams in any football, basketball, baseball, soccer or hockey league.

(2) Limited Sponsorships.

(A) No Participating Manufacturer may engage in more than one Brand Name Sponsorship in the States in any twelve-month period (such period measured from the date of the initial sponsored event).

(B) Provided, however, that

(i) nothing contained in subsection (2)(A) above shall require a Participating Manufacturer to breach or terminate any sponsorship contract in existence as of August 1, 1998 (until the earlier of (x) the current term of any existing contract, without regard to any renewal or option that may be exercised by such Participating Manufacturer or (y) three years after the MSA Execution Date); and

(ii) notwithstanding subsection (1)(A) above, Brown & Williamson Tobacco Corporation may sponsor either the GPC country music festival or the Kool jazz festival as its one annual Brand Name Sponsorship permitted pursuant to subsection (2)(A) as well as one Brand Name Sponsorship permitted pursuant to subsection (2)(B)(i).

(3) Related Sponsorship Restrictions. With respect to any Brand Name Sponsorship permitted under this subsection (c):

(A) advertising of the Brand Name Sponsorship event shall not advertise any Tobacco Product (other than by using the Brand Name to identify such Brand Name Sponsorship event);

(B) no Participating Manufacturer may refer to a Brand Name Sponsorship event or to a celebrity or other person in such an event in its advertising of a Tobacco Product;

(C) nothing contained in the provisions of subsection III(e) of this Agreement shall apply to actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to the provisions of subsections (2)(A) and (2)(B)(i); the Brand Name Sponsorship permitted by subsection (2)(B)(ii) shall be subject to the restrictions of subsection III(e) except that such restrictions shall not prohibit use of the Brand Name to identify the Brand Name Sponsorship;

(D) nothing contained in the provisions of subsections III(f) and III(i) shall apply to apparel or other merchandise: (i) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsections (2)(A) or (2)(B)(i) by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise; or (ii) used at the site of a Brand Name Sponsorship permitted pursuant to subsection (2)(A) or (2)(B)(i) (during such event) that are not distributed (by sale or otherwise) to any member of the general public; and

(E) nothing contained in the provisions of subsection III(d) shall: (i) apply to the use of a Brand Name on a vehicle used in a Brand Name Sponsorship; or (ii) apply to Outdoor Advertising advertising the Brand Name

Sponsorship, to the extent that such Outdoor Advertising is placed at the site of a Brand Name Sponsorship no more than 90 days before the start of the initial sponsored event, is removed within 10 days after the end of the last sponsored event, and is not prohibited by subsection (3)(A) above.

(4) Corporate Name Sponsorships. Nothing in this subsection (c) shall prevent a Participating Manufacturer from sponsoring or causing to be sponsored any athletic, musical, artistic, or other social or cultural event, or any entrant, participant or team in such event (or series of events) in the name of the corporation which manufactures Tobacco Products, provided that the corporate name does not include any Brand Name of domestic Tobacco Products.

(5) Naming Rights Prohibition. No Participating Manufacturer may enter into any agreement for the naming rights of any stadium or arena located within a Settling State using a Brand Name, and shall not otherwise cause a stadium or arena located within a Settling State to be named with a Brand Name.

(6) Prohibition on Sponsoring Teams and Leagues. No Participating Manufacturer may enter into any agreement pursuant to which payment is made (or other consideration is provided) by such Participating Manufacturer to any football, basketball, baseball, soccer or hockey league (or any team involved in any such league) in exchange for use of a Brand Name.

(d) Elimination of Outdoor Advertising and Transit Advertisements. Each Participating Manufacturer shall discontinue Outdoor Advertising and Transit Advertisements advertising Tobacco Products within the Settling States as set forth herein.

(1) Removal. Except as otherwise provided in this section, each Participating Manufacturer shall remove from within the Settling States within 150 days after the MSA Execution Date all of its (A) billboards (to the extent that such billboards constitute Outdoor Advertising) advertising Tobacco Products; (B) signs and placards (to the extent that such signs and placards constitute Outdoor Advertising) advertising Tobacco Products in arenas, stadiums, shopping malls and Video Game Arcades; and (C) Transit Advertisements advertising Tobacco Products.

(2) Prohibition on New Outdoor Advertising and Transit Advertisements. No Participating Manufacturer may, after the MSA Execution Date, place or cause to be placed any new Outdoor Advertising advertising Tobacco Products or new Transit Advertisements advertising Tobacco Products within any Settling State.

(3) Alternative Advertising. With respect to those billboards required to be removed under subsection (1) that are leased (as opposed to owned) by any Participating Manufacturer, the Participating Manufacturer will allow the Attorney General of the Settling State within which such billboards are located to substitute, at the Settling State's option, alternative advertising intended to discourage the use of Tobacco Products by Youth and their exposure to second-hand smoke for the remaining term of the applicable contract (without regard to any renewal or option term that may be exercised by such Participating Manufacturer). The Participating Manufacturer will bear the cost of the lease through the end of such remaining term. Any other costs associated with such alternative advertising will be borne by the Settling State.

(4) Ban on Agreements Inhibiting Anti-Tobacco Advertising. Each Participating Manufacturer agrees that it will not enter into any agreement that prohibits a third party from selling, purchasing or displaying advertising discouraging the use of Tobacco Products or exposure to second-hand smoke. In the event and to the extent that any Participating Manufacturer has entered into an agreement containing any such prohibition, such Participating Manufacturer agrees to waive such prohibition in such agreement.

(5) Designation of Contact Person. Each Participating Manufacturer that has Outdoor Advertising or Transit Advertisements advertising Tobacco Products within a Settling State shall, within 10 days after the MSA Execution Date, provide the Attorney General of such Settling State with the name of a contact person to whom the Settling State may direct inquiries during the time such Outdoor Advertising and Transit Advertisements are being eliminated, and from whom the Settling State may obtain periodic reports as to the progress of their elimination.

(6) Adult-Only Facilities. To the extent that any advertisement advertising Tobacco Products located within an Adult-Only Facility constitutes Outdoor Advertising or a Transit Advertisement, this subsection (d) shall not apply to such advertisement, provided such advertisement is not visible to persons outside such Adult-Only Facility.

(e) Prohibition on Payments Related to Tobacco Products and Media. No Participating Manufacturer may, beginning 30 days after the MSA Execution Date, make, or cause to be made, any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any motion picture, television show, theatrical production or other live performance, live or recorded performance of music, commercial film or video, or video game ("Media"); provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; or (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults.

(f) Ban on Tobacco Brand Name Merchandise. Beginning July 1, 1999, no Participating Manufacturer may, within any Settling State, market, distribute, offer, sell, license or cause to be marketed, distributed, offered, sold or licensed (including, without limitation, by catalogue or direct mail), any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this subsection shall (1) require any Participating Manufacturer to breach or

terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed, or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; or (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public.

(g) Ban on Youth Access to Free Samples. After the MSA Execution Date, no Participating Manufacturer may, within any Settling State, distribute or cause to be distributed any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Agreement, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

(h) Ban on Gifts to Underage Persons Based on Proofs of Purchase. Beginning one year after the MSA Execution Date, no Participating Manufacturer may provide or cause to be provided to any person without sufficient proof that such person is an Adult any item in exchange for the purchase of Tobacco Products, or the furnishing of credits, proofs-of-purchase, or coupons with respect to such a purchase. For purposes of the preceding sentence only, (1) a driver's license or other government-issued identification (or legible photocopy thereof), the validity of which is certified by the person to whom the item is provided, shall by itself be deemed to be a sufficient form of proof of age; and (2) in the case of items provided (or to be redeemed) at retail establishments, a Participating Manufacturer shall be entitled to rely on verification of proof of age by the retailer, where such retailer is required to obtain verification under applicable federal, state or local law.

(i) Limitation on Third-Party Use of Brand Names. After the MSA Execution Date, no Participating Manufacturer may license or otherwise expressly authorize any third party to use or advertise within any Settling State any Brand Name in a manner prohibited by this Agreement if done by such Participating Manufacturer itself. Each Participating Manufacturer shall, within 10 days after the MSA Execution Date, designate a person (and provide written notice to NAAG of such designation) to whom the Attorney General of any Settling State may provide written notice of any such third-party activity that would be prohibited by this Agreement if done by such Participating Manufacturer itself. Following such written notice, the Participating Manufacturer will promptly take commercially reasonable steps against any such non-de minimis third-party activity. Provided, however, that nothing in this subsection shall require any Participating Manufacturer to (1) breach or terminate any licensing agreement or other contract in existence as of July 1, 1998 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); or (2) retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer.

(j) Ban on Non-Tobacco Brand Names. No Participating Manufacturer may, pursuant to any agreement requiring the payment of money or other valuable consideration, use or cause to be used as a brand name of any Tobacco Product any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this subsection, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

(k) Minimum Pack Size of Twenty Cigarettes. No Participating Manufacturer may, beginning 60 days after the MSA Execution Date and through and including December 31, 2001, manufacture or cause to be manufactured for sale in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). No Participating Manufacturer may, beginning 150 days after the MSA Execution Date and through and including December 31, 2001, sell or distribute in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). Each Participating Manufacturer further agrees that following the MSA Execution Date it shall not oppose, or cause to be opposed (including through any third party or Affiliate), the passage by any Settling State of any legislative proposal or administrative rule applicable to all Tobacco Product Manufacturers and all retailers of Tobacco Products prohibiting the manufacture and sale of any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

(l) Corporate Culture Commitments Related to Youth Access and Consumption. Beginning 180 days after the MSA Execution Date each Participating Manufacturer shall:

promulgate or reaffirm corporate principles that express and explain its commitment to comply with the provisions of this Agreement and the reduction of use of Tobacco Products by Youth, and clearly and regularly communicate to its employees and customers its commitment to assist in the reduction of Youth use of Tobacco Products;

designate an executive level manager (and provide written notice to NAAG of such designation) to identify methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products; and

encourage its employees to identify additional methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products.

(m) Limitations on Lobbying. Following State-Specific Finality in a Settling State:

(1) No Participating Manufacturer may oppose, or cause to be opposed (including through any third party or Affiliate), the passage by such Settling State (or any political subdivision thereof) of those state or local legislative proposals or administrative rules described in Exhibit F hereto intended by their terms to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products. Provided, however, that the foregoing does not prohibit any Participating Manufacturer from (A) challenging enforcement of, or suing for declaratory or injunctive relief with respect to, any such legislation or rule on any grounds; (B) continuing, after State-Specific Finality in such Settling State, to oppose or cause to be opposed, the passage during the legislative session in which State-Specific Finality in such Settling State occurs of any specific state or local legislative proposals or administrative rules introduced prior to the time of State-Specific Finality in such Settling State; (C) opposing, or causing to be opposed, any excise tax or income tax provision or user fee or other payments relating to Tobacco Products or Tobacco Product Manufacturers; or (D) opposing, or causing to be opposed, any state or local legislative proposal or administrative rule that also includes measures other than those described in Exhibit F.

(2) Each Participating Manufacturer shall require all of its officers and employees engaged in lobbying activities in such Settling State after State-Specific Finality, contract lobbyists engaged in lobbying activities in such Settling State after State-Specific Finality, and any other third parties who engage in lobbying activities in such Settling State after State-Specific Finality on behalf of such Participating Manufacturer ("lobbyist" and "lobbying activities" having the meaning such terms have under the law of the Settling State in question) to certify in writing to the Participating Manufacturer that they:

(A) will not support or oppose any state, local or federal legislation, or seek or oppose any governmental action, on behalf of the Participating Manufacturer without the Participating Manufacturer's express authorization (except where such advance express authorization is not reasonably practicable);

(B) are aware of and will fully comply with this Agreement and all laws and regulations applicable to their lobbying activities, including, without limitation, those related to disclosure of financial contributions. Provided, however, that if the Settling State in question has in existence no laws or regulations relating to disclosure of financial contributions regarding lobbying activities, then each Participating Manufacturer shall, upon request of the Attorney General of such Settling State, disclose to such Attorney General any payment to a lobbyist that the Participating Manufacturer knows or has reason to know will be used to influence legislative or administrative actions of the state or local government relating to Tobacco Products or their use. Disclosures made pursuant to the preceding sentence shall be filed in writing with the Office of the Attorney General on the first day of February and the first day of August of each year for any and all payments made during the six month period ending on the last day of the preceding December and June, respectively, with the following information: (1) the name, address, telephone number and e-mail address (if any) of the recipient; (2) the amount of each payment; and (3) the aggregate amount of all payments described in this subsection (2)(B) to the recipient in the calendar year; and

(C) have reviewed and will fully abide by the Participating Manufacturer's corporate principles promulgated pursuant to this Agreement when acting on behalf of the Participating Manufacturer.

(3) No Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) in Congress or any other forum legislation or rules that would preempt, override, abrogate or diminish such Settling State's rights or recoveries under this Agreement. Except as specifically provided in this Agreement, nothing herein shall be deemed to restrain any Settling State or Participating Manufacturer from advocating terms of any national settlement or taking any other positions on issues relating to tobacco.

(n) Restriction on Advocacy Concerning Settlement Proceeds. After the MSA Execution Date, no Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) the diversion of any proceeds of this settlement to any program or use that is neither tobacco-related nor health-related in connection with the approval of this Agreement or in any subsequent legislative appropriation of settlement proceeds.

(o) Dissolution of The Tobacco Institute, Inc., the Council for Tobacco Research-U.S.A., Inc. and the Center for Indoor Air Research, Inc.

(1) The Council for Tobacco Research-U.S.A., Inc. ("CTR") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to the plan of dissolution previously negotiated and agreed to between the Attorney General of the State of New York and CTR, cease all operations and be dissolved in accordance with the laws of the State of New York (and with the preservation of all applicable privileges held by any member company of CTR).

(2) The Tobacco Institute, Inc. ("TI") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to a plan of dissolution to be negotiated by the Attorney General of the State of New York and the Original Participating Manufacturers in accordance with Exhibit G hereto, cease all operations and be dissolved in

accordance with the laws of the State of New York and under the authority of the Attorney General of the State of New York (and with the preservation of all applicable privileges held by any member company of TI).

(3) Within 45 days after Final Approval, the Center for Indoor Air Research, Inc. ("CIAR") shall cease all operations and be dissolved in a manner consistent with applicable law and with the preservation of all applicable privileges (including, without limitation, privileges held by any member company of CIAR).

(4) The Participating Manufacturers shall direct the Tobacco-Related Organizations to preserve all records that relate in any way to issues raised in smoking-related health litigation.

(5) The Participating Manufacturers may not reconstitute CTR or its function in any form.

(6) The Participating Manufacturers represent that they have the authority to and will effectuate subsections (1) through (5) hereof.

(p) Regulation and Oversight of New Tobacco-Related Trade Associations.

(1) A Participating Manufacturer may form or participate in new tobacco-related trade associations (subject to all applicable laws), provided such associations agree in writing not to act in any manner contrary to any provision of this Agreement. Each Participating Manufacturer agrees that if any new tobacco-related trade association fails to so agree, such Participating Manufacturer will not participate in or support such association.

(2) Any tobacco-related trade association that is formed or controlled by one or more of the Participating Manufacturers after the MSA Execution Date shall adopt by-laws governing the association's procedures and the activities of its members, board, employees, agents and other representatives with respect to the tobacco-related trade association. Such by-laws shall include, among other things, provisions that:

(A) each officer of the association shall be appointed by the board of the association, shall be an employee of such association, and during such officer's term shall not be a director of or employed by any member of the association or by an Affiliate of any member of the association;

(B) legal counsel for the association shall be independent, and neither counsel nor any member or employee of counsel's law firm shall serve as legal counsel to any member of the association or to a manufacturer of Tobacco Products that is an Affiliate of any member of the association during the time that it is serving as legal counsel to the association; and

(C) minutes describing the substance of the meetings of the board of directors of the association shall be prepared and shall be maintained by the association for a period of at least five years following their preparation.

(3) Without limitation on whatever other rights to access they may be permitted by law, for a period of seven years from the date any new tobacco-related trade association is formed by any of the Participating Manufacturers after the MSA Execution Date the antitrust authorities of any Settling State may, for the purpose of enforcing this Agreement, upon reasonable cause to believe that a violation of this Agreement has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days):

(A) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of such association insofar as they pertain to such believed violation; and

(B) interview the association's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation.

Documents and information provided to Settling State antitrust authorities shall be kept confidential by and among such authorities, and shall be utilized only by the Settling States and only for the purpose of enforcing this Agreement or the criminal law. The inspection and discovery rights provided to the Settling States pursuant to this subsection shall be coordinated so as to avoid repetitive and excessive inspection and discovery.

(q) Prohibition on Agreements to Suppress Research. No Participating Manufacturer may enter into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in this subsection shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

(r) Prohibition on Material Misrepresentations. No Participating Manufacturer may make any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Nothing in this subsection shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

IV. PUBLIC ACCESS TO DOCUMENTS

(a) After the MSA Execution Date, the Original Participating Manufacturers and the Tobacco-Related Organizations will support an application for the dissolution of any protective orders entered in each Settling State's lawsuit identified in Exhibit D with respect only to those documents, indices and privilege logs that have been produced as of the MSA Execution Date to such Settling State and (1) as to which defendants have made no claim, or have withdrawn any claim, of attorney-client privilege, attorney work-product protection, common interest/joint defense privilege (collectively, "privilege"), trade-secret protection, or confidential or proprietary business information; and (2) that are not inappropriate for public disclosure because of personal privacy interests or contractual rights of third parties that may not be abrogated by the Original Participating Manufacturers or the Tobacco-Related Organizations.

(b) Notwithstanding State-Specific Finality, if any order, ruling or recommendation was issued prior to September 17, 1998 rejecting a claim of privilege or trade-secret protection with respect to any document or documents in a lawsuit identified in Exhibit D, the Settling State in which such order, ruling or recommendation was made may, no later than 45 days after the occurrence of State-Specific Finality in such Settling State, seek public disclosure of such document or documents by application to the court that issued such order, ruling or recommendation and the court shall retain jurisdiction for such purposes. The Original Participating Manufacturers and Tobacco-Related Organizations do not consent to, and may object to, appeal from or otherwise oppose any such application for disclosure. The Original Participating Manufacturers and Tobacco-Related Organizations will not assert that the settlement of such lawsuit has divested the court of jurisdiction or that such Settling State lacks standing to seek public disclosure on any applicable ground.

(c) The Original Participating Manufacturers will maintain at their expense their Internet document websites accessible through "TobaccoResolution.com" or a similar website until June 30, 2010. The Original Participating Manufacturers will maintain the documents that currently appear on their respective websites and will add additional documents to their websites as provided in this section IV.

(d) Within 180 days after the MSA Execution Date, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of the following documents, except as provided in subsections IV(e) and IV(f) below:

(1) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in any action identified in Exhibit D or any action identified in section 2 of Exhibit H that was filed by an Attorney General. Among these documents, each Original Participating Manufacturer and Tobacco-Related Organization will give the highest priority to (A) the documents that were listed by the State of Washington as trial exhibits in the State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King); and (B) the documents as to which such Original Participating Manufacturer or Tobacco-Related Organization withdrew any claim of privilege as a result of the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County);

(2) all documents that can be identified as having been produced by, and copies of transcripts of depositions given by, such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in the litigation matters specified in section 1 of Exhibit H; and

(3) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date and listed by the plaintiffs as trial exhibits in the litigation matters specified in section 2 of Exhibit H.

(e) Unless copies of such documents are already on its website, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of documents produced in any production of documents that takes place on or after the date 30 days before the MSA Execution Date in any federal or state court civil action concerning smoking and health. Copies of any documents required to be placed on a website pursuant to this subsection will be placed on such website within the later of 45 days after the MSA Execution Date or within 45 days after the production of such documents in any federal or state court action concerning smoking and health. This obligation will continue until June 30, 2010. In placing such newly produced documents on its website, each Original Participating Manufacturer or Tobacco-Related Organization will identify, as part of its index to be created pursuant to subsection IV(h), the action in which it produced such documents and the date on which such documents were added to its website.

(f) Nothing in this section IV shall require any Original Participating Manufacturer or Tobacco-Related Organization to place on its website or otherwise disclose documents that: (1) it continues to claim to be privileged, a trade secret, confidential or proprietary business information, or that contain other information not appropriate for public disclosure because of personal privacy interests or contractual rights of third parties; or (2) continue to be subject to any protective order, sealing order or other order or ruling that prevents or limits a litigant from disclosing such documents.

(g) Oversized or multimedia records will not be required to be placed on the Website, but each Original Participating Manufacturers and Tobacco-Related Organizations will make any such records available to the public by placing copies of them in the document depository established in The State of Minnesota, et al. v. Philip Morris Incorporated, et al., C1-94-8565 (County of Ramsey, District Court, 2d Judicial Cir.).

(h) Each Original Participating Manufacturer will establish an index and other features to improve searchable access to the document images on its website, as set forth in Exhibit I.

(i) Within 90 days after the MSA Execution Date, the Original Participating Manufacturers will furnish NAAG with a project plan for completing the Original Participating Manufacturers' obligations under subsection IV(h) with respect to documents currently on their websites and documents being placed on their websites pursuant to subsection IV(d). NAAG may engage a computer consultant at the Original Participating Manufacturers' expense for a period not to exceed two years and at a cost not to exceed $100,000. NAAG's computer consultant may review such plan and make recommendations consistent with this Agreement. In addition, within 120 days after the completion of the Original Participating Manufacturers' obligations under subsection IV(d), NAAG's computer consultant may make final recommendations with respect to the websites consistent with this Agreement. In preparing these recommendations, NAAG's computer consultant may seek input from Settling State officials, public health organizations and other users of the websites.

(j) The expenses incurred pursuant to subsection IV(i), and the expenses related to documents of the Tobacco-Related Organizations, will be severally shared among the Original Participating Manufacturers (allocated among them according to their Relative Market Shares). All other expenses incurred under this section will be borne by the Original Participating Manufacturer that incurs such expense.

V. TOBACCO CONTROL AND UNDERAGE USE LAWS

Each Participating Manufacturer agrees that following State-Specific Finality in a Settling State it will not initiate, or cause to be initiated, a facial challenge against the enforceability or constitutionality of such Settling State's (or such Settling State's political subdivisions') statutes, ordinances and administrative rules relating to tobacco control enacted prior to June 1, 1998 (other than a statute, ordinance or rule challenged in any lawsuit listed in Exhibit M).

VI. ESTABLISHMENT OF A NATIONAL FOUNDATION

(a) Foundation Purposes. The Settling States believe that a comprehensive, coordinated program of public education and study is important to further the remedial goals of this Agreement. Accordingly, as part of the settlement of claims described herein, the payments specified in subsections VI(b), VI(c), and IX(e) shall be made to a charitable foundation, trust or similar organization (the "Foundation") and/or to a program to be operated within the Foundation (the "National Public Education Fund"). The purposes of the Foundation will be to support (1) the study of and programs to reduce Youth Tobacco Product usage and Youth substance abuse in the States, and (2) the study of and educational programs to prevent diseases associated with the use of Tobacco Products in the States.

(b) Base Foundation Payments. On March 31, 1999, and on March 31 of each subsequent year for a period of nine years thereafter, each Original Participating Manufacturer shall severally pay its Relative Market Share of $25,000,000 to fund the Foundation. The payments to be made by each of the Original Participating Manufacturers pursuant to this subsection (b) shall be subject to no adjustments, reductions, or offsets, and shall be paid to the Escrow Agent (to be credited to the Subsection VI(b) Account), who shall disburse such payments to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State.

(c) National Public Education Fund Payments.

(1) Each Original Participating Manufacturer shall severally pay its Relative Market Share of the following base amounts on the following dates to the Escrow Agent for the benefit of the Foundation's National Public Education Fund to be used for the purposes and as described in subsections VI(f)(1), VI(g) and VI(h) below: $250,000,000 on March 31, 1999; $300,000,000 on March 31, 2000; $300,000,000 on March 31, 2001; $300,000,000 on March 31, 2002; and $300,000,000 on March 31, 2003, as such amounts are modified in accordance with this subsection (c). The payment due on March 31, 1999 pursuant to this subsection (c)(1) is to be credited to the Subsection VI(c) Account (First). The payments due on or after March 31, 2000 pursuant to this subsection VI(c)(1) are to be credited to the Subsection VI(c) Account (Subsequent).

(2) The payments to be made by the Original Participating Manufacturers pursuant to this subsection (c), other than the payment due on March 31, 1999, shall be subject to the Inflation Adjustment, the Volume Adjustment and the offset for miscalculated or disputed payments described in subsection XI(i).

(3) The payment made pursuant to this subsection (c) on March 31, 1999 shall be disbursed by the Escrow Agent to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State. Each remaining payment pursuant to this subsection (c) shall be disbursed by the Escrow Agent to the Foundation only when State-Specific Finality has occurred in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date.

(4) In addition to the payments made pursuant to this subsection (c), the National Public Education Fund will be funded (A) in accordance with subsection IX(e), and (B) through monies contributed by other entities directly to the Foundation and designated for the National Public Education Fund ("National Public Education Fund Contributions").

(5) The payments made by the Original Participating Manufacturers pursuant to this subsection (c) and/or subsection IX(e) and monies received from all National Public Education Fund Contributions will be deposited and invested in accordance with the laws of the state of incorporation of the Foundation.

(d) Creation and Organization of the Foundation. NAAG, through its executive committee, will provide for the creation of the Foundation. The Foundation shall be organized exclusively for charitable, scientific, and educational purposes within the meaning of Internal Revenue Code section 501(c)(3). The organizational documents of the Foundation shall specifically incorporate the provisions of this Agreement relating to the Foundation, and will provide for payment of the Foundation's administrative expenses from the funds paid pursuant to subsection VI(b) or VI(c). The Foundation shall be governed by a board of directors. The board of directors shall be comprised of eleven directors. NAAG, the National Governors' Association ("NGA"), and the National Conference of State Legislatures ("NCSL") shall each select from its membership two directors. These six directors shall select the five additional directors. One of these five additional directors shall have expertise in public health issues. Four of these five additional directors shall have expertise in medical, child psychology, or public health disciplines. The board of directors shall be nationally geographically diverse.

(e) Foundation Affiliation. The Foundation shall be formally affiliated with an educational or medical institution selected by the board of directors.

(f) Foundation Functions. The functions of the Foundation shall be:

(1) carrying out a nationwide sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products;

(2) developing and disseminating model advertising and education programs to counter the use by Youth of substances that are unlawful for use or purchase by Youth, with an emphasis on reducing Youth smoking; monitoring and testing the effectiveness of such model programs; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs, as appropriate;

(3) developing and disseminating model classroom education programs and curriculum ideas about smoking and substance abuse in the K-12 school system, including specific target programs for special at-risk populations; monitoring and testing the effectiveness of such model programs and ideas; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs or ideas, as appropriate;

(4) developing and disseminating criteria for effective cessation programs; monitoring and testing the effectiveness of such criteria; and continuing to develop and disseminate revised versions of such criteria, as appropriate;

(5) commissioning studies, funding research, and publishing reports on factors that influence Youth smoking and substance abuse and developing strategies to address the conclusions of such studies and research;

(6) developing other innovative Youth smoking and substance abuse prevention programs;

(7) providing targeted training and information for parents;

(8) maintaining a library open to the public of Foundation-funded studies, reports and other publications related to the cause and prevention of Youth smoking and substance abuse;

(9) tracking and monitoring Youth smoking and substance abuse, with a focus on the reasons for any increases or failures to decrease Youth smoking and substance abuse and what actions can be taken to reduce Youth smoking and substance abuse;

(10) receiving, controlling, and managing contributions from other entities to further the purposes described in this Agreement; and

(11) receiving, controlling, and managing such funds paid by the Participating Manufacturers pursuant to subsections VI(b) and VI(c) above.

(g) Foundation Grant-Making. The Foundation is authorized to make grants from the National Public Education Fund to Settling States and their political subdivisions to carry out sustained advertising and education programs to (1) counter the use by Youth of Tobacco Products, and (2) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products. In making such grants, the Foundation shall consider whether the Settling State or political subdivision applying for such grant:

(1) demonstrates the extent of the problem regarding Youth smoking in such Settling State or political subdivision;

(2) either seeks the grant to implement a model program developed by the Foundation or provides the Foundation with a specific plan for such applicant's intended use of the grant monies, including demonstrating such applicant's ability to develop an effective advertising/education campaign and to assess the effectiveness of such advertising/education campaign;

(3) has other funds readily available to carry out a sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products; and

(4) is a Settling State that has not severed this section VI from its settlement with the Participating Manufacturers pursuant to subsection VI(i) below, or is a political subdivision in such a Settling State.

(h) Foundation Activities. The Foundation shall not engage in, nor shall any of the Foundation's money be used to engage in, any political activities or lobbying, including, but not limited to, support of or opposition to candidates, ballot initiatives, referenda or other similar activities. The National Public Education Fund shall be used only for public education and advertising regarding the addictiveness, health effects, and social costs related to the use of tobacco products and shall not be used for any personal attack on, or vilification of, any person (whether by name or business affiliation), company, or governmental agency, whether individually or collectively. The Foundation shall work to ensure that its activities are carried out in a culturally and linguistically appropriate manner. The Foundation's activities (including the National Public Education Fund) shall be carried out solely within the States. The payments described in subsections VI(b) and VI(c) above are made at the direction and on behalf of Settling States. By making such payments in such manner, the Participating Manufacturers do not undertake and expressly disclaim any responsibility with respect to the creation, operation, liabilities, or tax status of the Foundation or the National Public Education Fund.

(i) Severance of this Section. If the Attorney General of a Settling State determines that such Settling State may not lawfully enter into this section VI as a matter of applicable state law, such Attorney General may sever this section VI from its settlement with the Participating Manufacturers by giving written notice of such severance to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k) hereof. If any Settling State exercises its right to sever this section VI, this section VI shall not be considered a part of the specific settlement between such Settling State and the Participating Manufacturers, and this section VI shall not be enforceable by or in such Settling State. The payment obligation of subsections VI(b) and VI(c) hereof shall apply regardless of a determination by one or more Settling States to sever section VI hereof; provided, however, that if all Settling States sever section VI hereof, the payment obligations of subsections (b) and (c) hereof shall be null and void. If the Attorney General of a Settling State that severed this section VI subsequently determines that such Settling State may lawfully enter into this section VI as a matter of applicable state law, such Attorney General may rescind such Settling State's previous severance of this section VI by giving written notice of such rescission to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k). If any Settling State rescinds such severance, this section VI shall be considered a part of the specific settlement between such Settling State and the Participating Manufacturers (including for purposes of subsection (g)(4)), and this section VI shall be enforceable by and in such Settling State.

VII. ENFORCEMENT

(a) Jurisdiction. Each Participating Manufacturer and each Settling State acknowledge that the Court: (1) has jurisdiction over the subject matter of the action identified in Exhibit D in such Settling State and over each Participating Manufacturer; (2) shall retain exclusive jurisdiction for the purposes of implementing and enforcing this Agreement and the Consent Decree as to such Settling State; and (3) except as provided in subsections IX(d), XI(c) and XVII(d) and Exhibit O, shall be the only court to which disputes under this Agreement or the Consent Decree are presented as to such Settling State. Provided, however, that notwithstanding the foregoing, the Escrow Court (as defined in the Escrow Agreement) shall have exclusive jurisdiction, as provided in section 15 of the Escrow Agreement, over any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, the Escrow Agreement.

(b) Enforcement of Consent Decree. Except as expressly provided in the Consent Decree, any Settling State or Released Party may apply to the Court to enforce the terms of the Consent Decree (or for a declaration construing any such term) with respect to alleged violations within such Settling State. A Settling State may not seek to enforce the Consent Decree of another Settling State; provided, however, that nothing contained herein shall affect the ability of any Settling State to (1) coordinate state enforcement actions or proceedings, or (2) file or join any amicus brief. In the event that the Court determines that any Participating Manufacturer or Settling State has violated the Consent Decree within such Settling State, the party that initiated the proceedings may request any and all relief available within such Settling State pursuant to the Consent Decree.

(c) Enforcement of this Agreement.

(1) Except as provided in subsections IX(d), XI(c), XVII(d) and Exhibit O, any Settling State or Participating Manufacturer may bring an action in the Court to enforce the terms of this Agreement (or for a declaration construing any such term ("Declaratory Order")) with respect to disputes, alleged violations or alleged breaches within such Settling State.

(2) Before initiating such proceedings, a party shall provide 30 days' written notice to the Attorney General of each Settling State, to NAAG, and to each Participating Manufacturer of its intent to initiate proceedings pursuant to this subsection. The 30-day notice period may be shortened in the event that the relevant Attorney General reasonably determines that a compelling time-sensitive public health and safety concern requires more immediate action.

(3) In the event that the Court determines that any Participating Manufacturer or Settling State has violated or breached this Agreement, the party that initiated the proceedings may request an order restraining such violation or breach, and/or ordering compliance within such Settling State (an "Enforcement Order").

(4) If an issue arises as to whether a Participating Manufacturer has failed to comply with an Enforcement Order, the Attorney General for the Settling State in question may seek an order for interpretation or for monetary, civil contempt or criminal sanctions to enforce compliance with such Enforcement Order.

(5) If the Court finds that a good-faith dispute exists as to the meaning of the terms of this Agreement or a Declaratory Order, the Court may in its discretion determine to enter a Declaratory Order rather than an Enforcement Order.

(6) Whenever possible, the parties shall seek to resolve an alleged violation of this Agreement by discussion pursuant to subsection XVIII(m) of this Agreement. In addition, in determining whether to seek an Enforcement Order, or in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation of an Enforcement Order, the Attorney General shall give good-faith consideration to whether the Participating Manufacturer that is claimed to have violated this Agreement has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless such party has been guilty of a pattern of violations of like nature.

(d) Right of Review. All orders and other judicial determinations made by any court in connection with this Agreement or any Consent Decree shall be subject to all available appellate review, and nothing in this Agreement or any Consent Decree shall be deemed to constitute a waiver of any right to any such review.

(e) Applicability. This Agreement and the Consent Decree apply only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a breach or violation of this Agreement or the Consent Decree (or any Declaratory Order or Enforcement Order issued in connection with this Agreement or the Consent Decree) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such breach or violation, and the Court shall have no jurisdiction to do so.

(f) Coordination of Enforcement. The Attorneys General of the Settling States (through NAAG) shall monitor potential conflicting interpretations by courts of different States of this Agreement and the Consent Decrees. The Settling States shall use their best efforts, in cooperation with the Participating Manufacturers, to coordinate and resolve the effects of such conflicting interpretations as to matters that are not exclusively local in nature.

(g) Inspection and Discovery Rights. Without limitation on whatever other rights to access they may be permitted by law, following State-Specific Finality in a Settling State and for seven years thereafter, representatives of the Attorney General of such Settling State may, for the purpose of enforcing this Agreement and the Consent Decree, upon reasonable cause to believe that a violation of this Agreement or the Consent Decree has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days): (1) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of each Participating Manufacturer insofar as they pertain to such believed violation; and (2) interview each Participating Manufacturer's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation. Documents and information provided to representatives of the Attorney General of such Settling State pursuant to this section VII shall be kept confidential by the Settling States, and shall be utilized only by the Settling States and only for purposes of enforcing this Agreement, the Consent Decree and the criminal law. The inspection and discovery rights provided to such Settling State pursuant to this subsection shall be coordinated through NAAG so as to avoid repetitive and excessive inspection and discovery.

VIII. CERTAIN ONGOING RESPONSIBILITIES OF THE SETTLING STATES

(a) Upon approval of the NAAG executive committee, NAAG will provide coordination and facilitation for the implementation and enforcement of this Agreement on behalf of the Attorneys General of the Settling States, including the following:

(1) NAAG will assist in coordinating the inspection and discovery activities referred to in subsections III(p)(3) and VII(g) regarding compliance with this Agreement by the Participating Manufacturers and any new tobacco-related trade associations.

(2) NAAG will convene at least two meetings per year and one major national conference every three years for the Attorneys General of the Settling States, the directors of the Foundation and three persons designated by each Participating Manufacturer. The purpose of the meetings and conference is to evaluate the success of this Agreement and coordinate efforts by the Attorneys General and the Participating Manufacturers to continue to reduce Youth smoking.

(3) NAAG will periodically inform NGA, NCSL, the National Association of Counties and the National League of Cities of the results of the meetings and conferences referred to in subsection (a)(2) above.

(4) NAAG will support and coordinate the efforts of the Attorneys General of the Settling States in carrying out their responsibilities under this Agreement.

(5) NAAG will perform the other functions specified for it in this Agreement, including the functions specified in section IV.

(b) Upon approval by the NAAG executive committee to assume the responsibilities outlined in subsection VIII(a) hereof, each Original Participating Manufacturer shall cause to be paid, beginning on December 31, 1998, and on December 31 of each year thereafter through and including December 31, 2007, its Relative Market Share of $150,000 per year to the Escrow Agent (to be credited to the Subsection VIII(b) Account), who shall disburse such monies to NAAG within 10 Business Days, to fund the activities described in subsection VIII(a).

(c) The Attorneys General of the Settling States, acting through NAAG, shall establish a fund ("The States' Antitrust/Consumer Protection Tobacco Enforcement Fund") in the form attached as Exhibit J, which will be maintained by

such Attorneys General to supplement the Settling States' (1) enforcement and implementation of the terms of this Agreement and the Consent Decrees, and (2) investigation and litigation of potential violations of laws with respect to Tobacco Products, as set forth in Exhibit J. Each Original Participating Manufacturer shall on March 31, 1999, severally pay its Relative Market Share of $50,000,000 to the Escrow Agent (to be credited to the Subsection VIII(c) Account), who shall disburse such monies to NAAG upon the occurrence of State-Specific Finality in at least one Settling State. Such funds will be used in accordance with the provisions of Exhibit J.

IX. PAYMENTS

(a) 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) <u>Allocation among Settling States of NPM Adjustment for Original Participating Manufacturers.</u>

(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.

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)(l) 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 (l) 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
<u>FORM OF ESCROW AGREEMENT</u>

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-l. 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 CV96-0148414S (Conn.)

8. Georgia
State of Georgia et al. v. Philip Morris, Inc., et al., Superior Court, Fulton County, No. CA E-61692 (Ga.)

9. Hawaii
State of Hawaii v. Brown & Williamson Tobacco Corp., et al., Circuit Court, First Circuit, No. 97-0441-01 (Haw.)

10. Idaho
State of Idaho v. Philip Morris, Inc., et al., Fourth Judicial District, Ada County, No. CVOC 9703239D (Idaho)

11. Illinois
People of the State of Illinois v. Philip Morris et al., Circuit Court of Cook County, No. 96-L13146 (Ill.)

12. Indiana
State of Indiana v. Philip Morris, Inc., et al., Marion County Superior Court, No. 49D 07-9702-CT-000236 (Ind.)

13. Iowa
State of Iowa v. R.J. Reynolds Tobacco Company et al., Iowa District Court, Fifth Judicial District, Polk County, No. CL71048 (Iowa)

14. Kansas
State of Kansas v. R.J. Reynolds Tobacco Company, et al., District Court of Shawnee County, Division 2, No. 96-CV-919 (Kan.)

15. Louisiana
Ieyoub v. The American Tobacco Company, et al., 14th Judicial District Court, Calcasieu Parish, No. 96-1209 (La.)

16. Maine
State of Maine v. Philip Morris, Inc., et al., Superior Court, Kennebec County, No. CV 97-134 (Me.)

17. Maryland
Maryland v. Philip Morris Incorporated, et al., Baltimore City Circuit Court, No. 96-122017-CL211487 (Md.)

18. Massachusetts
Commonwealth of Massachusetts v. Philip Morris Inc., et al., Middlesex Superior Court, No. 95-7378 (Mass.)

19. Michigan
Kelley v. Philip Morris Incorporated, et al., Ingham County Circuit Court, 30th Judicial Circuit, No. 96-84281-CZ (Mich.)

20. Missouri
State of Missouri v. American Tobacco Co., Inc. et al., Circuit Court, City of St. Louis, No. 972-1465 (Mo.)

21. Montana
State of Montana v. Philip Morris, Inc., et al., First Judicial Court, Lewis and Clark County, No. CDV 9700306-14 (Mont.)

22. Nebraska
State of Nebraska v. R.J. Reynolds Tobacco Co., et al., District Court, Lancaster County, No. 573277 (Neb.)

23. Nevada
Nevada v. Philip Morris, Incorporated, et al., Second Judicial Court, Washoe County, No. CV97-03279 (Nev.)

24. New Hampshire
New Hampshire v. R.J. Reynolds, Tobacco Co., et al., New Hampshire Superior Court, Merrimack County, No. 97-E-165 (N.H.)

25. New Jersey
State of New Jersey v. R.J. Reynolds Tobacco Company, et al., Superior Court, Chancery Division, Middlesex County, No. C-254-96 (N.J.)

26. New Mexico
State of New Mexico, v. The American Tobacco Co., et al., First Judicial District Court, County of Santa Fe, No. SF-1235 c (N.M.)

27. New York State
State of New York et al. v. Philip Morris, Inc., et al., Supreme Court of the State of New York, County of New York, No. 400361/97 (N.Y.)

28. Ohio
State of Ohio v. Philip Morris, Inc., et al., Court of Common Pleas, Franklin County, No. 97CVH055114 (Ohio)

29. Oklahoma
State of Oklahoma, et al. v. R.J. Reynolds Tobacco Company, et al., District Court, Cleveland County, No. CJ-96-1499-L (Okla.)

30. Oregon
State of Oregon v. The American Tobacco Co., et al., Circuit Court, Multnomah County, No. 9706-04457 (Or.)

31. Pennsylvania
Commonwealth of Pennsylvania v. Philip Morris, Inc., et al., Court of Common Pleas, Philadelphia County, April Term 1997, No. 2443

32. Puerto Rico
Rossello, et al. v. Brown & Williamson Tobacco Corporation, et al., U.S. District Court, Puerto Rico, No. 97-1910JAF

33. Rhode Island
State of Rhode Island v. American Tobacco Co., et al., Rhode Island Superior Court, Providence, No. 97-3058 (R.I.)

34. South Carolina
State of South Carolina v. Brown & Williamson Tobacco Corporation, et al., Court of Common Pleas, Fifth Judicial Circuit, Richland County, No. 97-CP-40-1686 (S.C.)

35. South Dakota
State of South Dakota, et al. v. Philip Morris, Inc., et al., Circuit Court, Hughes County, Sixth Judicial Circuit, No. 98-65 (S.D.)

36. Utah
State of Utah v. R.J. Reynolds Tobacco Company, et al., U.S. District Court, Central Division, No. 96 CV 0829W (Utah)

37. Vermont
State of Vermont v. Philip Morris, Inc., et al., Chittenden Superior Court, Chittenden County, No. 744-97 (Vt.) and 5816-98 (Vt.)

38. Washington
State of Washington v. American Tobacco Co. Inc., et al., Superior Court of Washington, King County, No. 96-2-1505608SEA (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.
[XXXXXX XXXXX XXXX], et al.,
Defendants.

- x

CONSENT DECREE AND FINAL JUDGMENT

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."

(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.

---

[1] [A State may elect to delete the "findings and purposes" section in its entirety. Other changes or substitutions with respect to the "findings and purposes" section (except for particularized state procedural or technical requirements) will mean that the statute will no longer conform to this model.]

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(i) "Tobacco Product Manufacturer" means an entity that after the date of enactment of this Act directly (and not exclusively through any affiliate):

(1) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsections II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

(2) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(3) becomes a successor of an entity described in paragraph (1) or (2).

The term "Tobacco Product Manufacturer" shall not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within any of (1) - (3) above.

(j) "Units sold" means the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State. The [fill in name of responsible state agency] shall promulgate such regulations as are necessary to ascertain the amount of State excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

Section __. Requirements.

Any tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary or intermediaries) after the date of enactment of this Act shall do one of the following:

(a) become a participating manufacturer (as that term is defined in section II(jj) of the Master Settlement Agreement) and generally perform its financial obligations under the Master Settlement Agreement; or

(b) (1) place into a qualified escrow fund by April 15 of the year following the year in question the following amounts (as such amounts are adjusted for inflation) --

1999: $.0094241 per unit sold after the date of enactment of this Act;[2]

2000: $.0104712 per unit sold after the date of enactment of this Act;[3]

for each of 2001 and 2002: $.0136125 per unit sold after the date of enactment of this Act;

for each of 2003 through 2006: $.0167539 per unit sold after the date of enactment of this Act;

for each of 2007 and each year thereafter: $.0188482 per unit sold after the date of enactment of this Act.

(2) A tobacco product manufacturer that places funds into escrow pursuant to paragraph (1) shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances --

(A) to pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the State or any releasing party located or residing in the State. Funds shall be released from escrow under this subparagraph (i) in the order in which they were placed into escrow and (ii) only to the extent and at the time necessary to make payments required under such judgment or settlement;

(B) to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the State's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement (as determined pursuant to section IX(i)(2) of the Master Settlement Agreement, and before any of the adjustments or offsets described in section IX(i)(3) of that Agreement other than the Inflation Adjustment) had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or

(C) to the extent not released from escrow under subparagraphs (A) or (B), funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

(3) Each tobacco product manufacturer that elects to place funds into escrow pursuant to this subsection shall annually certify to the Attorney General [or other State official] that it is in compliance with this subsection. The Attorney General [or other State official] may bring a civil action on behalf of the State against any tobacco product 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]

[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.]

[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 B

CONSENT DECREE

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Chief Civil Department,
and
Judge William Downing
Noted without oral argument May 11, 2001

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR THE COUNTY OF KING

STATE OF WASHINGTON, Plaintiff, v. AMERICAN TOBACCO CO., et al Defendants.	NO. 96-2-15056-8SEA NOTICE FOR HEARING SEATTLE COURTHOUSE ONLY (Clerk's Action Required)
STATE OF WASHINGTON Plaintiff, v. R.J. REYNOLDS TOBACCO COMPANY, a New Jersey corporation. Defendant.	NO.-01-2-08153-5SEA NOTICE FOR HEARING SEATTLE COURTHOUSE ONLY (Clerk's Action Required)

TO: **THE CLERK OF THE COURT** and to all other parties per list on reverse side:
PLEASE TAKE NOTICE that an issue of law in this case will be heard on the date below and the Clerk is directed to note this issue on the calendar checked below.

Calendar Date: May 11, 2001 Day of Week: Friday
Nature of Motion: Stipulation and Order

COPY

DESIGNATED CALENDAR FOR JUDGE HEARINGS - SEATTLE COURTHOUSE

CASES ASSIGNED TO INDIVIDUAL JUDGES - Seattle

[X] Without oral argument (Mon - Fri) [ ] With oral argument Hearing

Date/Time: May 11, 2001

If oral argument on the motion is allowed (LR 7(b)(2)), contact staff of assigned judge to schedule date and time before filing this notice.

Judge's Name: William Downing Trial Date:_August 5, 2002

- **Working Papers:** The ***judge's name***, date and time of hearing ***must*** be noted in the upper right corner of the Judge's copy. ***Deliver Judge's copies to Judges' Mailroom at C203.***

CHIEF CRIMINAL DEPARTMENT - Seattle in E1201

[ ] Bond Forfeiture 3:15 pm, 2nd Thur of each month

[ ] Certificates of Rehabilitation- Weapon Possession (Convictions from Limited Jurisdiction Courts) 3:30 First Tues of each month.

CHIEF CIVIL DEPARTMENT – Seattle – (Please report to W764 for assignment)

[ ] Extraordinary Writs (Show Cause Hearing) (LR40(a)(2)(R) 1:30 p.m. Tues/Wed -report to Room E913

[ ] Supplemental Proceedings (1:30 pm Tues/ Wed) [ ] Public Use and Necessity Hearing (1:30 pm Tues)

[ ] DOL Stays 1:30 pm Tues/Wed [X] Motions to Consolidate (without oral argument)

Non-Assigned Cases:

[ ] Certificates of Rehabilitation (**Employment**) 1:30 pm Tues/Wed

[ ] Dispositive Motions and Revisions (1:30 pm Tues/Wed)

[ ] Non-Dispositive Motions M-F (without oral argument)

- ***Deliver working copies to Judges' Mailroom, Room C203.*** *In upper right corner of papers write "Chief Civil Department" and date of hearing*

Signature ___[signature]___

Print/Type Name: Robert A. Lipson, Assistant Attorney General WSBA # 11889

Address: 900 Fourth Avenue, #2000 City, State, Zip: Seattle, WA 98164-1012

Attorney for: Attorney General of Washington

Telephone: (206) 389-2513 Date: April 27, 2001

COPY

LIST NAMES, ADDRESSES & TELEPHONE NUMBERS
OF ALL PARTIES REQUIRING NOTICE

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TELEPHONE: (212) 403-1000

ATTORNEY FOR: Philip Morris Tobacco Company

IMPORTANT NOTICE REGARDING CASES

Party requesting hearing must file motion & affidavits separately along with this notice. List names, addresses and telephone numbers of all parties requiring notice (including GAL) on this page. Serve a copy of this notice, with motion documents, on all parties.

The original must be filed at the Clerk's Office not less than six court days prior to requested hearing date, except for Summary Judgment Motions (to be filed with Clerk 28 days in advance).

THIS IS ONLY A PARTIAL SUMMARY OF THE LOCAL RULES AND ALL PARTIES ARE ADVISED TO CONSULT WITH AN ATTORNEY.

The SEATTLE COURTHOUSE is in Seattle, Washington at 516 Third Avenue. The Clerk's Office is on the sixth floor, room E609. The Judges' Mailroom is Room C203.

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APPENDIX C

ARBITRATION FINAL AWARD RE: STATE OF WASHINGTON IN THE 2003 NPM ADJUSTMENT PROCEEDINGS

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Hon. Fern M. Smith (Ret.)
JAMS
Two Embarcadero Center, Suite 1500
San Francisco, CA 94111
Telephone: (415) 982-5267
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ARBITRATOR

ARBITRATION

In the 2003 NPM Adjustment Proceedings	**JAMS Ref No. 1100053390** **FINAL AWARD RE: STATE OF WASHINGTON**

CHAPTER I: THE PARTIES TO A SPECIFIC STATE AWARD

Petitioners are manufacturers of tobacco products that have joined the MSA ("Master Settlement Agreement"), entered into in 1998, and agreed to be bound by its terms. The MSA refers to such manufacturers as "Participating Manufacturers" or "PMs." *See* MSA § II(jj). The PMs fall into two categories. The "Original Participating Manufacturers," or "OPMs," are those manufacturers that were original parties to the MSA: Philip Morris USA Inc., R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company. *See* MSA § II(hh). (A fourth OPM, Brown & Williamson Tobacco Corporation, combined with R.J. Reynolds Tobacco Company in 2004.) The "Subsequent Participating Manufacturers," or "SPMs," are smaller manufacturers, most of which were never sued by the States, but joined the MSA thereafter. *See* MSA § II(tt). The following SPMs claim entitlement to an NPM Adjustment for 2003 and are petitioners in these proceedings: Commonwealth Brands, Inc., Compania Industrial de Tabacos Monte Paz, S.A., Daughters & Ryan, Inc., House of Prince A/S, Japan Tobacco International U.S.A. Inc., King Maker Marketing, Inc., Kretek International, Liggett Group LLC, Peter Stokkebye

Tobaksfabrik A/S, P.T. Djarum, Santa Fe Natural Tobacco Company, Inc., Sherman 1400 Broadway N.Y.C., Inc., Top Tobacco LP, and Von Eicken Group. All Petitioners are collectively referred to as PMs for purposes of this Award, and a finding as to one PM is a finding as to all, unless specifically noted.

Respondents in the Petitioners' claim were initially listed as the 52 States and Territories that are parties to the MSA. The MSA refers to these States and Territories as "Settling States."

The Settling States originally consisted of Alabama, Alaska, American Samoa, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Georgia, Guam, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, the Northern Marianas Islands, Ohio, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Tennessee, U.S. Virgin Islands, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. (Four States–Florida, Minnesota, Mississippi, and Texas–had entered into separate settlements with certain PMs prior to the MSA and, therefore, are not parties to the MSA.) Since this proceeding began, the PMs have dismissed their allegations against several states (Alaska, Delaware, Hawaii, Idaho, Massachusetts, New Jersey, Rhode Island, South Dakota, Utah, Vermont, Wisconsin, Wyoming, Guam, the Northern Mariana Islands, American Samoa, and the U.S. Virgin Islands; *see* Participating Manufacturers' Notice of Contest as to Certain States' Claims of Diligent Enforcement, filed November 3, 2011). Further, numerous other states entered into a Settlement Agreement with the PMs, dated March 12, 2013, leaving 15 States who remain in this proceeding for whom Awards are now addressed by this Arbitration Panel (the "Panel"). Numerous issues ("Global Issues") are decided and applicable to all remaining Parties; however, because each remaining Settling State may have recourse to its own MSA Court, the Panel will issue a separate Award for each specific state, including therein both the Global Issues and also determinations that are specific to that state only.

Although numerous references may be made to the National Association of Attorneys General ("NAAG") and the "NAAG Tobacco Project," which assist the states in implementing

the MSA and through which the states often act with respect to NPM Adjustment issues and enforcement of the Escrow Statutes, NAAG was never made a party to this Arbitration proceeding. NAAG is defined in the Definitions section of the MSA as "the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement." MSA § II(bb). It is undisputed that NAAG served as an advisory and legal resource to the Settling States, including interpreting the MSA and opining on potential requirements for "diligent enforcement." These Awards may also refer to determinations made by the MSA's "Independent Auditor," which since 1998 has been PriceWaterhouseCoopers LLP ("PwC"). The MSA provides that the "Independent Auditor" is responsible for "calculat[ing] and determin[ing] all payments" under the MSA, applying the MSA's various "adjustments, reductions and offsets" (including the NPM Adjustment) to those payments, and determining "the allocation of such payments, reductions, offsets . . . among the Settling States." MSA § XI(a)(1). Although the Independent Auditor plays a major role in the implementation of the MSA, it is not a party to this Arbitration, and the Panel has no jurisdiction over its actions or determinations.

CHAPTER II: THE BACKGROUND

A. Origin of the Dispute.

This section is set forth as a summary and does not constitute either findings of fact or conclusions of law by the Panel.

Both the Supreme Court and the Settling States have referred to the MSA as a "landmark" public health agreement. *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 533 (2001); NAAG March 8, 2006 News Release. The MSA settled and released past and future claims by the Settling States for, among other things, recovery of health-care costs attributed to smoking-related illnesses. In exchange, the PMs agreed to make substantial annual payments in perpetuity based upon their annual nationwide cigarette sales and to be subject to an array of advertising, marketing, and other restrictions. Since the MSA was first signed in November 1998, over 50 tobacco companies have agreed to be bound by its terms. Tobacco product manufacturers who have not joined the MSA and agreed to its terms are referred to as Non-Participating

Manufacturers ("NPMs").

Pursuant to the MSA, each PM makes a single annual payment based on its nationwide cigarette sales volume during each calendar year. The annual payment on a year's volume is due on April 15 of the following year. It is alleged, and not disputed, that these annual payments total in the billions of dollars each year. For example, the OPMs' aggregate base payment obligation was approximately $8 billion for 2003 (the year in question here). *See* MSA §§ IX(c)(1)-(2). The SPMs make separate annual payments also based on their sales volume during the year. *See* MSA § IX(i). The PMs' annual payments are calculated by an "Independent Auditor" agreed to by the parties. *See* MSA § XI(a)(1).

The MSA's annual base payment amounts are subject to various adjustments, including an Inflation Adjustment and a Volume Adjustment (under which the base payments are increased or decreased in proportion to changes in the OPMs' nationwide volume of sales). *See* MSA §§ IX(c), XI(a). According to the PMs, and not disputed, the OPMs' aggregate annual payments after these and other adjustments (other than the NPM Adjustment) since the MSA was entered into have been as follows: 1999–$3.545 billion; 2000–$4.022 billion; 2001–$5.066 billion; 2002–$4.967 billion; 2003–$5.950 billion; 2004–$6.048 billion; 2005–$6.128 billion; 2006–$6.221 billion; 2007–$7.076 billion; 2008–$7.011 billion; and 2009–$6.497 billion. These payments are split among the OPMs in proportion to their relative market shares. *See* MSA §§ IX(c)(1)-(2).

Each SPM makes annual payments that, on a per-cigarette basis, approximate the OPMs' annual payments and that are likewise based on the SPMs' sales volume during the year in question. *See* MSA § IX(i). The SPMs' aggregate annual payments for each year have been claimed as follows: 1999–$46.4 million; 2000–$98.5 million; 2001–$200.4 million; 2002–$319.0 million; 2003–$484.5 million; 2004–$433.7 million; 2005–$441.5 million; 2006–$517.7 million; 2007–$475.0 million; 2008–$569.5 million; and 2009–$571.5 million.

These annual payments continue each year into perpetuity. The PMs' total MSA payments to the Settling States to date exceed $70 billion, including the annual payments listed above and additional "initial" payments made by the OPMs.

The PMs do not make these payments to individual States. Instead, each PM makes a single, nationwide payment in the overall amount calculated and determined by the Independent Auditor. The Independent Auditor then allocates those nationwide payments among the States by applying pre-set "Allocable Share" percentages previously negotiated by the States (and set forth in Exhibit A to the MSA), which represent each State's percentage share of the PMs' nationwide payments. *See* MSA §§ II(f)-(g); IX(b)-(c); IX(j), clause thirteenth; MSA Ex. A.

The MSA's payment obligations impose substantial costs on the PMs. The NPMs, by contrast, do not bear these MSA costs and thus do not reflect them in their pricing. Absent enforcement of statutes imposing similar costs on NPMs, that differential cost between the PMs and the NPMs could be harmful to both the PMs and to the States, as well as to the public, by undermining the goals and purpose of the MSA.

In an attempt to minimize that disadvantage, the MSA included the prospect of reduced payments to supply an incentive for each Settling State to enact and enforce a statute that imposes similar payment obligations on NPMs and thereby neutralizes the MSA-related cost disadvantage imposed on PMs. Moreover, if Settling States nevertheless failed to enact and enforce such a statute, the payment reduction would compensate the PMs for their MSA-related loss of sales.

The NPM Adjustment was made a part of the MSA to address that cost differential or, as the PMs describe it, to "level the playing field." The MSA provides that "[t]o protect the public health gains achieved by this Agreement," the PMs' annual MSA payments "shall" be subject to an NPM Adjustment. *See* MSA § IX(d)(1)(A). The Adjustment provides for a potential reduction in the PMs' MSA payments in event of an MSA-related market-share shift to NPMs above a specified threshold. It is designed to give the States an incentive to eliminate the MSA cost disadvantage faced by PMs, and with it the threat to the MSA's public health gains–and to provide compensation to the PMs in the event such a market-share shift nevertheless occurs. The NAAG Tobacco Project has thus described the NPM Adjustment as follows:

> [The] NPM Adjustment provides [an] incentive to ameliorate these adverse effects [*i.e.*, "undermin[ing] the MSA's public health goals" and "unfairly

> disadvantag[ing] companies that had chosen to" join the MSA. It provides that if, because of the disadvantages imposed on them by the MSA, the PMs lose "Market Share" to NPMs, the PMs' payments to the States can be reduced.

NAAG Tobacco Project, *Understanding and Enforcing the NPM Statute*, MSA Issues Seminar (Oct. 15-16, 2001).

The NPM Adjustment is set forth in Section IX(d) of the MSA (beginning at page 58 of the Agreement). The first subsection, Section IX(d)(1), governs when the NPM Adjustment applies. It provides that the Adjustment "shall apply" to the PMs' annual payment for the year in question if two conditions are met. MSA § IX(d)(1)(C).

First, the PMs must have suffered a "Market Share Loss," which is defined to mean that the PMs' collective market share during that year decreased by more than two percentage points compared to their collective market share in 1997, the last full year before the MSA was signed. MSA §§ IX(d)(1)(A); IX(d)(1)(B).

Second, a nationally recognized firm of economic consultants jointly selected and retained by the OPMs and the States (the "Firm") must have determined that the disadvantages experienced by the PMs as a result of the provisions of the MSA were a "significant factor" contributing to the Market Share Loss for the year in question. *See* MSA § IX(d)(1)(C).

The only exception is where a State demonstrates that it has enacted and "diligently enforced" a "Qualifying Statute." MSA § IX(d)(2)(B). A "Qualifying Statute" is defined as a statute 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 MSA]." MSA § IX(d)(2)(E). States are thus not required either to enact or enforce such a statute, but if they want the benefit of the contractual exemption from the NPM Adjustment, they must do both.

If an individual Settling State demonstrates that it diligently enforced such a statute during the year in question, the NPM Adjustment still applies to the PMs' MSA payments for that year, but none of it is allocated to that Settling State's share of those payments. *See* MSA § IX(d)(2)(B). It is of critical import that nowhere in the MSA or any of the supporting exhibits, is the term "diligent enforcement" defined. The MSA merely states that an exception to the NPM

Adjustment shall be available ". . . 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 . . ." *Id.* Thus, defining what standard is required before a State qualifies for this critical exception is left for this Panel to decide.

Where an individual Settling State qualifies for this exception, the MSA provides that its share of the NPM Adjustment will be reallocated to all other States that do not qualify for the exception because they have not demonstrated diligent enforcement of their own Qualifying Statute. Section IX(d)(2)(C) of the MSA thus provides that the "aggregate amount of the NPM Adjustments that would have applied" to Settling States that prove they fall within the diligent enforcement exception "shall be reallocated among all other Settling States pro rata in proportion to their respective [payment shares]," and that those States' MSA payments "shall be further reduced" up to the full amount of their MSA payments for that year. MSA § IX(d)(2)(C); *see also id.* § IX(d)(2)(D). As a result of this reallocation provision, the greater the number of Settling States that did not diligently enforce a Qualifying Statute, the more widely the NPM Adjustment is spread and the less the share of the Adjustment that each such State bears. Conversely, if only a few Settling States fail to prove diligent enforcement, those Settling States face a more concentrated application of the NPM Adjustment – and hence a greater reduction of their payments, subject only to the limitation that the Adjustment applied to a Settling State can be no greater than the total MSA payment it received for that year. The diligent enforcement and reallocation provisions thus create a dual incentive for individual Settling States to enact and enforce a Qualifying Statute.

The MSA defines a "Qualifying Statute" as one that, among other things, "effectively and fully neutralizes the cost disadvantages that the [PMs] experience vis-à-vis [NPMs] within such Settling State as a result of" the MSA. MSA § IX(d)(2)(E). Exhibit T to the MSA provides a model for such a statute: a "model" Escrow Statute. The MSA provides that this "model" Escrow Statute, if enacted with those modifications necessary to reflect "particularized state

procedural or technical requirements" will "constitute a Qualifying Statute." *Id.*

The "model" Escrow Statute provides for each NPM to make escrow deposits on the cigarettes it sells in the enacting Settling State in the year in question. The escrow deposits are to be made into a "[q]ualified escrow fund," which is defined as an escrow arrangement with a qualifying financial institution in which the deposits are held for the benefit of the State. *See* MSA, Ex. T, at T-2 (§ (f)). The deposits are to remain in escrow for 25 years except insofar as they are used to pay a judgment to or settlement with the State for liability on claims like those the Settling States settled against the PMs in the MSA. *See* MSA, Ex. T, at T-4 & T-5 (§ (b)(2)(A)-(C)). The escrow deposits thus guarantee the State a source of recovery should it subsequently sue or settle with that NPM on claims like those the State settled against the PMs in the MSA, and avoid the risk that NPMs would otherwise use their MSA-related "cost advantage to derive large, short-term profits . . . and then becom[e] judgment-proof before liability [to the State] may arise." MSA Ex. T, at T-1 (§§ (a), (f)).

The Settling States all enacted Escrow Statutes following the MSA. But following the signing of the MSA in 1998, and despite the Settling States' universal enactment of Escrow Statutes imposing payment obligations on NPMs, the NPMs' market share increased at significant rates.

This shift of market share from PMs to NPMs has triggered the NPM Adjustment provision of the MSA for multiple years. The PMs and the States settled the NPM Adjustments through 2002. The NPM Adjustments for 2003 and subsequent years, however, were not resolved, and the dispute over the Adjustment for the first of these years–2003–has culminated in the proceedings before this Panel.

As a beginning and necessary step leading to this Arbitration, in connection with its April 2004 calculation of the PMs' MSA payment for 2003, the Independent Auditor determined that the MSA's first condition for application of the 2003 NPM Adjustment was satisfied: the PMs had suffered a "Market Share Loss" for 2003. The Auditor calculated that there had been a market-share shift of approximately 8% to the NPMs from 1997 to 2003, and thus a Market Share Loss of approximately 6% after giving effect to the two percentage point buffer.

The States have not disputed the Independent Auditor's determination that the PMs suffered a Market Share Loss for 2003, the magnitude of that loss or the amount of the 2003 NPM Adjustment.

After the Independent Auditor's finding of a Market Share Loss, the States and OPMs instituted proceedings in April 2005 for a determination by the Firm as to whether the disadvantages experienced by the PMs as a result of the provisions of the MSA were a "significant factor" contributing to that Market Share Loss. The OPMs and States engaged the Brattle Group to make this "significant factor" determination.

The OPMs and the States then participated in a 10-month evidentiary proceeding before the Firm. On March 27, 2006, the Firm issued a 163-page opinion and final determination, finding that the disadvantages experienced by the PMs as a result of the MSA were a "significant factor" contributing to the 2003 Market Share Loss. The MSA expressly provides that the Firm's significant factor determination is "conclusive and binding upon all parties" and "final and non-appealable." *See* MSA § IX(d)(1)(C).

Following the Firm's determination in March 2006, the PMs requested that the Independent Auditor apply the 2003 NPM Adjustment as a credit against their next MSA payments. The Settling States opposed the request, asking the Independent Auditor to "presume" diligent enforcement and to refuse to apply the 2003 adjustment.

Following the Independent Auditor's determination not to apply the NPM Adjustment, some of the PMs paid the disputed amounts into a "Disputed Payment Account," and the PMs requested that the Settling States arbitrate the dispute pursuant to the MSA's Arbitration Clause. That clause, which is set forth in Section XI(c) of the MSA, provides that "[a]ny dispute, controversy or claim arising out of or relating to" the Independent Auditor's calculations or determinations "shall be submitted to binding arbitration" before a panel of three former federal judges.

The Settling States initially refused to agree to arbitration, and sought relief in their individual state courts, which was denied in virtually every case. It was not until January 30, 2009, that 45 Settling States had signed an Agreement to Arbitrate ("the ARA"). Pursuant to the

ARA's "partial liability reduction," the PMs will reimburse each of those 45 Settling States that the Panel determines did not diligently enforce its Escrow Statute in 2003 with 20% of the portion of the 2003 NPM Adjustment that it bears as a result. *See* ARA § 3(b). Four Settling States–Ohio, Oklahoma, North Carolina, and Wisconsin–refused to sign the ARA, but were ordered to arbitration by their state courts, and participated in this Arbitration. Thereafter, the PMs and 48 Settling States, including the four Settling States that declined to sign the ARA, negotiated a separate "Agreement Regarding Procedures for Formation of Arbitration Panel." Pursuant to that Agreement and Section XI(c) of the MSA, this Panel was selected to resolve the 2003 NPM Adjustment dispute.

B. The Arbitration Clause.

The MSA is approximately 150 pages long, plus numerous exhibits. Despite the complexity and uniqueness of the issues in this matter, and the large number of parties involved, the Arbitration Clause ("the Clause") is virtually devoid of any procedural guidelines or objective criteria to be used by the Panel in deciding this matter. The Clause merely states as follows:

> 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.

MSA § XI(c).

C. The Arbitration Panel.

The Panel consists of the following Arbitrators, each of whom is a former Article III federal judge:

Judge William G. Bassler, selected by the PMs;

Judge Abner J. Mikva, selected by the Settling States; and

Judge Fern M. Smith, selected by Judges Bassler and Mikva.

CHAPTER III: THE PROCEDURAL HISTORY

The actual proceedings in the Arbitration began with the Parties filing mutual Motions for Case Management Schedule and Discovery Plan on July 2, 2010. The first joint status hearing took place in Chicago, Illinois. At that time, 17 PMs and 52 States and territories were parties of record, although several States appeared only with reservations of rights, including objections to the Panel's jurisdiction. Because neither the Agreement nor the Clause gave direction, decisions had to be made by the Panel as to the governing law, governing procedural rules, *e.g.*, rules of evidence, type of hearings required, dispositive motions, if any, burden of proof, priorities, and location of hearings, as well as other questions that arose as the Panel proceeded. Because the pre-hearing process was lengthy, as well as complex and significant, a meaningful summary is virtually impossible; therefore, the Panel has attached, as Appendix I, a list of all of the Panel's pre-hearing rulings. (Note: The Panel's rulings, as well as all of the Parties' filings, are posted on a LexisNexis data bank, which is available to authorized readers.)

CHAPTER IV: THE CONTENTIONS OF THE PARTIES

A. The Claimants' Contentions.

The PMs' Claim for Arbitration is almost 200 pages long, which is understandable, given the number of Settling States against whom claims are made. In essence, however, the PMs request that this Panel determine the following:

1. Determine that the Independent Auditor was required to apply the 2003 NPM Adjustment to the PMs' April 2006 annual payments once the Firm determined that the MSA was a significant factor contributing to the PMs' Market Share Loss for 2003.
2. Determine that the Independent Auditor erred when it refused to apply the 2003 NPM Adjustment to the PMs' April 2006 annual payments and when it adopted a presumption that each State had diligently enforced its Escrow Statute.
3. Determine that the Independent Auditor is required to immediately credit the 2003 NPM Adjustment, with applicable interest, to the PMs' next MSA payments.

4. Determine that individual States have the burden of proving diligent enforcement of a Qualifying Statute.
5. Allow the discovery necessary for the parties--and the Panel--to evaluate and determine individual States' claims that they diligently enforced a Qualifying Statute during 2003.
6. Determine the claims of individual States that they diligently enforced a Qualifying Statute during 2003 and that, accordingly, their Allocable Share of the 2003 NPM Adjustment should be reallocated to other States.
7. Determine such other issues related to the application, allocation, and recovery of the 2003 NPM Adjustment as the parties shall raise and the Panel shall deem appropriate.

The primary focus of this Arbitration has been on Contention Six, *i.e.*, which Settling States "diligently enforced" their respective Qualifying Statute in 2003, and the individual state-specific hearings have focused solely on that question. The first five Contentions were expressly or implicitly decided in the pre-hearing determinations set forth in Appendix I. Contention Seven will be addressed, if necessary, in these Awards.

B. The Respondents' Contentions.

Each of the Settling States filed its own response to the PMs' claims and contentions; however, the majority of the defenses raised were duplicative and common to each of the Settling States. There was also a joint response filed on behalf of all of the Settling States. By the time the state-specific hearings were held, the only remaining question for the Panel to answer was that set forth in PMs' Contention Six, *i.e.*, did the Settling State "diligently enforce" its Qualifying Statute in 2003.

CHAPTER V: DISCUSSION AND DECISION

A. Common Findings/Conclusions.

1. Introduction.

As stated above, the majority of defenses and issues raised by both the PMs and the Settling States were common to all parties and were either resolved in pre-arbitration motion proceedings, or were deferred until all of the state-specific hearings were completed. Included in

this Award, therefore, are final determinations of those deferred issues, each of which was a significant factor in the Panel's ultimate Awards and each of which is common to the each state-specific Award. They include the following:

- The Panel's definition of Diligent Enforcement
- The Panel's definition of Units Sold
- Whether a State used the Fabricator or Control Test in its enforcement efforts
- Defining "two knowing violations" in seeking injunctive relief
- Enforcement efforts against House of Prince/Carolina/Leonidias
- Whether a State had the obligation to amend or enact legislation as an aid to enforcement
- The use of Allocable Share Releases
- The significance, *i.e.*, use/weight of a State's "collection rate"

It is critical to note that although all of the above were "factors," which the Panel considered in deciding whether the defined diligent enforcement standard was met, the Panel did not rank the factors or give them a numerical score, *i.e.*, each, except for the definition of "diligent enforcement," was considered in the over-all context of a Settling State's existing policies and circumstances in 2003. It is therefore not a useful exercise, or even valid, to compare the decision as to one State against the decision as to another. It is also important to note that the Panel has not distinguished between "Findings" and "Conclusions." Most of the questions addressed are mixed questions, and the Panel views each with equal weight. All findings and/or conclusions were decided by a unanimous Panel.

It was decided during pre-hearing motions (*see* Appendix 1) that the Settling States had the burden of proof on the question of diligent enforcement. Thus, each State presented its case in chief first.

2. "Diligent Enforcement" Defined.

Diligent Enforcement is an ongoing and intentional consideration of the requirements of a Settling State's Qualifying Statute, and a significant attempt by the Settling State to meet those requirements, taking into account a Settling State's competing laws and policies that may

conflict with its MSA contractual obligations. Both the legislative and executive branches of a Settling State are bound by the MSA obligations.

That definition is measured by an objective standard, and the Panel has considered numerous factors in determining whether that standard has been met. The Panel has not ranked the factors, but has considered them as a whole in making its determination.

3. *"Units Sold" Defined.*

"Units Sold" is defined in Exhibit T to the MSA (commonly referred to in this Arbitration as the "Model Statute") as follows:

> "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 . . . .

MSA Exhibit T, T-3, Definitions, (j).

As opposed to much of the MSA, that definition seems clear and unambiguous, and many of the Settling States requested that the Panel find to be binding, as a question of law. The PMs, however, as well as several of the Settling States, disagreed.

The PMs argued that the issue of "units sold" was state-specific and depended on the facts and circumstances of each individual state. For example, the PMs argued that while a minority of states attempted to exempt entire categories of NPM cigarette sales from the escrow payment obligations, such as NPM cigarettes sold through Native American reservations or unstamped roll-your-own cigarettes ("RYO"), other states assessed and attempted to enforce escrow with respect to all NPM cigarettes sold in their state. The PMs argued that the different states' understanding and course of performance in enforcing the NPM escrow obligations were thus factual issues subject to discovery which would have bearing on the Panel's determination of the "units sold" issue.

Because each side to this dispute raised colorable arguments, the Panel deferred ruling until all state-specific hearings were completed. That time has now arrived, and the Panel finds that the PMs have failed to support their arguments that the express definition means anything

other than what it says.

The collective evidence did show that different Settling States reacted in different ways to the Model Statute definition, *e.g.*, some Settling States modified their Qualifying Statute, some changed their practices regarding RYO or sales by tribes, and some took the stated definition literally and declined to include certain types of sales as "units sold." What the Panel did not see was any evidence of collusive behavior, *i.e.*, no Settling State, in the Panel's opinion, manipulated the definition or counting of "units sold" in order to purposefully evade their enforcement obligations. In particular, although some Settling States with large numbers of cigarettes sold on Tribal Lands declined to change their policy regarding non-taxation of such sales, those Settling States presented valid policy reasons for their decisions. Although the Settling States had binding contractual obligations to "diligently enforce," they were not required to elevate those obligations above other statutory or rational policy considerations. Unless otherwise stated in a state-specific Award, the Panel reaches the same conclusion for RYO sales.

For these reasons, the Panel finds, as a matter of law, that the Model Statute definition of "units sold" is unambiguous and binding. Further, even if parol evidence were considered, the PMs have failed to show that a different meaning should be applicable to any specific Settling State.

4. <u>Whether a State Used the "Fabricator" or "Control" Test.</u>

This issue also arises under the "Model Statute," which sets forth certain remedies that a State has against a "Tobacco Product Manufacturer" ("TPM"), a term specifically defined under the "Definitions" section of the Model Statute. In that definition, a TPM is defined as an entity that "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 . . . ." MSA Ex. T, T-3.

The "Requirements" section of the Model Statute establishes that the Attorney General of a Settling State may file a civil action against a TPM under certain express conditions. MSA Ex. T, T-5. The right to file a civil action is the only express remedy against TPMs that is set forth in the MSA or Model Statute. The PMs argued in all state-specific hearings that the right to file a

lawsuit was critical to diligent enforcement and that the Settling States had an obligation to file such suits often and as soon as possible.

The controversy over this term arose because some Settling States interpreted the definition strictly, *i.e.*, as applying solely to manufacturers, many of which were in foreign jurisdictions, and not easily amenable to jurisdiction (the "Fabricator Test"). Other Settling States were more liberal in their interpretation, and included entities within the United States who played a significant role in getting the subject cigarettes into the market, *e.g.*, distributors and wholesalers (the "Control Test"). For obvious reasons, the Control Test made it easier and faster to file lawsuits. The PMs argue that Settling States that used the Fabricator Test were less "diligent" than followers of the Control Test. The Panel disagrees. The problem, if any, lies with the drafting of the Model Statute, which expressly limits the right to file civil actions to suits against "manufacturers." In hindsight, the definition of TPM should have been broader, but the fault for that does not lie with the Settling States.

5. *Defining "Two Knowing Violations" in Seeking Injunctive Relief.*

This question also arises out of the "Remedies" section of the Model Statute which limited injunctive relief to TPMs that have committed "two knowing violations." The dispute centers on defining a "knowing violation," and the differences among the Settling States in making that determination. Again, the PMs ask the Panel to penalize those States that accepted a more restrictive and literal definition of that term. The Panel finds no legal or equitable basis to penalize a Settling State who reads the express words of the Model Statute in a rational way. Again, the fault, if any, lies in the drafting of the Model Statute, for which the Settling States are no more to blame than the PMs.

6. *Enforcement Effort Against House of Prince/Carolina/Leonidias.*

Much time was spent in discussing the role that these entities played, and, more important, their status during the 2003 time period, *i.e.*, were they NPMs, SPMs, contract manufacturers, etc. The value of understanding the relationships lies only in how their status affected a given Settling State's "compliance rate," *i.e.*, the percentage of escrow paid against the total number of units sold in a Settling State by NPMs. The PMs' case rested in great part on the

use of expert testimony, an important facet of which was establishing a compliance rate for each state. Because of the legitimate confusion over whether the above entities were NPMs or not, many Settling States took a "wait and see" attitude and did not seek escrow from them, resulting in a lower compliance rate, based on the PMs' calculations. The Panel understands the PMs' theory, but also is unwilling, in hindsight, to classify such decisions as a failure in diligent enforcement. This is especially true because the status of those entities has since resolved.

7. *Whether a Settling State Had the Obligation to Amend or Enact Legislation as an Aid to Diligent Enforcement.*

The PMs have argued both implicitly and explicitly that Settling States could have and should have passed legislation that made enforcement easier to accomplish. The Panel has considered that as a factor, especially the alacrity of a Settling State in passing what has been referred to as "Complementary Legislation," which was specifically aimed at increasing remedies available against non-performing NPMs. On the other hand, the Panel has given less weight to the argument that a Settling State should have legislatively changed, for example, its taxation laws, in order to increase its escrow collection rate. The MSA put no such demand on the Settling States.

8. *Allocable Share Release.*

Significant time was spent by the PMs discussing the negative effect of the Allocable Share Release ("ASR"), which is set forth in the Model Statute. The Panel understands the PMs' theory, but does not agree that the Settling States should be faulted for what was a poorly conceived policy, set forth in the Model Statute. The deficiencies, if any, caused by the ASR provision, were eliminated by most states in 2003 with the passing of additional legislation. The Panel mentions the ASR in individual cases, if at all, only if it found that a Settling State's procedure for releasing ASR funds had a material effect on its enforcement results.

9. *The Significance, i.e., Use/Weight of a State's "Collection Rate."*

The PMs' case-in-chief relied almost completely on the testimony of expert witnesses. One category of expert testimony was provided by economists, who based their opinions primarily on the "collection rate" of a Settling State, *i.e.*, what amount of money was deposited

by NPMs into escrow accounts in a given year, as compared to the experts' determination of what amount was actually due. The collection rates among and between the Settling States differed significantly, and the variance was intended to be used in a comparative way for the Panel to determine the lack of diligent enforcement. The Panel concurs that the collection rate is a significant factor, but it is not the only factor, nor is it always the primary factor. Predicating a Settling State's diligence, therefore, based solely on the collection rate is unlikely to be fruitful. Further, because in most cases, the "underreported" collection rate is similar across states, the Panel has not factored that into its analysis, except in unusual circumstances.

B. State-Specific Findings and Conclusions as to the State of Washington.

1. *The Attorneys and Witnesses for the Washington Hearing.*

a. The Attorneys for Washington

i. Washington State Office of the Attorney General

Rene Tomisser

David Hankins

b. The Attorneys for the PMs

i. Jones Day

Barbara Harding

Jason Winchester

Abby Wakefield

William Laxton

Graham Keithley

ii. Winston & Strawn LLP

Alexander Shaknes

iii. Greenberg Traurig LLP

Scott Martin

c. Witnesses for the State

i. Lee Smith

Excise tax examiner for cigarette excise tax in the Department of Revenue

ii. David Hankins

Office of the Attorney General

d. Witnesses for the PMs

i. Daniel Garrett

Expert Witness

ii. Colleen Waring

Expert Witness

2. *Factors Considered in the Determination of Diligent Enforcement.*

The Panel has previously articulated a definition of diligent enforcement. In order to objectively assess a Settling State's diligent enforcement in light of that definition, the Panel has developed a number of components that it believes aid in evaluating a Settling State's enforcement of its Qualifying Statute and its diligence in doing so. Those factors are:

a. Collection Rate

b. Lawsuits Filed

c. Gathering Reliable Data

d. Resources Allocated to Enforcement

e. Preventing Non-Compliant NPMs from Future Sales

f. Legislation Enacted

g. Actions Short of Legislation

h.. Efforts to be Aware of NAAG and Other States' Enforcement Efforts

These factors are not listed in their order of importance nor are they necessarily given equal weight. But overall they provide a reliable and objective metric to assess a Settling State's obligation to enforce its Qualifying Statute with diligence in order to avoid the contractually agreed upon determination that the PMs are entitled to a reduction in their payments for the calendar year 2003.

3. Analysis.

The following is an analysis of those facts found by the Panel to be true and necessary to the Award. To the extent that this recitation differs from any Party's position, that is the result of determinations as to credibility of witnesses, including experts, determinations of relevance, burden-of-proof considerations, and the weighing of the evidence, both oral and written. The Panel has also considered the inferences that could or could not be drawn from the testimony and documents.

It should be noted that the analysis for Washington, much like that for New York, focuses to a great extent on Washington's policy regarding tobacco sales on tribal lands, and Washington's view of "Units Sold." Because that issue predominated in the evidentiary hearing, and because it appears to be at the core of the PMs' dispute with Washington, the Panel's discussion of that issue is more detailed than for other factors. That does not mean, however, that the other factors listed have not been taken into account.

a. Collection Rate

Based on the Levinsohn, Reiss, and Garrett analysis, the collection rate for reported sales was 62%, or 60% if one deducts ASR payments. Those numbers, however, do not count tribal sales, the actual number of which is unknown, but which appears to be very large. If tribal sales are ignored, the collection rate is better than average for the contested states.

b. Lawsuits Filed

Washington filed eighteen lawsuits before 2003 and twelve in 2004, but none in 2003, although they were still actively litigating nine from prior years, not including the House of Prince litigation. Because Complementary Legislation was pending, more effort was spent on getting non-compliant NPMs out of the market than on filing new lawsuits.

c. Gathering Reliable Data

Lee Smith headed the day-to-day Department of Revenue responsibilities. The Department of Revenue was in charge of receiving and computing monthly distributor reports as they came in and sending the numbers to Mr. Hankins at the Office of the Attorney General. The departments coordinated their efforts reasonably well and used a system of monthly distributor

reports and annual NPM certifications as a verification method, although they did not perform audits. The Panel found the performance of the Department of Revenue to be limited, but its deficiencies were balanced by the dedicated and effective monitoring of David Hankins.

d. Resources Allocated to Enforcement

There was little, if any, evidence regarding this factor, leading the Panel to believe that the resources were sufficient.

e. Preventing Non-Compliant NPMs from Future Sales

Washington performed well in this regard. Although it filed no lawsuits in 2003, follow-up efforts resulted in eight non-compliant NPMs making voluntary payments. Further, by the end of 2003, the list of non-compliant NPMs went from fifteen to zero.

f. Legislation Enacted

In addition to having passed the Escrow Statute early on, Washington passed both Complementary Legislation and ASR repeal legislation in 2003. Complicating the picture, however, was the fact that in 2001 Washington passed legislation allowing tribes within the State to change from the prior "allocation" system, to a "compact" system. By the end of 2003, seven of the State's twenty-nine tribes had entered into compacts with Washington, and were selling cigarettes under that system. The PMs do not dispute Washington's right to tribal compacts, but seriously disagree with the concomitant decision that escrow was not due on any compact sales. The PMs' position is understandable, especially because the PMs were including compact sales in their MSA payment calculations, but were not getting what they perceive as "the benefit of the bargain" in return.

There was, in fact, strong disagreement within the State as to whether products sold by compact tribes should be escrowed and the disagreements continued throughout the year. David Hankins, who was the chief escrow officer for the Office of the Attorney General, believed that escrow obligations attached; however, the chief taxation officer for the Department of Revenue disagreed, based on a strict interpretation of the unit sold definition. The Attorney General sided with the Department of Revenue and overruled Hankins.

The PMs allege that NPM sales to tribes escalated sharply after the compacts were signed; however, Washington provided rational policy reasons for instituting compacts with the tribes, and the PMs provided no evidence to the contrary. Even if the Panel were to agree that the PMs' and Hankins' position as to escrow was the correct one, the Panel's role is not to opine on the wisdom of internal policy decisions or the correctness of their legal analysis.

g. Actions Short of Legislation

Washington formed a tobacco enforcement team in 2000, shortly after the MSA was signed. The team was headed by David Hankins who did a very effective job. Both notice and demand letters were sent.

h. Efforts to be Aware of NAAG and Other States' Enforcement Efforts

Mr. Hankins was actively involved in both NAAG and knowing what other states were doing.

4. Conclusion.

The PMs ask the Panel to find that the Doctrine of Nullification applies in this case. The Panel disagrees, although it does not endorse in any way a unilateral changing of any Settling States' cigarette tax laws, without notice to the PMs. In fact, the Panel agrees that such action will "raise a red flag." The Panel does not take a position as to when the PMs knew or should have known that the tribal compacts had been legislated and entered into, although there was admissible evidence of an active PM lobbyist within Washington. The Panel also notes that the laws have since been changed in order to resolve the escrow problem as it relates to the compacts.

Counsel for Washington made the following statement in his closing argument:

> No matter how good the Court thinks it would have been . . . as a policy matter to make this circle a lot bigger, and to make the units sold be on a cigarette upon which excise tax was due, the fact of the matter is at the bargaining table, that isn't what happened . . . . [T]he shrinking of the circle is not a diligent enforcement issue. What the state has to do is regardless of how large or small we make this circle, we have to diligently enforce within it . . . . It was, in fact, done as a matter of government-to-government relations with the tribes to reduce the conflict, to reduce the contraband traffic flowing through the tribes that were selling allocated

cigarettes, all things that are aboveboard, legitimate government decisions to make, and not a bad faith effort to undermine NPM[s].

Washington Hearing Transcript, 1184:6-13; 1187:18-22; 1189:12-23 (Apr. 23, 2013). The Panel does not agree that a Settling State has an unfettered right to a "shrinking of the circle;" however, because a review of the record in this specific case indicates no evidence of intentional escrow evasion, but rather a good faith effort to address an intractable problem, the Panel accepts Counsel's argument.

Considering the record as a whole, the Panel finds that Washington has met its burden by a preponderance of the evidence.

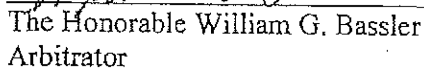
FINAL AWARD

The Panel unanimously finds that the State of Washington diligently enforced its Qualifying Statute during calendar year 2003 and therefore is not subject to an NPM Adjustment pursuant to Section IX(d)(2)(B) of the Master Settlement Agreement.

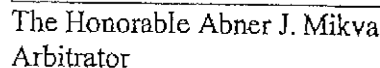
All other claims, if any, not specifically addressed in the Final Award are Denied. This Final Award therefore resolves all claims set forth in this proceeding.

SO ORDERED.

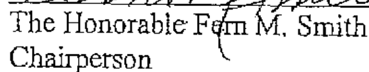
Dated: September 11, 2013



The Honorable William G. Bassler
Arbitrator



The Honorable Abner J. Mikva
Arbitrator



The Honorable Fern M. Smith
Chairperson

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APPENDIX D

IHS GLOBAL REPORT

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A Forecast of U.S. Cigarette Consumption (2013-2033) for the Tobacco Settlement Authority

Submitted to:

Tobacco Settlement Authority

Prepared by:

IHS Global Inc.

October 2, 2013

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Executive Summary

IHS Global Insight has developed a cigarette consumption model based on historical U.S. data between 1965 and 2033. 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 2013 through 2033. Our forecast indicates that total consumption in 2033 will be 149 billion cigarettes (or 150 billion including roll-your-own tobacco equivalents), a 48% decline from the 2012 level. From 2012 through 2033 the average annual rate of decline is projected to be 3.1%.

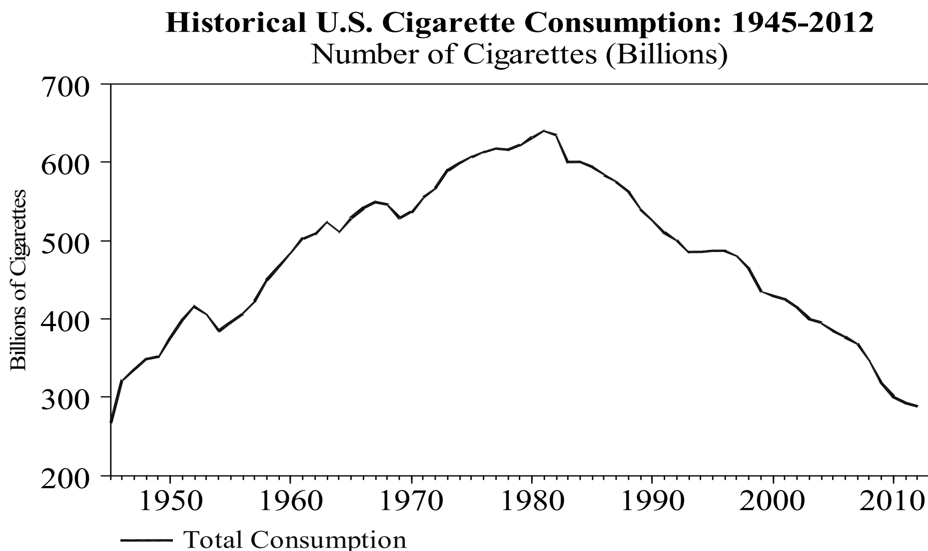
Our model was constructed based on widely accepted economic principles and IHS Global Insight's considerable experience in building econometric forecasting models. A review of the economic research literature indicates that our model is consistent with the prevalent consensus among economists concerning 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 workplace smoking restrictions first instituted widely in the 1980s, the stricter restrictions on smoking in public places instituted over the last decade, and the trend over time in individual behavior and preferences. This forecast is based on reasonable assumptions regarding the future paths of these factors.

Disclaimer

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

Cigarette Use in the United States

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 U.S. consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico, and other U.S. possessions, and small tax-exempt categories[2] as reported by the Bureau of Alcohol, Tobacco, Firearms, and Explosives. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion cigarettes in 1900 to a peak of 640 billion in 1981[3]. Consumption declined in the 1980s, 1990s, and 2000s, reaching a level of 465 billion cigarettes in 1998 and decreased to less than 400 billion cigarettes in 2003[4] and 290 billion in 2012[5]. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.



While the historical trend in consumption prior to 1981 was increasing, there was a decline in cigarette consumption of 9.8% 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

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

[2] Bureau of Alcohol, Tobacco, Firearms, and Explosives 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. April 2005.

[5] *Source*: US Tobacco and Tax Bureau

Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.2% between 1965 and 1981. Between 1981 and 1990, however, U.S. cigarette consumption declined at an average annual rate of 2.2%. From 1990 to 1998, the average annual rate of decline in cigarette consumption was 1.5%; but for 1998 the decline increased to 3.1% and increased further to 6.5% for 1999. These declines are correlated with large price increases in 1998 and 1999 following the Master Settlement Agreement ("MSA") and previously settled state agreements. In 2000 and 2001, the rate of decline moderated, to 1.2%. In the early part of the decade, coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2003 to an annual rate of 3.0%. The decline moderated for the next four years, through 2007, averaging 2.3%.

The rate of decline accelerated dramatically beginning in 2008, with a 3.8% decline in the number of cigarettes (including roll-your-own equivalents to cigarettes as defined by the MSA at 0.0325 ounces of loose tobacco per cigarette) for that year, 9.1% in 2009, and 6.4% in 2010 before finally decelerating to 2.7% in 2011 and 2.0% in 2012.

The following table sets forth United States domestic cigarette consumption, with and without roll-your-own equivalents, for the fifteen years ended December 31, 2012[6]. The data in this table vary from statistics on cigarette shipments in the United States. While this Report is based on consumption, payments made under the MSA dated November 23, 1998 between certain cigarette manufacturers and certain settling states are computed based in part on shipments in or to the fifty United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

[6] *Source:* USDA-ERS; 2004, 2005, 2006, estimates by IHS Global Insight. USDA estimates for 2004, 2005, and 2006 diverge significantly from estimates based on independent data from the industry and from the US Tobacco and Tax Bureau. In 2004, the manufacturers report domestic shipments of 394.5 billion, and the TTB reports a total of 397.7 billion. These contrast with a USDA estimate of 388 billion. In 2005, the manufacturers report 381.7 billion, TTB reports 381.1 billion, and USDA 376 billion. In 2006, the manufacturers report 372.5 billion, TTB reports 380.9 billion, and USDA 372 billion. The USDA has discontinued this service, publishing its final report on October 24, 2007. For 2007 TTB reports 361.6 billion, while the manufacturers report 357.2 billion.

U.S. Cigarette Consumption

Year Ended December 31,	Consumption (Billions of Cigarettes)	Percentage Change	Consumption (Billions of Cigarettes with roll-your-own equivalents)	Percentage Change
2012	288	-1.87	290	-1.98
2011	293	-2.48	296	-2.67
2010	301	-5.62	304	-6.45
2009	319	-8.08	325	-9.14
2008	348	-4.35	358	-3.79
2007	368	-2.28	372	-4.97
2006	377	-1.93	391	0.26
2005	384	-2.69	390	-3.51
2004	395	-1.28	404	0.09
2003	400	-3.66	404	-3.30
2002	415	-2.35	418	-2.68
2001	425	-1.16	429	-1.51
2000	430	-1.15	436	-1.30
1999	435	-6.45	442	
1998	465	-3.13		

There was a confluence of factors which led to the dramatically reduced consumption through 2009. First, indoor smoking bans spread rapidly across the country in the latter half of the decade. We now estimate that their impact on decreased smoking and cigarette consumption was approximately 6 billion sticks in 2009. Second, the latter months of 2008 saw a very deep recession. Our model projects that, given the lower realized levels of household income in 2009, consumption was negatively impacted by about 8 billion sticks. Third, the increase in the federal excise tax to $1.01 per pack, effective April 1, 2009 decreased cigarette demand by about 10 billion in 2009 according to our model of price elasticity. Fourth, the acceleration, prompted by the recession, of state excise tax increases similarly reduced consumption by a further 4 billion.

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according the National Association of Attorneys General, the three leading manufacturers accounted for 84.5% of U.S. shipments in 2012, 84.5% in 2011, and 83.6% in 2010. These top companies are Philip Morris USA, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. These companies commanded 46.92%, 23.9%, and 13.9%, respectively of the domestic market in 2012[7]. The market share of the leading manufacturers has declined from over 96% in 1998 due to inroads by smaller manufacturers and importers following the MSA and other state settlement agreements.

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 had fallen from 3.4% in 1950 to approximately 0.4% prior to the 2009 federal excise tax increase. In fiscal year 2012, the federal government received $15.7 billion in excise tax revenue from tobacco sales. In addition, state governments also raised significant revenues, $15.0 billion in 2011 from excise taxes. Cigarettes constitute the majority of these sales, which also include cigars and other tobacco products.

Survey of the Economic Literature on Smoking

Many organizations have conducted studies on U.S. 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 43.8 million American adults were current smokers in 2011, representing approximately 19.0% of the population age 18 and older, a decline from 19.3% in 2010, according to a Centers for Disease Control and Prevention ("CDC") study[8] released in 2012. 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 and 24.1% in 1998, the incidence rate has declined relatively slowly through the following decade. The decline had accelerated between 2002, when the incidence rate was 22.5%, to 2004, when the incidence rate dropped to 20.9%, though it remained as high as 20.6% in 2009.

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[7] IHS Global Insight calculation based on industry shipments data.

[8] *Source*: CDC. Morbidity and Mortality Weekly Report. "Tobacco Use Among Adults – United States, 2011". November, 2012.

The CDC, in November 2011, released the results of a study of quitting smoking[9]. It found that, in 2010, 68.8% of smokers wanted to stop smoking, 52.4% had made a quit attempt in the past year, 6.2% had recently quit, 48.3% had been advised by a health professional to quit, and 31.7% had used counseling and/or medications when they tried to quit.

A recent trend, likely influenced by extensive indoor smoking bans in the U.S., is growing numbers of "light smokers", those who smoke just a few cigarettes per day. Thus the decline in the overall prevalence of smoking has slowed while the rate of decline of the volume of cigarettes consumed has accelerated. In a similar fashion electronic cigarettes have replaced cigarette consumption in locations subject to indoor smoking bans.

Youth Smoking

Certain studies have focused in whole or in part on youth cigarette consumption. Surveys of youth typically define a "current smoker" as a person who has smoked a cigarette on one or more of the 30 days preceding the survey. The CDC's Youth Risk Behavior Survey ("YRBS") estimated that from 1991 to 1999 incidence among high school students (grades 9 through 12) rose from 27.5% to 34.8%, representing an increase of 26.5%. By 2003, incidence had fallen to 21.9%, a decline of 37.1% over four years. The rate of decline has continued, though at a slower pace. By 2011, the prevalence was 18.1%.[10]

According to the Monitoring the Future Study, a school-based study of cigarette consumption and drug use conducted by the Institute for Social Research at the University of Michigan, smoking incidence over the prior 30 days among twelfth graders was lower in 2012 than in 2011, continuing trends that began in 1996. Smoking incidence in all grades is well below where it was in 1991, having fallen below that mark in 2001 for eighth graders and in 2002 for tenth and twelfth graders.

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

Grade	1991 (%)	2011 (%)	2012 (%)	‘91-’12 Change (%)
8th	14.3	6.1	4.9	-65.7%
10th	20.8	11.8	10.8	-48.1%
12th	28.3	18.7	17.1	-39.6%

The 2011 National Survey on Drug Use and Health (formerly called National Household Survey on Drug Abuse) conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services ("SAMHSA") estimated that approximately 68.2 million Americans age 12 and older

[10] *Source*: CDC. Morbidity and Mortality Weekly Report. “Tobacco Use Among Adults – United States, 2010”. September, 2011.

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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). The survey found that an estimated 7.8% of youths age 12 to 17 were current cigarette smokers in 2011, down from 8.4% in 2010 and 13.0% in 2002. The National Youth Tobacco Survey of the CDC found that 5.2% of middle school students were smokers in 2009, a prevalence unchanged from 2006.

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These surveys all indicate that youth smoking, which had increased during the 1990s following two decades of decline, is again decreasing. In most of the nation the minimum legal age to purchase cigarettes is 18. In 2013 New York City is considering an increase in that age to 21. Mayor Bloomberg has also proposed the prohibition of cigarette displays in retail outlets. A similar proposal to raise the smoking age was subsequently introduced in the New York State and New Jersey legislatures. Four states Alabama, Alaska, New Jersey, and Utah, and three New York counties currently set the minimum age at 19.

Price Elasticity of Cigarette Demand

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

Two studies published by the National Bureau of Economic Research examine the price elasticity of youth smoking. In their study on youth smoking in the United States, Gruber and Zinman estimate an elasticity of smoking participation (defined as smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to 1997.[11] 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.[12] The price elasticity of cessation for males averaged 1.12 and for females averaged 1.19 in this study. These estimates imply that a 1% increase in the real price of cigarettes will result in an increase in the probability of smoking cessation for high school senior males and females of 1.12% and 1.19%, respectively. A study utilizing more recent data, from 1975 to 2003, by

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[11] *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.

[12] 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.

Grossman, estimated an elasticity of smoking participation of just -0.12.[13] Nevertheless it concludes that price increases subsequent to the 1998 MSA explain almost the entire 12% drop in youth smoking over that time.

In another study, Czart et al. (2001) looked at several factors which they felt could influence smoking among college students. These factors included price, school policies regarding tobacco use on campus, parental education levels, student income, student marital status, sorority/fraternity membership, and state policies regarding smoking. The authors considered two ways in which smoking behavior could be affected: (1) smoking participation; and (2) the amount of cigarettes consumed per smoker. The results of the study suggest that, (1) the average estimated price elasticity of smoking participation is –0.26, and (2), the average conditional demand elasticity is –0.62. These results indicate that a 1% increase in cigarette prices, will reduce smoking participation among college students by 0.26% and will reduce the level of smoking among current college students by 0.62%.[14]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[15] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least one to five cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticities of initiation are –0.27 for any smoking, -0.81 for smoking at least one to five cigarettes, and –0.96 for smoking at least one-half pack of cigarettes. These results above indicate that a 10% increase in the price of cigarettes will decrease the probability of smoking initiation between approximately 3% and 10% depending on how initiation is defined. In a related study, Powell et al. (2003) estimated a price elasticity of youth smoking participation of –0.46, implying that a 1% increase in price leads to a 0.46% reduction in smoking participation.[16]

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

Nicotine Replacement Products

Nicotine replacement products, such as Nicorette Gum and Nicoderm patches, are used to aid those who are attempting to quit smoking. Before 1996, these products were only available with a doctor's prescription. Currently, they are available as over-the-counter

[13] Michael Grossman. "Individual Behaviors and Substance Use: The Role of Price". Working Paper No. W10948. National Bureau of Economic Research. December 2004.

[14] 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.

[15] Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press. Copyright 2001.

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

products. Many researchers now recommend that those trying to quit smoking use a variety of these methods in combination.

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." In 2002, the Food and Drug Administration ("FDA") approved the Commit lozenge for over-the-counter sale. This product is similar to the gum and patch nicotine replacement products. NicoBloc, a liquid applied to cigarettes which blocks tar and nicotine from being inhaled, is another cessation product on the market since 2003. Zyban is a non-nicotine drug that has been available since 2000. It has been shown to be effective when combined with intensive behavioral support.[18]

In 2006, the FDA approved varenicline, a Pfizer product marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. Tests indicate that it is more effective as a cessation aid than Zyban. Pfizer introduced Chantix with a novel marketing program, GETQUIT, an integrated consumer support system which emphasizes personalized treatment advice with regular phone and e-mail contact. The drug debuted with strong sales in 2007, but suffered a reversal the following year due to safety concerns. It has since seen increased sales and marketing success. Free & Clear, a provider of tobacco treatment services, reported in June 2008, that Chantix has achieved higher average quit rates than Zyban, patches, gum, and lozenges. Though Pfizer reported additional positive results in 2009, the FDA required that Pfizer update the Chantix label with the most restrictive, "Black Box", safety labeling describing the risks. But the FDA does conclude: "The Agency continues to believe that the drug's benefits outweigh the risks and the current warnings in the Chantix label are appropriate." These warnings include changes in behavior, hostility, agitation, depressed mood, and suicidal thoughts or actions, as well as serious skin reactions and heart and blood vessel problems. Nevertheless the FDA said on October 24, 2011 that it will continue to evaluate the risk of mood changes and other psychiatric events associated with its use. In March 2013, researchers at the University of Texas M.D. Anderson Cancer Center reported a better quitting experience with varenicline than other treatments. In September 2013 researchers in a Pfizer sponsored study concluded that the drug does help some patients with depression or mood disorders to quit smoking without worsening symptoms of depression or anxiety. In September 2011, the New England Journal of Medicine reported positive smoking cessation efficacy and safety tests for Cytisine, an inexpensive compound long sold in Eastern Europe as Tabex, as a cessation aid.

Several new drugs may also appear on the market in the near future. In 2005, Cytos Biotechnology AG announced the successful completion of Phase II testing of a virus-based vaccine, genetically engineered to attract an immune system response against

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[17] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. Summer 2000. http:\\tc.bmjjournals.com.

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

nicotine and its effects. In 2007 the company entered into a partnership with Novartis to commercialize the drug, NIC002, but a subsequent Phase II trial was unsuccessful. Novartis though has continued study and commenced a new Phase II trial in November 2011. Nabi Biopharmaceuticals had successfully completed its Phase IIB clinical trials for NicVAX, a vaccine to prevent and treat nicotine addiction by triggering antibodies that bind with Nicotine molecules; but after Fast Track Designation from the FDA, the drug failed its initial Phase III trials in 2009. In September 2011 the second Phase III trial failed as well. The Xenova Group is set to begin Phase II testing of its similar vaccine, Ta-Nic. Positive results were reported in July 2006 by Somaxon Pharmaceuticals from a pilot Phase II study of Nalmefene. Nalmefene has been used for over 10 years for the reversal of opioid drug effects. The company is seeking to develop it as a treatment for impulse control disorders. In 2008, Evotec AG announced it would launch a Phase II study of EVT 302, a drug intended to ease smoker's cravings and nicotine withdrawal symptoms after cigarette deprivation. In 2011 the FDA cleared an Investigational New Drug Application to conduct a Phase II-B trial of X-22, a smoking cessation kit of very low nicotine cigarettes made by the 22nd Century Group. In 2012, a team from Weill Cornell Medical College reported the development of an anti-nicotine vaccine using a genetically engineered virus. The vaccine was successful in test with mice, though it will take several years before it can be tested in humans. It is expected that products such as these and others will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. Our forecast includes a strong negative trend in smoking rates which incorporates the influence of these factors.

Further aiding sales of these products is the decision by 45 state Medicaid programs to offer cessation benefits to Medicaid beneficiaries. And at least ten states (California, Colorado, Maryland, New Jersey, New Mexico, New York, North Dakota, Oregon, Rhode Island, and Vermont) have established minimum standards for private insurance coverage of cessation products and services. Most recently, in October 2010, Medicare coverage was expanded to provide cessation counseling to seniors without tobacco-related disease.

Electronic Cigarettes

Electronic cigarettes have also gained in popularity in recent years. NJOY, Vapor, Logic, and Blu, are marketing and advertising extensively across the US. Sales in 2012 have been estimated to be as much as $500 million, and increasing rapidly. The CDC in February 2013 reported survey results that indicate 6.2% of the adult population, and 21% of smokers, had tried e-cigarettes at some time. These were roughly double estimates in 2010. Lorillard acquired Blu Ecigs in 2012, Reynolds has tested an e-cigarette, Vuse, and Altria announced in 2013 that it would introduce a product later in the year.

They are, on one hand, alternatives to cigarettes as smokers cope with indoor bans, but also cessation devices whose nicotine content can be controlled. In 2010 the U.S. Court of Appeals for the District of Columbia Circuit ruled that the FDA could not regulate electronic cigarettes as a drug, rather it must regulate them as tobacco products. It is

unclear what actions the FDA may take towards electronic cigarettes in the future. Their role though in smoking, and smoking cessation, is ambiguous. On the one hand they can be used as a cessation device weaning a smoker away from cigarettes. In this case, as a substitute for cigarettes, they result in lower cigarette consumption. On the other hand, they can, in the presence of indoor smoking bans, allow smokers to maintain a nicotine habit or addiction, offsetting some of the ban's effectiveness in reducing smoking and consumption of cigarettes. In this case electronic cigarettes are complements to cigarettes. Indoor smoking restrictions have reduced the consumption of cigarettes and created a demand for electronic cigarettes. But electronic cigarettes themselves do not further reduce consumption except to the extent that they are substitutes for cigarette usage. Nevertheless, a 2013 study in the United Kingdom found that 76% of e-cigarette users said they started using their devices to replace cigarettes entirely. And results of a trial in Italy, published by the journal Plos One in June 2013, found that 8.7% of electronic cigarette users stopped smoking cigarettes. In September 2013, The Lancet published a New Zealand study which concluded that smoking cessation attempts using e-cigarettes were at least as effective as those using nicotine patches. (In a sample the quit rate after six months with e-cigarettes was 7.3%, versus 5.8% with patches).

A Centers for Disease Control and Prevention study published in the September 6th issue of Morbidity and Mortality Weekly Report says that according to data from the National Youth Tobacco Survey of middle school and high school students in the US, e-cig use among all students increased from 3.3% in 2011 to 6.8% in 2012.

For the consumer, e-cigs are a less expensive alternative as they are not taxed as cigarettes. A cartridge and battery for an electronic cigarette would cost less than half as much as an equivalent pack of cigarettes in a average tax state.

Researchers have reported several safety concerns with the products, including concerns on the variability in delivered nicotine content. The U.S. Department of Transportation is proposing a ban on electronic cigarettes on all flights to and from the U.S., a prohibition already enacted by Amtrak on its trains. And Ohio County, WV is one of a number of counties which are discussing banning e-cigarette use in indoor public places. In August 2013 the Consumer Advocates for Smoke-free Alternatives Association released a study it funded by the Drexel University School of Public Health. It found that chemicals in electronic cigarettes (e-cigarettes) pose no health concern for users or bystanders.

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.[19] 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

[19] *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.

correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day a smoker spent working in a smoking restricted environment, the greater the decline in the quantity of cigarettes that smoker consumed.

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) workplace smoking bans, (vii) smoking bans in public places, (viii) nicotine dependence and (ix) 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.

Price Elasticity of Demand. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5. Based on Global Insight's multivariate regression analysis using U.S. data from 1965 to 2012, the long-run price elasticity of consumption for the entire population is -0.33; a 1.0% increase in the price of cigarettes decreases consumption by 0.33%.

In 1998, the average price of a pack of cigarettes in the U.S. in nominal terms was $2.20. This increased to $2.88 per pack in 1999, representing a nominal growth in the price of cigarettes of 30.9% from 1998. During 1999, consumption declined by 6.45%. This was primarily due to a $0.45 per pack increase in November 1998 which was intended to offset the costs of the MSA and agreements with previously settled states.

Over the next several years the cigarette manufacturers continued to increase wholesale prices, and state excise taxes rose dramatically across the nation. By 2008 the weighted average state excise tax was $1.23 per pack and cigarette prices averaged $5 per pack.

The 2008-2009 recession and its stress on state budget revenues prompted acceleration in excise tax increases, as sixteen states increased taxes, resulting in an average tax of $1.34 at the end of 2009. In 2010, Hawaii, New Mexico, New York, South Carolina, Utah, and Washington, raised taxes. In 2011, excise tax increases went into effect in Connecticut, again in Hawaii, and in Vermont. In 2012, Illinois, by $1.00 per pack, and Rhode Island, by $0.04 per pack, raised cigarette excise taxes. In March 2013, Cook County, Illinois increased its cigarette excise tax by $1.00 per pack, to push city, county, and state taxes in Chicago to $6.67 per pack. This year, in July, Minnesota increased its excise tax by $1.60 per pack, and Massachusetts by $1.00 per pack. The average state tax rate is currently $1.53. Also in 2013 the legislatures in Florida, Maryland, New Hampshire, and Rhode Island are considering tax increases. A group in California is backing a 2014 ballot initiative to add $1.00 per pack to the state excise tax. A similar ballot initiative was unsuccessful at the polls in 2012. Nevertheless, in May 2013, two California Senate committees have recommended a bill to raise the state excise by $1.95 per pack.

The federal excise tax had remained constant, at $0.39 per pack, from 2002 until 2009. But the U.S. Congress adopted legislation which raised the tax by $0.62, to $1.01, effective April 1, 2009. As a result the total state and federal excise tax now equals $2.47 on average in the U.S. In 2011 a U.S. senate bill was sponsored by 14 Democrats and would have raised the excise tax to $2.01 per pack, but it was not successful. On January 22, 2013 Senator Tom Harkin introduced legislation, the Healthy Lifestyles and Prevention America Act, which would double the Federal excise tax on cigarettes and roll-your-own tobacco and increase the tax on smokeless tobacco products. This year President Obama's 2013 federal budget proposal included an increase in the Federal Excise Tax to $2.00 per pack.

Purchases of roll-your-own cigarette tobacco were discouraged by 2009 legislation, as its excise tax was raised substantially. But the excise tax changes also had the effect of encouraging the use of pipe tobacco, combined with the availability of roll-your-own machines to circumvent the higher excise taxes. Legislation introduced by Senator Richard Durbin on January 31, 2013, the Tobacco Tax Equity Act, would similarly equalize Federal excise tax rates on all tobacco products.

During much of the period following the MSA, the major manufacturers refrained from wholesale price increases, and also actively pursued extensive promotional and dealer and retailer discounting programs which served to hold down retail prices. They did this in part due to the state tax increases, but primarily to maintain their market share from its erosion by a deep discount segment which grew rapidly following the MSA. The major manufacturers were finally successful in stemming the increase in the deep discount market share, which stabilized in 2004. The major manufacturers have raised prices or reduced discounts and promotions in each year since 2004. The average price, including excise taxes in August 2013 was $7.27 per pack.
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Over the longer term our forecast expects price increases to continue to exceed the general rate of inflation due to increases in the manufacturers' prices as well as further increases in excise taxes. In December 2012 R.J. Reynolds and Philip Morris USA announced list price increases of 6 cents per pack. This followed June increases of 6 cents as well. At that time Lorillard raised its price by 8 cents per pack.

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 some sales are typically exempt from taxes, provides another opportunity for consumers to reduce the cost of smoking. Similarly, Internet sales of cigarettes grew rapidly, though credit card companies and shippers including the U.S. Postal Service have now put significant restrictions on shipping of cigarettes, and the federal government has enacted the Prevent All Cigarette Trafficking ("PACT") Act which requires the collection of all applicable taxes on Internet and mail-order cigarette shipments. Under the MSA volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped. The availability of lower price

alternatives lessens the negative impact of price increases on cigarette volume, but it may negatively impact MSA receipts.

Changes in Disposable Income. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found cigarette consumption in the United States increases as disposable income increases.[20] However, a few studies found cigarette consumption decreases as disposable income increases.[21] Based on our multivariate regression analysis the income elasticity of consumption is 0.27; a 1.0% increase in real disposable income per capita increases per capita cigarette consumption by 0.27%. In normal periods of economic growth this factor contributes a positive impact to cigarette demand, offsetting some of the negative impacts previously discussed. However, with the recession of 2008-2009 this factor also impacted cigarette demand and consumption in a negative way.

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,[22] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[23] One study examines the effects of youth smoking on future adult smoking.[24] 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 U.S. 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. 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.

In 2012, the Surgeon General issued a report, "Preventing Tobacco Use among Youth and Young Adults". Among its major conclusions were, 1) that prevention efforts must focus on both adolescents and young adults, 2) that advertising and promotional activities by tobacco companies have been shown to cause the onset and continuation of smoking among youth, 3) that after years of steady progress, declines in tobacco use by the young have slowed, and 4) that coordinated, multi-component interventions that combine mass media campaigns, price increases, school-based programs, and community wide smoke-free policies and norms are effective in reducing tobacco use. Also in 2012 the CDC produced a mass-media advertising campaign featuring graphic descriptions of the adverse health effects of smoking. In August 2012 the CDC declared the campaign a

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[20] Ippolito, et al.; Fuji.
[21] Wasserman, et al.; Townsend et al.
[22] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.
[23] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."
[24] *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.

major success, as the agency concluded that the ads helped to double the amount of calls to their telephone quit line. A new CDC campaign, with graphic adverse health images began in March 2013, and in September 2013 the CDC announced survey results which concluded that cessation attempts increased from 31.1% to 34.8% of smokers who had seen th graphic ads, which the CDC extrapolated to 100,000 sustained quitters, approximately 0.25% of US smokers.

Trend Over Time. Since 1964 there has been a significant decline in 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 Family Smoking Prevention and Tobacco Control Act ("FSPTCA") requires that cigarette packages have larger and more visible graphic health warnings. Regulations that were to go into effect in September 2012 mandated that a series of nine graphic health warnings must appear on the upper portion of the front and rear panels of each cigarette package and comprise at least the top 50 percent of these panels. Five manufacturers challenged the implementation of these new warnings on First Amendment grounds, and on November 7, 2011 a federal judge issued a preliminary injunction blocking the FDA requirement. The judge ruled that the labels were not factual, but rather, "…calculated to provoke the viewer to quit…." In 2012 a federal judge in Washington blocked the new requirement, while an appeals court in Ohio ruled to uphold parts of the Act. In March 2013 the Attorney General decided not to ask the U.S. Supreme Court to review the case. Instead the FDA announced on March 19, 2013 that it would undertake research to support new rulemaking. On April 22, 2013 the Supreme Court upheld the provisions of the 2009 law, allowing the FDA to develop and implement new graphic warning labels. In September 2013 the CDC announced results of a survey that demonstrated increased quit attempt rates among smokers who had seen television ads exhibiting graphic pictures of ill-health impacts of smoking. Cessation

attempts increased from 31.1% to 34.8% of smokers, which the CDC extrapolated to 100,000 sustained quitters (roughly 0.25% of smokers).

At least six states, Alabama, Georgia, Idaho, Kentucky, South Carolina, and West Virginia, charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. Several large corporations, including Meijer Inc., Gannett Co., American Financial Group Inc., Bank One, JP Morgan Chase, PepsiCo Inc., Northwest Airlines, Safeway, Tribune Co., and Whirlpool, are now charging smokers higher premiums.

Smoking Bans in Public Places. Beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. In September 2003 Alabama joined the other 49 states and the District of Columbia in requiring smoke-free indoor air to some degree or in some public places.[25]

The most comprehensive bans, extending to restaurants and bars, have been enacted since 1998 in 39 states and a number of large cities. Restrictions to all workplaces, restaurants, and bars cover 47.9% of the U.S, according to the American Nonsmokers' Rights Foundation ("ANRF"). In 2012 North Dakota became the most recent state to adopt these bans in public places. In 2013 Kentucky is considering a similar ban.

The ANRF documents clean indoor air ordinances by local governments throughout the U.S. As of July 8, 2013, there were 3,888 municipalities with indoor smoking restrictions. Of these, 846 local governments required non-hospitality workplaces to be 100% smoke-free while 878 governments required 100% smoke-free conditions in restaurants, and 747 required the same for bars. The number of such ordinances has grown rapidly in the past two decades. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars.[26]

Based on the regression analysis using data from 1965 to 2012, the restrictions on workplace smoking that proliferated in the 1980s appear to have an independent effect on per capita cigarette consumption. We estimate 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. Bauer, et al. estimate that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[27] Research in Canada, by the Ontario Tobacco Research Unit, concludes that consumption drops in workplaces where smoking is banned, by almost five cigarettes per person per day. Tauras, in a study based on a large survey of smokers, found that the more restrictive smoke-free air laws decrease

[25] *Source*: American Lung Association. "State Legislated Actions on Tobacco Issues". 2002.
[26] *Source:* American Nonsmokers' Rights Foundation. http://www.no-smoke.org. July 2013.
[27] Bauer, Hyland, Li, Steger, and Cummings. "A Longitudinal Assessment of the Impact of Smoke-Free Worksite Policies on Tobacco Use". American Journal of Public Health. June 2005

average smoking, but have little influence on prevalence.[28] The study predicts that moving from no smoking restrictions at all to the most restrictive bans reduces average smoking from 5% to 8%.

The extension of the indoor bans to restaurants and bars in the last decade began largely in the Northeast and did not appear, in our econometric analysis, to have a significant independent impact on smoking there. However, with data available from later in the decade across a wider geography, econometric analysis reveals that the bans did have a significant impact and we have added a variable quantifying the effect in our consumption model.

The first extensive outdoor smoking restrictions were instituted in March 2006 in Calabasas, California. The cities of Los Angeles and Oakland, Contra Costa County, and the California municipalities of Belmont, Beverly Hills, Campbell, Concord, Dublin, El Cajon, Emeryville, Hayward, Loma Linda, Santa Cruz, and Santa Monica have also established extensive outdoor restrictions, as have Davis County and the City of Murray in Utah. In 2011 the New York City Council approved a bill to ban smoking in all city parks, beaches and pedestrian plazas. That ban went into effect on May 23, 2011. According to ANRF, as of July 2013, 844 municipalities prohibit smoking in city parks, and 170 municipalities mandate smoke-free city beaches. In January 2014 a smoking ban will go into effect on Hawaii's beaches.

Additional restrictions are being placed in residential units as well. First, many hotels, including the Marriott, Sheraton, and Westin chains have adopted completely smoke-free room standards. And multi-family residential buildings have been increasingly subject to restrictions, beginning in 2008 in the California cities of Belmont and Calabasas, which have approved ordinances which restrict smoking anywhere in the city except for single-family detached homes. Alameda, Oakland, Pasadena, Santa Monica, and Thousand Oaks are among seven other California cities with such extensive bans. In September 2011 Sonoma County imposed a similar ban, effective June 2012. In August 2011 the California Legislature passed legislation enabling landlords to ban smoking in residential rental units. In June 2012, the Towbes Group of Santa Barbara became the largest apartment portfolio, with 2,000 units, to impose a smoking ban. In April 2013 California Assembly Bill 746 was defeated; it would have prohibited smoking in, and within 20 feet of entrances of, condominiums, duplexes, and apartment units throughout the state. A similar bill has also been introduced in Massachusetts.

New York City's first non-smoking apartment building opened in late 2009. Many landlords and condominium associations in California, and in New York City, have also established smoke-free apartment policies. Most recently Related Companies, which manages 40,000 rental units, announced a ban on smoking for all new tenants. In July 2011 the San Antonio Housing Authority announced a ban, effective in January 2012, on smoking in its 6,175 rental units. Similar bans went into effect in 2012 for public housing in Boston and Minneapolis.

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[28] Tauras, John A. "Smoke-Free Air Laws, Cigarette Prices, and Adult Cigarette Demand" Economic Inquiry, April 2006.

In 2007, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. They are now among 143 municipalities which have banned smoking on beaches, and 707 who have banned smoking in municipal parks.

New Jersey has prohibited smoking in college dormitories since 2005. At least 798 colleges nationwide now prohibit smoking everywhere on campus. In 2013 the California and Louisiana state college and university systems have banned tobacco use, joining Arkansas and Oklahoma with no-smoking restrictions at public colleges and universities, and Iowa, which prohibits smoking at all colleges and universities. Twenty-one states have banned smoking, indoors and outdoors, at state prisons. Arkansas, California, Louisiana, Maine, Puerto Rico, Texas, and Rockland County, NY now prohibit smoking in a car where there are children present, and similar legislation has been proposed in Maryland, New York, Oregon, Utah, Virginia, and other states.

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

Smokeless Tobacco Products. Unlike electronic cigarettes, smokeless tobacco products have been available for centuries. As cigarette consumption expanded in the last century, the use of smokeless products declined. Chewing tobacco and snuff are the most significant components. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and potentially spit-free. Chewing tobacco and dry snuff consumption had been declining in the U.S. into this century, but moist snuff consumption has increased at an annual rate of more than 5% since 2002. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST (purchased by Altria in 2009), was the largest producer of moist smokeless tobacco, and explicitly targeted adult smoker conversion in its growth strategy over the last decade. As with e-cigarettes, the leading cigarette manufacturers soon themselves added smokeless products, responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. Philip Morris USA now markets Marlboro Snus which has experienced sales growth of over 6% annually into 2012, and Reynolds American has enjoyed similar gains with one of its smokeless products, Camel Snus.

In 2011, according to SAMHSA's National Survey on Drug Use & Health, 3.2% of adults used smokeless tobacco products. And young adults were twice as likely to use smokeless products. A Massachusetts survey in 2011 found that 29% of male smokers aged 18-24 in snus test markets had tried snus products.

Advocates of the use of snuff as part of a harm reduction strategy point to Sweden, where "snus", a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men.[29] The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. A May 2008 study using data from the 2000 National Health Interview Survey reports that U.S. men who used smokeless tobacco as a smoking cessation method achieved significantly higher quit rates than those who used other cessation aids.[30] A 2010 study concluded however that young males who used smokeless tobacco products were more likely to be concurrent smokers.[31] Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[32] and the American Medical Association[33] (AMA) 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.

Regulation. Since June 22, 2009 when President Obama signed the FSPTCA, the FDA has had broad authority over the sale, distribution, and advertising of tobacco products. Such legislation significantly restricts tobacco marketing and sales to youth, requires the disclosure of cigarette ingredients, bigger and bolder health warnings, and bans labels thought to be deceptive, such as "light", and "low-tar" from cigarettes.

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[29] Foulds, Ramstrom, Burke, and Fagerstrom. "Effect of Smokeless Tobacco (Snus) on Smoking and Public Health in Sweden". Tobacco Control. Vol. 12, 2003.

[30] Rodu and Phillips, "Switching to Smokeless Tobacco as a Smoking Cessation Method: Evidence form the 2000 National Health Interview Survey". Harm Reduction Journal. 23 May 2008.

[31] Tomar, Alpert, and Connolly, "Patterns of Dual Use of Cigarettes and Smokeless Tobacco among US Males: Findings from National Surveys". Tobacco Control. 11 December 2009.

[32] *Source:* Surgeon General's 1988 Report, "The Health Consequences of Smoking – Nicotine Addiction".

[33] *Source*: Council on Scientific Affairs, "Reducing the Addictiveness of Cigarettes," Report to the AMA House of Delegates, June 1998.

A significant issue before the FDA is the role of menthol cigarettes. It has been argued that menthol flavoring serves as an inducement to youth smoking and that its prevalence is especially high among minority groups, raising a call for a ban on its manufacture and sale. The FDA has established a working group to study the issue. Menthol cigarette sales represent almost 30% of total cigarette sales. Moreover, menthol smoking rates have increased among young adults during the past decade. In September 2012 the American Journal of Public Health published the first peer-reviewed data on menthol smokers. It reported the results of a national survey of those smokers showing that nearly 40% of menthol smokers say they would quit smoking if menthol cigarettes were no longer available.

The FDA, in July 2013, released its review, "Preliminary Scientific Evaluation of the Possible Public Health Effects of Menthol Versus Nonmenthol Cigarettes". It concluded that menthol in cigarettes is likely to be associated with, first, altered physiological responses to tobacco smoke, second, increased dependence, third, reduced success in smoking cessation, and fourth, increased smoking initation by youth. Though the report did not constitute a decision about regulatory action, the FDA did conclude that it is likely that menthol cigarettes pose a public health risk above that seen with nonmenthol cigarettes. In August 2013 the American Academy of Family Physicians advocated a menthol ban in an open letter to the Food and Drug Administration.

While an outright ban would no doubt prompt a significant number of these smokers to switch to other brands, any significant amount of quitting as a result would have a large negative effect on total consumption and sales. This survey suggests that the effect might be as large as a 12% reduction in cigarette consumption.

In 2011 the FDA's Tobacco Products Scientific Advisory Committee ("TPSAC") determined that menthol use is most prevalent among younger smokers, and among African Americans. It concludes that the availability of menthol cigarettes more likely than not: 1.) increases experimentation and regular smoking, 2.) increases the likelihood and degree of addiction in youth smokers and, 3.) results in lower likelihood of smoking cessation success in African Americans. TPSAC continues to study the issue in 2013. The FDA submitted a draft report of its independent review of research related to the effects of menthol in cigarettes on public health, if any, to an external peer review panel in July 2011, adding that after peer review, the results and the preliminary scientific assessment will be available for public comment in the Federal Register. In addition TPSAC has initiated discussions on the nature and impact of dissolvable tobacco products on public health.

Whether FDA regulation will result in a significantly faster rate of decline of smoking in the U.S. cannot be determined at this time. But it clearly does have that potential if regulators take an aggressive and effective approach towards that goal. One of the most profound actions it is empowered to take is to mandate the reduction of nicotine levels in cigarettes. It will surely study the issue, perhaps opting to phase out nicotine, the addictive factor in cigarettes over some time period. The smaller manufacturers believe, on the other hand, that FDA regulation will strengthen the role of the major producers, as

it raises costs of compliance and narrows price gaps of discount cigarettes. In October 2011, the FDA and the U.S. National Institutes of Health announced a national study of the effects of new tobacco regulation on smokers. The study will examine, by following more than 40,000 smokers, susceptibility to tobacco use, use patterns, resulting health problems, and will evaluate how regulations affect tobacco-related attitudes and behaviors. In January 2013 a state legislator in Oregon took an unprecedented step in cigarette regulation by introducing a bill which would make nicotine a controlled substance, requiring a doctor's prescription.

Research has indicated, and our model incorporates, a negative impact on cigarette consumption due to tobacco tax increases, and a negative trend decline in levels of smoking since the Surgeon General's 1964 warning, subsequent anti-smoking initiatives, and regulations which restrict smoking. Our model and forecast acknowledges the efficacy of these activities in reducing smoking and assumes that the effectiveness of such anti-smoking efforts will continue. For instance, in 2001, Canada required cigarette labels to include large graphic depictions of adverse health consequences of smoking. Recent research suggests that these warnings have some effectiveness, as one-fifth of the participants in a survey reported smoking less as a result of the labels.[34] More recent survey research has found that smokers were more likely to say they wanted to quit after having seen such graphic images. As the prevalence of smoking declines, it is likely that the achievement of further declines will require either a greater level of spending, or more effective programs. This is the common economic principle of diminishing returns**.**

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. 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
2) the level of real disposable income per capita
3) the impact of restrictions on smoking in public places
4) the trend over time in individual behavior and preferences

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 IHS Global Insight's standard population growth forecast, we projected actual cigarette consumption (in billions of cigarettes) out to 2033. It should also be noted that since our entire dataset

[34] Hammond, Fong, McDonald, Brown, and Cameron. "Graphic Canadian Warning Labels and Adverse Outcomes: Evidence from Canadian Smokers". *American Journal of Public Health.* August 2004.

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 2012 on the variables described above, we developed the following regression equation.

log (per capita consumption) = 54.1

- 0.024 * trend

- 0.223 * log (cigarette price)

- 0.104 * log (cigarette price last year)

+ 0.274 * log (per capita disposable income)

- 0.001 * percentage of U.S. with strong indoor smoking ban

- 0.002 * percentage of U.S. with strong indoor smoking ban last year.

This model has an R-square in excess of 0.99, meaning that it explains more than 99 percent of the variation in U.S. adult per capita cigarette consumption over the 1965 to 2012 period. In terms of explanatory power this indicates a very strong model with a high level of statistical significance.

According to the regression equation specified above, cigarette consumption per capita (CPC) displays a trend decline of 2.4% 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. Some of the impact of the availability e-cigarettes may be captured here, though it is also captured in the indoor smoking ban terms. 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.

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 IHS Global Insight forecasts. Annual population growth is projected to average 0.7%, and real per capita personal disposable income is projected to increase over the long term at just over 2.1% per year.

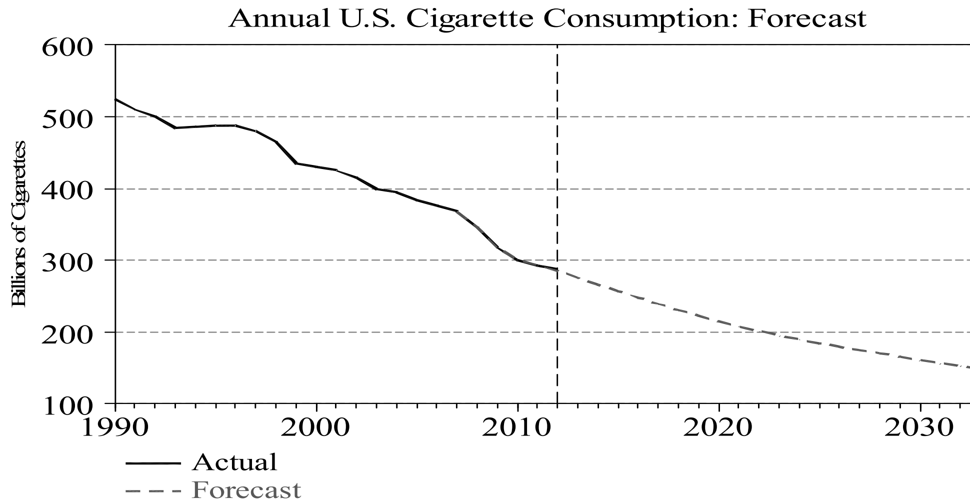
The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the MSA and other state settlement agreements and subsequent excise tax increases. Cigarette prices increased dramatically in November 1998, as manufacturers raised prices by $0.45 per pack. Subsequent increases by the manufacturers and numerous federal and state hikes in excise taxes brought prices to an average of $3.84 per pack in 2004, to $4.04 in 2005, to $4.18 in 2006, $4.47 in 2007, $4.75 in 2008, and to $5.99 in 2009, $6.62 in 2010, $6.85 in 2011, and $7.00 in 2012, following federal and state tax increases. Our forecast assumptions have incorporated price increases in excess of general inflation to offset excise and other taxes. Relative to other goods, cigarette prices will rise by an average of 1.9% per year over the long term. The average real increase over the 30 years ending 1998 was 1.48% per year.

President Obama's 2013 federal budget proposal included an increase in the Federal Excise Tax to $1.95 per pack. Our model predicts that, if enacted, the tax increase would reduce cigarette consumption by an additional 4.6%, resulting in a total decline of approximately 8% in the first year after enactment.

In addition, we assume that the prevalence of indoor and outdoor restrictions on smoking will continue to increase. It is assumed that by 2020 100% of states and municipalities will completely restrict smoking in workplaces, restaurants and bars. At the same time, outdoor and residential restrictions will proliferate over this, and the following decades. These bans are assumed to be as effective in reducing smoking as the indoor bans.

Forecast of Cigarette Consumption

The graph below illustrates total actual and projected cigarette consumption in the United States.



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 6.5% reduction in consumption in 1999. The rate of decline moderated considerably in the following years, averaging 2.1% from 1999 to 2007, before accelerating sharply in 2008.

The economic downturn in the US in 2008 turned into the deepest since the 1930s, with sharply negative effects on household disposable income. At the same time a rapid increase in gasoline and energy prices significantly reduced the discretionary spending of consumers. In addition, cigarette price increases continued, the federal excise tax was raised dramatically, and indoor smoking bans continued to proliferate. Consumption fell by over 4% in 2008 and by over 8% in 2009. Cigarette shipment declines moderated from 2010 to 2012, when the rate of decline was slightly less than 2%. (Roll-your-own tobacco had represented as much as 3% of tobacco volume under the MSA, but has declined in volume by over 70% since 2008, after federal excise taxes were substantially increased.)

In 2013, shipments reported by MSAI for the first half of the year were 6.0% lower than a year ago. This decline was exaggerated by the existence of one fewer shipping day, but also likely influenced by a slowdown in economic activity and higher gasoline prices. Through June the TTB reports shipments 4.7% lower than the comparable period in 2012. For the year we project a consumption decline of 3.7%, largely due to a reduction in IHS' per capita disposable income growth forecast to 1.0%.

Over the longer term our model includes estimates of the negative impact of indoor smoking bans, which we anticipate will ultimately be enacted in all states. For instance, in 2011 legislation to establish indoor bans in Texas and Louisiana made significant advances before being defeated. We also assume that stringent restrictions on smoking will continue to be enacted, including their gradual extension to outdoor public places, as well as to private indoor residential spaces such as in multi-family housing.

From 2012 through 2033 the average annual rate of decline is projected to be 3.1%.

Forecast U.S. Consumption of Cigarettes

	Total Consumption	**Decline Rate**	**Consumption including Roll-Your-Own**	**Decline Rate**
	(billions)	*(%)*	*(billions)*	*(%)*
2009	318.7	-9.1%	325.0	-8.1%
2010	300.8	-6.4%	304.1	-5.6%
2011	293.3	-2.7%	296.0	-2.5%
2012	287.9	-2.0%	290.1	-1.9%
		FORECAST		
2013	277.1	-3.7%	279.3	-3.7%
2014	267.7	-3.4%	269.8	-3.4%
2015	258.5	-3.4%	260.5	-3.4%
2016	249.5	-3.5%	251.4	-3.5%
2017	240.5	-3.6%	242.4	-3.6%
2018	232.0	-3.6%	233.8	-3.6%
2019	223.9	-3.5%	225.6	-3.5%
2020	216.3	-3.4%	218.0	-3.4%
2021	209.2	-3.3%	210.9	-3.3%
2022	202.7	-3.1%	204.2	-3.1%
2023	196.5	-3.0%	198.1	-3.0%
2024	190.9	-2.9%	192.4	-2.9%
2025	185.6	-2.8%	187.0	-2.8%
2026	180.6	-2.7%	182.0	-2.7%
2027	175.8	-2.7%	177.1	-2.7%
2028	171.1	-2.7%	172.4	-2.7%
2029	166.5	-2.7%	167.8	-2.7%
2030	162.0	-2.7%	163.3	-2.7%
2031	157.7	-2.7%	158.9	-2.7%
2032	153.5	-2.7%	154.6	-2.7%
2033	149.2	-2.7%	150.4	-2.7%

Comparison With Prior Forecasts

In October 2002 IHS Global, then DRI•WEFA presented a similar study, “A Forecast of U.S. Cigarette Consumption (2000-2032) for the Tobacco Settlement Authority” That report projected consumption in 2032 of 247.16 billion cigarettes, reflecting an average decline rate of 1.72%. The current forecast projects an average decline rate of 3.10% through 2032, to an annual consumption level of 125.7 billion sticks. Through 2006 the 2005 study accurately projected consumption declines, but the sharp acceleration in the decline rate thereafter resulted in a substantial forecast error. The new forecast was developed with consideration of the large federal tax increase on 2009 and of the negative effects of the proliferation on smoking ban legislation across the US.

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APPENDIX E

DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS

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THE SALE AGREEMENT

The following summary describes certain terms of the Sale Agreement. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to the provisions of the Sale Agreement. Copies of the Sale 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.

Conveyance of Tobacco Assets

On the Tobacco Assets Purchase Date, and simultaneously with the Authority's delivery of the consideration in accordance with the provisions of the Sale 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 Sale Agreement) in accordance with and subject to the terms of the Sale Agreement, all of its right, title and interest on the Tobacco Assets Purchase Date in and to the Tobacco Assets, being that portion, as determined by the Governor of the State by the Sale 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 Sale Agreement to the Indenture Trustee.

The right of the Authority to receive 29.2% of (1) the payments 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 Tobacco Assets Purchase Date, and simultaneously with the State's sale and conveyance of the Tobacco Assets in accordance with the provisions of the Sale 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 Tobacco Assets Purchase 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 Sale Agreement and to carry out its terms.

Binding Obligation. The Sale Agreement has been duly executed and delivered by the State and, assuming the due authorization, execution and delivery of the Sale 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 Sale 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.

Title to Tobacco Assets. The State is the sole owner of the Tobacco Assets to be sold to the Authority under the Sale Agreement. On and after the Tobacco Assets Purchase 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 Sale 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 Sale 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 Sale 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 the Indenture Trustee, 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 Indenture 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 Sale 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 Sale 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 Sale Agreement, for any action taken or for refraining from the taking of any action pursuant to the Sale 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 Bondholders, 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 Sale 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 Bondholders 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 Bondholders, 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 Sale 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 Indenture 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 Series 2002 Bonds to enable the interest thereon to be so excluded.

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.

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.

Amendment

Except as otherwise provided in the third paragraph of "Pledges; Protection of Title; Non-Impairment Covenant," the Sale 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 Sale 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 Sale 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 Sale 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 Sale 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 ot the Sale 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 Sale 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 Sale 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:

"**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.

"**Rating Confirmation**" means written confirmation from each national 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.

"**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 Tobacco Assets Purchase Date and before July 1, 2003, and (2) 29.2% of:

(a) the payments 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.

"**Tobacco Assets Purchase Date**" means November 5, 2002, being the date of issuance of the Series 2002 Bonds.

"**Transaction Documents**" means the Sale Agreement and the Indenture.

"**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 Tobacco Assets Purchase 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 2013 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 2013 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 2013 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 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 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 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; (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 Sale Agreement, including the representations, warranties and covenants of the State in the Sale Agreement; (5) 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; (6) all proceeds of the foregoing; and (7) 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 (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 Sale Agreement for the benefit of the Bondholders.

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 and are not subject to the lien of the Indenture. The right of the Authority to receive 29.2% of (1) the payments 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 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.

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

Operating Expenses due and payable constituting termination payments on investment contracts or investment agreements for Accounts, or on forward purchase contracts for investments in Accounts, shall have been paid, (4) the Residual Certificate shall have been surrendered to the Indenture Trustee for cancellation in exchange for a transfer of the Collateral, and (5) 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 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 in accordance with clauses (1) and (2) of *"Defeasance"* above. Thereafter, the Holders of such Defeased Bonds 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.

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 Costs of Issuance Account; and

(8) the Surplus 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; provided, however, that amounts on deposit in the Surplus Account from time to time that are not reasonably expected by the Issuer to be used to pay the purchase or redemption price of Bonds on or before the next Distribution Date shall be continuously invested in Non-AMT Tax-Exempt Obligations. 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, Principal 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 Barclays Capital Inc. 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 Sale Agreement, and the Authority is authorized to include such covenant and agreement in the Indenture for the benefit of the Bondholders or other parties receiving the express benefit of the security for the Bonds ("**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 Sale 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 Sale 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 Sale Agreement constitute important security provisions of the Bonds and waives any right to assert any claim to the contrary and agrees that it shall neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the State or any other person of, any such claim to the contrary. By acknowledging that the MSA, the Consent Decree and the Sale 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 Sale 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 (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 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 Tax-Exempt 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 Tax-Exempt Bonds that would cause the Tax-Exempt Bonds to be "private activity bonds" within the meaning of Section 141(a) of the Tax Code or would cause interest on the Tax-Exempt Bonds to not be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code.

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 Tax-Exempt Bonds will at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Tax-Exempt Bond to be an "arbitrage bond" as defined in the 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.

Rating

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 one nationally recognized statistical rating organization.

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 Sale Agreement or the Authority Tax Certificate or the performance by any party thereunder; (4) enforce the Sale 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 Sale 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;

(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 Sale 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 Sale 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, Sale 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 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;

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

(5) 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.

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 Sale 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 Principal Maturity or Sinking Fund Installment;

(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.

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. On each Distribution Date after the occurrence of an Event of Default hereunder and on each Distribution Date thereafter, the Bonds shall be paid on a Pro Rata basis.

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; 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 Sale Agreement

Except as otherwise provided in the third paragraph of "THE SALE AGREEMENT—Pledges; Protection of Title; Non-Impairment Covenant" and "THE INDENTURE—Non-Petition Covenant," the Sale 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 an Opinion of Counsel that the amendment is permitted under the Sale Agreement and will not adversely affect the tax exemption of interest on the Tax-Exempt Bonds. The Sale Agreement may also be amended for any purpose, other than as provided in the third paragraph of "THE SALE 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 Sale

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 Sale 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 2013 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 60 Livingston Avenue, St. Paul, Minnesota 55107 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'') 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) non-callable 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); and

(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) or (2) which fund may be applied only to the payment when due of such bonds or other obligations; provided, however, that at the time of purchase of such bonds or other obligations, each Rating Agency shall have rated them based solely upon the security provided by the fund described in clause (b).

"**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 Federal Housing Administration, the Private Export Funding Corporation or the Resolution Trust Company;

(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 six months after the date of issuance thereof, if such deposits or instruments are rated "A-1" by S&P;

(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 two 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 and that are either (a) payable at par on demand or on a specified date not more than 270 days, after the date of issuance thereof and that have long-term ratings of "A" by S&P, 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 (if payable on demand or on a specified date no more than six

months after the date of issuance thereof), or rated by each Rating Agency rating such bonds in one of its two 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 at least "BBB" by S&P; *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) forward purchase agreements with respect to the future purchase by the Issuer or the Trustee of any security described in clauses (1), (2), (3) or (5) above entered into with any financial institution 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 is entered into, by each Rating Agency, in one of its three highest rating categories; provided that securities purchased pursuant to such agreement shall in all respects comply with the requirements set forth in those provisions of the Indenture summarized above under the caption "Investments";

(8) 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 "A-1" by S&P 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;

(9) 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 two 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;

(10) 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 two 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;

(11) solely for investment of money in the Surplus Account, Non-AMT Tax-Exempt Obligations; and

(12) 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."

"**Non-AMT Tax-Exempt Obligation**" means a debt obligation the interest on which (i) is excludible from gross income for federal income tax purposes pursuant to Section 103 of the Code, (ii) is not a preference item for purposes of computing alternative minimum tax by reason of Section 57(a)(5) of the Code, and (iii) is rated "A-1" or "A" or higher by S&P.

"**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; (5) Bonds purchased with money in the Surplus Account; and (6) 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.

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

"**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 as in effect on the Tobacco Assets Purchase Date, 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.

"**Tax-Exempt Bonds**" means all Bonds so identified in any Series Supplement, including the Series 2013 Bonds.

"**Unpledged TSRs**" means 70.8% of:

(a) the payments 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.

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APPENDIX F

PROPOSED FORMS OF OPINIONS OF CO-BOND COUNSEL

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October 17, 2013

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 $334,700,000 aggregate principal amount of Tobacco Settlement Revenue Refunding Bonds, Series 2013 (the "Series 2013 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 Chapter 43.340, Revised Code of Washington codifying Chapter 365, Laws of the State, 2002, as amended (the "Act").

In such examination, 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 2013 Bonds are authorized and issued pursuant to the Act and a resolution of the Authority adopted July 1, 2013, and are issued pursuant to an Indenture dated as of October 1, 2002, as amended and restated on October 17, 2013 and a Series 2013 Supplement dated October 17, 2013, each by and between the U.S. Bank National Association, as trustee (the "Indenture Trustee") and the Authority (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 2013 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, 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 interest on the Series 2013 Bonds from gross income under Section 103 of the Code. We have assumed the due authorization, execution and delivery of the Sale Agreement by the State and of the Indenture by the Indenture Trustee. We have also assumed the enforceability of the Sale Agreement against the State and the enforceability of the Indenture against the Indenture Trustee, each in accordance with its respective terms.

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 Sale Agreement, to perform the duties and obligations of the Authority under the Indenture and the Sale Agreement, and to issue the Series 2013 Bonds.

3. Each of the 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 twenty-nine and two-tenths percent (29.20%) of (i) the payments 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 (70.80%) of said revenues.

6. The Series 2013 Bonds have been duly and validly authorized and issued by the Authority in accordance with the 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 2013 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. Payments of the principal of, interest on, and

redemption or prepayment premium, if any, on the Series 2013 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 2013 Bonds.

8. Under existing statutes and court decisions, (i) interest on the Series 2013 Bonds is excluded from the gross income of the owners for Federal income tax purposes pursuant to Section 103 of the Code, and (ii) interest on the Series 2013 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

Except as expressly stated above, we express no opinion regarding any other federal or state income tax consequences of acquiring, carrying, owning or disposing of the Series 2013 Bonds. Owners of the Series 2013 Bonds should consult their tax advisors regarding the applicability of any collateral tax consequences of owning the Series 2013 Bonds, which may include original issue discount, original issue premium, purchase at a market discount or at a premium, taxation upon sale, redemption or other disposition, and various withholding requirements. 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 2013 Bonds.

In rendering this opinion, we are advising you that the enforceability of rights and remedies with respect to the Series 2013 Bonds, the Indenture and the 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).

We undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Series 2013 Bonds and we express no opinion with respect thereto.

This opinion is rendered as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

Very truly yours,

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October 17, 2013

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 $334,700,000 aggregate principal amount of Tobacco Settlement Revenue Refunding Bonds, Series 2013 (the "Series 2013 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 Chapter 43.340, Revised Code of Washington codifying Chapter 365, Laws of the State, 2002, as amended (the "Act").

In such examination, 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 2013 Bonds are authorized and issued pursuant to the Act and a resolution of the Authority adopted July 1, 2013, and are issued pursuant to an Indenture dated as of October 1, 2002, as amended and restated on October 17, 2013 and a Series 2013 Supplement dated October 17, 2013, each by and between U.S. Bank National Association, as trustee (the "Indenture Trustee") and the Authority (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 2013 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, 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 interest on the Series 2013 Bonds from gross income under Section 103 of the Code. We have assumed the due authorization, execution and delivery of the Sale Agreement by the State and of the Indenture by the Indenture Trustee. We have also assumed the enforceability of the Sale Agreement against the State and the enforceability of the Indenture against the Indenture Trustee, each in accordance with its respective terms.

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 Sale Agreement, to perform the duties and obligations of the Authority under the Indenture and the Sale Agreement, and to issue the Series 2013 Bonds.

3. Each of the 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 twenty-nine and two-tenths percent (29.20%) of (i) the payments 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 (70.80%) of said revenues.

6. The Series 2013 Bonds have been duly and validly authorized and issued by the Authority in accordance with the 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 2013 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. Payments of the principal of, interest on, and redemption or prepayment premium, if any, on the Series 2013 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 2013 Bonds.

8. Under existing statutes and court decisions, (i) interest on the Series 2013 Bonds is excluded from the gross income of the owners for Federal income tax purposes pursuant to Section 103 of the Code, and (ii) interest on the Series 2013 Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

Except as expressly stated above, we express no opinion regarding any other federal or state income tax consequences of acquiring, carrying, owning or disposing of the Series 2013 Bonds. Owners of the Series 2013 Bonds should consult their tax advisors regarding the applicability of any collateral tax consequences of owning the Series 2013 Bonds, which may include original issue discount, original issue premium, purchase at a market discount or at a premium, taxation upon sale, redemption or other disposition, and various withholding requirements. 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 2013 Bonds.

In rendering this opinion, we are advising you that the enforceability of rights and remedies with respect to the Series 2013 Bonds, the Indenture and the 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).

We undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Series 2013 Bonds and we express no opinion with respect thereto.

This opinion is rendered as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

Very truly yours,

PACIFICA LAW GROUP LLP

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