NEW ISSUE **BOOK-ENTRY ONLY**

*In the opinion of Harris Beach PLLC, Bond Counsel to the Corporation, based on existing statutes, regulations, administrative rulings and court decisions, and assuming compliance with the tax covenants described herein, interest on the Series 2014 Senior Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "**Code**"). Furthermore, Bond Counsel is of the opinion that interest on the Series 2014 Senior Bonds is not an "item of tax preference" for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Series 2014 Senior Bonds is, however, included in the computation of "adjusted current earnings" for purposes of calculating the federal alternative minimum tax imposed on certain corporations. Bond Counsel is further of the opinion that, based on existing law, interest on the Series 2014 Senior Bonds is exempt from personal income taxes imposed by the State of New York and any political subdivision thereof. See "TAX MATTERS" herein regarding certain other tax considerations.*

$44,295,000
NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
Tobacco Settlement Asset-Backed Bonds, Series 2014

Dated: Date of Delivery **Maturity Dates: May 15, as set forth on the inside cover**

The Niagara Tobacco Asset Securitization Corporation (the "**Corporation**") is issuing $44,295,000 aggregate principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2014 (the "**Series 2014 Senior Bonds**"). The Corporation is a local development corporation organized by the County of Niagara, New York (the "**County**") under the Not-For-Profit Corporation Law of the State of New York (the "**State**"). The Corporation is an instrumentality of, but separate and apart from, the County.

The Series 2014 Senior Bonds are to be issued by the Corporation pursuant to an Indenture between the Corporation and Manufacturers and Traders Trust Company, as trustee (the "**Indenture Trustee**"), dated as of November 1, 2000 (the "**Original Indenture**"), as amended as of November 1, 2005, and as further amended as of August 14, 2014, and the Series 2014 Supplement between the Corporation and the Indenture Trustee, dated as of August 14, 2014 (as so amended and supplemented, the "**Indenture**"). The Series 2014 Senior Bonds are also being issued in accordance with a certain Consent and Waiver and related Purchase Agreement, Consent and Release, each dated as of July 31, 2014, which evidence the agreement of the Corporation, the holders of all of the outstanding New York Counties Tobacco Trust V Tobacco Settlement Pass-Through Bonds, Series 2005 (the "**NYCTT V Bonds**") and Manufacturers and Traders Trust Company, in its capacities as Indenture Trustee and the trustee for the NYCTT V Bonds, to the issuance of the Series 2014 Senior Bonds and the use of the proceeds thereof in the manner described herein notwithstanding any restrictions to the contrary contained in the Series 2005 Supplemental Indenture (as defined herein). The Series 2014 Senior Bonds are being issued to (i) currently refund all of the Corporation's outstanding Tobacco Settlement Asset-Backed Bonds, Series 2000 (the "**Series 2000 Bonds**"), (ii) acquire by negotiated purchase all of the $6,572,480 initial principal amount of outstanding New York Counties Tobacco Trust V Tobacco Settlement Pass-Through Bonds, Series 2005 S4B attributable to the Corporation, for the purpose of cancellation, (iii) cancel the related bond RS4B-1 of the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2005 (the "**Series 2005 Subordinate Bonds**"), (iv) fund a payment to the owner of the Residual Certificate (as defined herein) in an amount not to exceed $2,000,000 in order to provide the County with funds for capital purposes, and (v) pay the costs of issuance of the Series 2014 Senior Bonds. The Series 2014 Senior Bonds are being issued as Senior Bonds (as defined herein), senior to the Corporation's Series 2005 Subordinate Bonds.

The Series 2000 Bonds were issued by the Corporation to finance the Corporation's purchase of the "**Tobacco Assets**" from the County, which consist of all right, title and interest of the County under the MSA and Consent Decree (each such term as hereinafter defined), pursuant to the Purchase and Sale Agreement, dated as of November 1, 2000 (the "**Purchase and Sale Agreement**"), between the County and the Corporation. 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, and the Consent Decree and Final Judgment, entered in New York State Supreme Court for New York County in December 1998 (the "**Consent Decree**"), allocates to the County 0.467% of the State's 12.7620310% share of the Initial Payments and Annual Payments (as such terms are defined herein) required to be made by the PMs under the MSA. The Initial Payments and Annual Payments payable to the Corporation pursuant to the MSA, Consent Decree and Purchase and Sale Agreement are referred to herein as the "**TSRs**".

The Series 2014 Senior Bonds are limited obligations of the Corporation, secured by and payable solely from (i) the TSRs and investment earnings on accounts pledged under the Indenture (as more fully described herein, the "Collections") and (ii) amounts held in the accounts established and pledged under the Indenture. The Corporation has no financial assets other than the Collections and the amounts held in the accounts established under the Indenture.

The Corporation has pledged the TSRs as security and in trust for the benefit of the Holders of the Series 2014 Senior Bonds. Payment of the Series 2014 Senior Bonds depends on receipt by the Indenture Trustee, as collateral assignee of the Corporation, of the TSRs. The amount of 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 (as defined herein), some of which have occurred and may continue to occur and may be material. See "BONDHOLDERS' RISKS" and "LEGAL CONSIDERATIONS RELATING TO TSRS" herein for a discussion of certain factors that should be considered in connection with an investment in the Series 2014 Senior Bonds.

The Series 2014 Senior Bonds will be dated their date of delivery and mature on May 15 in the years as set forth on the inside cover page (each such date, a "**Maturity Date**"). Interest on the Series 2014 Senior Bonds will be payable on each May 15 and November 15 (each, a "**Distribution Date**"), commencing November 15, 2014. The Series 2014 Senior 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 2014 Senior 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 2014 SENIOR BONDS SHALL NOT BE A DEBT OF THE COUNTY OR THE STATE NOR SHALL THE COUNTY OR THE STATE BE LIABLE THEREON. THE CORPORATION SHALL NOT HAVE THE POWER TO PLEDGE THE CREDIT, THE REVENUES OR THE TAXING POWER OF THE COUNTY OR THE STATE, AND NONE OF THE CREDIT, THE REVENUES OR THE TAXING POWER OF THE COUNTY OR THE STATE SHALL BE, OR SHALL BE DEEMED TO BE, PLEDGED TO THE PAYMENT OF ANY OF THE SERIES 2014 SENIOR BONDS. THE CORPORATION HAS NO TAXING POWER.

The Series 2014 Senior Bonds are offered when, as and if issued by the Corporation and accepted by the Underwriter, subject to the approval of legality by Harris Beach PLLC, Buffalo, New York, Bond Counsel to the Corporation. Certain legal matters will be passed upon for the Corporation by its counsel, Rupp, Baase, Pfalzgraf, Cunningham & Coppola LLC, Lockport, New York; for the County by Claude A. Joerg, County Attorney; and for the Underwriter by Hawkins Delafield & Wood LLP, New York, New York, counsel to the Underwriter. It is expected that the Series 2014 Senior Bonds will be available for delivery on or about September 24, 2014, in book-entry form through The Depository Trust Company, New York, New York.

Raymond James

Dated: September 9, 2014

MATURITY SCHEDULE

$44,295,000
Niagara Tobacco Asset Securitization Corporation
Tobacco Settlement Asset-Backed Bonds, Series 2014

$12,870,000 Serial Bonds

Maturity Date (May 15)	Principal Amount	Interest Rate	Yield	CUSIP†
2015	$ 730,000	4.00%	0.54%	653364BB4
2016	795,000	4.00	0.81	653364BC2
2017	855,000	5.00	1.10	653364BD0
2018	1,295,000	5.00	1.46	653364BE8
2019	1,325,000	5.00	1.84	653364BF5
2020	1,400,000	5.00	2.21	653364BG3
2021	1,480,000	5.00	2.57	653364BH1
2022	1,570,000	5.00	2.88	653364BJ7
2023	1,660,000	5.00	3.10	653364BK4
2024	1,760,000	5.00	3.30	653364BL2

$31,425,000 Term Bonds††

$9,950,000 4.00% Series 2014 Term Bonds due May 15, 2029; Price: 100%;
CUSIP† 653364BM0; First Optional Redemption Date: May 15, 2015

$9,645,000 5.25% Series 2014 Term Bonds due May 15, 2034; Yield: 3.87%;
CUSIP† 653364BN8; First Optional Redemption Date: May 15, 2024

$11,830,000 5.25% Series 2014 Term Bonds due May 15, 2040; Yield: 4.08%;
CUSIP† 653364BP3; First Optional Redemption Date: May 15, 2024

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† Copyright, American Bankers Association. CUSIP data herein are provided by Standard & Poor's CUSIP Service Bureau, a division of McGraw-Hill Financial, Inc. The CUSIP numbers listed above are being provided solely for the convenience of Bondholders only at the time of issuance of the Series 2014 Senior Bonds. Neither the Corporation nor the Underwriter makes any representation with respect to such numbers or undertakes 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 2014 Senior 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 2014 Senior 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 2014 SENIOR 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 CORPORATION, THE COUNTY OR THE UNDERWRITER. 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 2014 SENIOR BONDS PAYABLE FROM TOBACCO SETTLEMENT PAYMENTS MADE UNDER THE MSA. THERE CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES 2014 SENIOR 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 2014 SENIOR BONDS.

This Official Statement has been prepared by the Corporation and contains information furnished by IHS Global and other sources, all of which the Corporation 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 Corporation 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 Corporation 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 Corporation 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 Corporation 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 TSRs (see "BONDHOLDERS' RISKS," "LEGAL CONSIDERATIONS RELATING TO TSRS" 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 Corporation, the County, IHS Global or the Underwriter 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 Purchase and Sale Agreement and the Continuing Disclosure Undertaking do not purport to be complete. Refer to the Indenture, the Purchase and Sale Agreement and the Continuing Disclosure Undertaking for full and complete details of their provisions. Copies of the Indenture, the Purchase and Sale Agreement and the Continuing Disclosure Undertaking are on file with the Corporation 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 their 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 Corporation. These forward-looking statements speak only as of the date of this Official Statement. The Corporation 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 Corporation's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

The Underwriter has provided the following sentence for inclusion in this Official Statement. The Underwriter has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does 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 2014 SENIOR 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 2014 Senior 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 Niagara Tobacco Asset Securitization Corporation (the "**Corporation**") is issuing $44,295,000 aggregate principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2014 (the "**Series 2014 Senior Bonds**").

The Series 2014 Senior Bonds are to be issued by the Corporation pursuant to an Indenture between the Corporation and Manufacturers and Traders Trust Company, as trustee (the "**Indenture Trustee**"), dated as of November 1, 2000 (the "**Original Indenture**"), as amended as of November 1, 2005, and as further amended as of August 14, 2014, and the Series 2014 Supplement between the Corporation and the Indenture Trustee, dated as of August 14, 2014 (as so amended and supplemented, the "**Indenture**"). The Series 2014 Senior Bonds are also being issued in accordance with a certain Consent and Waiver and related Purchase Agreement, Consent and Release, each dated as of July 31, 2014 (collectively, the "**Consent and Waiver**"), which evidence the agreement of the Corporation, the holders of all of the outstanding NYCTT V Bonds (as defined below) and Manufacturers and Traders Trust Company, in its capacities as Indenture Trustee and the trustee for the NYCTT V Bonds, to the issuance of the Series 2014 Senior Bonds and the use of the proceeds thereof in the manner described herein notwithstanding any restrictions to the contrary contained in the Series 2005 Supplemental Indenture (as defined below).

The Series 2014 Senior Bonds are being issued to (i) currently refund all of the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2000 (the "**Series 2000 Bonds**"), currently outstanding in the aggregate principal amount of $38,690,000, (ii) acquire by negotiated purchase all of the $6,572,480[†] initial principal amount of outstanding New York Counties Tobacco Trust V Tobacco Settlement Pass-Through Bonds, Series 2005 S4B attributable to the Corporation (collectively, the "**NYCTT V/NTASC S4B Bonds**"), for the purpose of cancellation, (iii) cancel the related bond RS4B-1 of the Corporation's Series 2005 Subordinate Bonds (as defined below), (iv) fund a payment to the owner of the Residual Certificate (as defined herein) in an amount not to exceed $2,000,000 in order to provide the County with funds for capital

[†] Issued as capital appreciation bonds, and will be acquired at a price representing a negotiated percentage of the accreted value as of the Closing Date (as defined herein).

purposes, and (v) pay the costs of issuance of the Series 2014 Senior Bonds.

The Series 2014 Senior Bonds, together with any additional bonds issued under the Indenture on a parity therewith, are collectively referred to herein as the "**Senior Bonds**." The Senior Bonds and any subordinate obligations issued under the Indenture ("**Subordinate Bonds**") are collectively referred to herein as the "**Bonds**." In 2005 the Corporation issued its Tobacco Settlement Asset-Backed Bonds, Series 2005 S1 (Subordinate Turbo CABs), Series 2005 S2 (Subordinate Turbo CABs), Series 2005 S3 (Subordinate Turbo CABs), Series 2005 S4A (Subordinate Turbo CABs) and Series 2005 S4B (Subordinate Turbo CABs) (collectively, the "**Series 2005 Subordinate Bonds**") pursuant to the Indenture and the Series 2005 Supplemental Bond Indenture, dated as of November 1, 2005, as amended, by and between the Corporation and the Indenture Trustee (the "**Series 2005 Supplemental Indenture**"). The Series 2005 Subordinate Bonds were issued to secure a like amount of New York Counties Tobacco Trust V's Tobacco Settlement Pass-Through Bonds, Series 2005 (the "**NYCTT V Bonds**") (which include the NYCTT V/NTASC S4B Bonds). The Series 2005 Subordinate Bonds are Subordinate Bonds under the Indenture and, as such, are subordinated in right of payment to principal, premium, if any, and interest payments on the Series 2014 Senior Bonds. Payments of debt service to Holders of the Series 2005 Subordinate Bonds constitute Junior Payments under the Indenture. As a result of the Consent and Waiver, there will be no payments of debt service to Holders of the Series 2005 Subordinate Bonds until the Series 2014 Senior Bonds are paid in full.

The Series 2000 Bonds were issued by the Corporation to finance the Corporation's purchase of the "**Tobacco Assets**" from Niagara County, New York (the "**County**"), which consist of all right, title and interest of the County under the MSA and Consent Decree (each such term as defined below) following such purchase, pursuant to the Purchase and Sale Agreement, dated as of November 1, 2000 (the "**Purchase and Sale Agreement**"), between the County and the Corporation.

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. The Consent Decree and Final Judgment, entered in New York State Supreme Court for New York County in December 1998 (the "**Consent Decree**"), allocates to the County 0.467% of the State of New York's (the "**State**") share of the Initial Payments and Annual Payments (as such terms are defined below) required to be made by the PMs (as defined below) under the MSA, as described further below. The Initial Payments and Annual Payments payable to the Corporation pursuant to the MSA, Consent Decree and Purchase and Sale Agreement are referred to herein as the "**TSRs**".

THE SERIES 2014 SENIOR BONDS ARE SPECIAL LIMITED OBLIGATIONS OF THE CORPORATION PAYABLE FROM THE TSRS. THE SERIES 2014 SENIOR BONDS SHALL NOT BE A DEBT OF THE COUNTY OR THE STATE NOR SHALL THE COUNTY OR THE STATE BE LIABLE THEREON. THE CORPORATION SHALL NOT HAVE THE POWER TO PLEDGE THE CREDIT, THE REVENUES OR THE TAXING POWER OF THE COUNTY OR THE STATE, AND NONE OF THE CREDIT, THE REVENUES OR THE TAXING POWER OF THE COUNTY OR THE STATE SHALL BE, OR SHALL BE DEEMED TO BE, PLEDGED TO THE PAYMENT OF ANY OF THE SERIES 2014 SENIOR BONDS. THE CORPORATION HAS NO TAXING POWER.

The Corporation .... The Corporation is a special purpose, bankruptcy-remote local development corporation organized by the County and incorporated under the provisions of Section 1411 of the New York State Not-For-Profit Corporation Law (the "**Act**"). The Corporation is an instrumentality of, but separate and apart from, the County. The Corporation has no taxing power.

Sale of Tobacco Assets .... Pursuant to the Purchase and Sale Agreement, the County sold the Tobacco Assets to the Corporation. The Corporation has assigned and pledged all of its rights and interest in the Tobacco Assets, which constitute the TSRs, to the Indenture Trustee pursuant to the Indenture. Pursuant to the Purchase and Sale Agreement, the County has directed the State to instruct the MSA Escrow Agent to pay the TSRs directly to the Indenture Trustee. Such direction is irrevocable until the Bonds have been repaid. See Appendix E — "DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS—The Purchase and Sale Agreement."

Securities Offered .... The Series 2014 Senior Bonds will be issued pursuant to the Indenture. It is expected that the Series 2014 Senior Bonds will be delivered in book-entry form on or about September 24, 2014 (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 2014 Senior Bonds will not receive physical delivery of bond certificates. See "THE SERIES 2014 SENIOR BONDS—Book-Entry Only System."

Security for the Bonds .... The Bonds, including the Series 2014 Senior Bonds, are limited obligations of the Corporation secured by and payable solely from (a) the TSRs and all aid, rents, fees, charges, payments, investment earnings and other income and receipts (including bond proceeds other than refunding bond proceeds but only to the extent deposited in an Account) paid to the Corporation or the Indenture Trustee for the account of the Corporation or the Bondholders (the "**Revenues**") (Revenues deposited in the Collection Account or the Debt Service Account are referred to herein as "**Collections**"), (b) all rights to receive the Revenues and the proceeds of

such rights, (c) all Accounts and assets thereof, including money, contract rights, general intangibles or other personal property, held by the Indenture Trustee under the Indenture, (d) subject to the following sentence, all rights and interest of the Corporation under the Purchase and Sale Agreement, including the representations, warranties and covenants of the County therein, the Tobacco Assets and payments in respect of Tobacco Assets and (e) any and all other property of every kind and nature from time to time, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture (collectively, the "**Trust Estate**"). The assignment and pledge of the Trust Estate under the Indenture does not include: (i) the rights of the Corporation pursuant to provisions for consent or other action by the Corporation, notice to the Corporation, indemnity or the filing of documents with the Corporation, or otherwise for its benefit and not for that of the Bondholders, (ii) any right or power reserved to the Corporation pursuant to the Act or other law or (iii) the provisions of the Purchase and Sale Agreement limiting the County's use of the purchase price of the Series 2000 Bonds; in addition, the assignment and pledge under the Indenture does not preclude the Corporation's enforcement of its rights under and pursuant to the Purchase and Sale Agreement for the benefit of the Bondholders and the owner of the Residual Certificate as provided in the Indenture.

Liquidity Reserve Account .... One of the accounts held under the Indenture is the "**Liquidity Reserve Account**". The Corporation is required to maintain a balance in the Liquidity Reserve Account, to the extent of available Collections, equal to the lesser of: (i) the maximum amount of Required Principal Payments and interest on Senior Bonds payable in the then current or any future Fiscal Year (defined below); or (ii) the maximum amount that may be held in the Liquidity Reserve Account, in the opinion of Bond Counsel, without adversely affecting the tax-exempt status of the Tax-Exempt Bonds (the "**Liquidity Reserve Requirement**"). Amounts on deposit in the Liquidity Reserve Account will be available to pay principal and interest on the Senior Bonds and Extraordinary Payments (as defined herein), to the extent Collections are insufficient for such purposes. As described herein, subject to the provisions of the Indenture regarding application of Collections, amounts in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement will be transferred to the Debt Service Account. Other than amounts in excess of the Liquidity Reserve Requirement and other than after the occurrence of an Event of Default, amounts withdrawn from the Liquidity Reserve Account will be replenished from Collections as described herein. "**Fiscal Year**" means the twelve-month period ending each December 31.

The Liquidity Reserve Account will be fully funded on the date of issuance of the Series 2014 Senior Bonds by the Debt Service Reserve Forward Delivery Agreement, dated as of November 9, 2000, as amended as of September 24, 2014 (as so amended, the "**Forward Delivery Agreement**"), by and among the Indenture Trustee, the Corporation and Citigroup Financial Products Inc. (the "**Forward Delivery Agreement Provider**"). Pursuant to the terms of the Forward

Delivery Agreement, the Forward Delivery Agreement Provider is required to deliver to the Indenture Trustee, on the Business Day prior to each May 15 and November 15 (each such May 15 and November 15, a "**Distribution Date**"), securities, as specified therein, which will mature not later than the Business Day prior to the next succeeding Distribution Date in an aggregate amount equal to the Liquidity Reserve Requirement, and which the Indenture Trustee will purchase from the Forward Delivery Agreement Provider with amounts held in the Liquidity Reserve Account at a purchase price to provide a guaranteed yield on such investments. See "BONDHOLDERS' RISKS—Certain Risks Associated with the Forward Delivery Agreement."

Covenants.................................. The Corporation and the County have made certain covenants for the benefit of the Bondholders. The Corporation has covenanted in the Indenture to, among other things, at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Corporation on Tax-Exempt Bonds, including the Series 2014 Senior Bonds, is excludable from gross income for Federal income tax purposes pursuant to §103(a) of the Internal Revenue Code of 1986, as amended (the "**Code**"). The County has covenanted in the Purchase and Sale Agreement to, among other things, take all actions as may be required by law fully to preserve, maintain, defend, protect and confirm the interest of the Corporation and the interests of the Indenture Trustee on behalf of the Bondholders in the Tobacco Assets and the proceeds thereof; not take any action that will adversely affect the Corporation's ability to receive payments made under the MSA and the Consent Decree; not limit or alter the rights of the Corporation to fulfill the terms of its agreements with Bondholders or in any way impair the rights and remedies of the Bondholders or the security for Bonds until the Bonds, together with the interest due thereon or payable in respect thereof and all costs and expenses in connection with any action or proceeding by or on behalf of such Bondholders, are fully met and discharged; and not take any action, and use its best reasonable efforts not to permit any action to be taken by others, that would release any person from or result in a modification of any of such person's covenants or obligations under the Consent Decree and the MSA or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the Consent Decree or the MSA or otherwise materially adversely affect the interests of the Corporation or the Bondholders therein, nor, without the prior written consent of the Corporation and the Indenture Trustee on behalf of the Bondholders, amend, modify, terminate, waive or surrender, or agree to any amendment, modification, termination, waiver or surrender of, the terms of the Consent Decree, the MSA or the Purchase and Sale Agreement, or waive timely performance or observance under such documents, in each case if the effect thereof would be materially adverse to the Corporation or the Bondholders. The Corporation has assigned the covenants of the County to the Indenture Trustee for the benefit of the Bondholders. See Appendix E — "DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS—The Indenture" for a summary of the

covenants made by the Corporation and "—The Purchase and Sale Agreement" for a summary of the covenants made by the County.

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 then 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. On July 15, 2014 Reynolds American and Lorillard, Inc. (the parent company of Lorillard) entered into an agreement for a merger, which such companies expect to occur in the first half of 2015. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Industry Overview" herein.

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. The MSA also provides for the imposition of certain tobacco advertising and marketing restrictions, among other things. Neither the County nor the Corporation is 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.

New York Consent Decree .... Under the MSA, the State is entitled to 12.7620310% of the Initial Payments and Annual Payments (as defined below) made by PMs under the MSA. The Consent Decree allocates 0.467% of the State's share of the Initial Payments and Annual Payments to the County, and the remainder among the State, The City of New York (the "**City**"), and all other counties within the State. The County sold all of its right, title and interest under the MSA and the Consent Decree to the Corporation pursuant to the Purchase and Sale Agreement. As a result, the Corporation is entitled to receive 0.05959868477% of Initial Payments (all of which have been made) and Annual Payments made by the PMs under the MSA following the date of the Purchase and Sale Agreement. The monies to which the County is entitled are paid directly by the MSA Escrow Agent (as defined herein) to the Indenture Trustee, do not pass through the State, and are not subject to State appropriation.

Under the Consent Decree, the State is entitled to receive Strategic Contribution Payments (as defined below). The County does not have an interest in the Strategic Contribution Payments; accordingly, such payments are not part of the TSRs pledged to the Corporation and are not discussed in detail herein.

The Consent Decree became final on August 17, 1999 and is not subject to further appeal. As a result, the State has achieved State-Specific Finality (as defined herein) under the MSA. See "NEW YORK CONSENT DECREE" herein for a summary of the Consent Decree and Appendix B attached hereto for a copy of the Consent Decree.

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, 2014 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, 2014 payments have already been paid (the "**Strategic Contribution Payments**"). Strategic Contribution Payments are not allocated to the County under the Consent Decree and therefore are not available to the Corporation and are not included in the TSRs.

Under the MSA, each OPM is required to pay an allocable portion of each Annual 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 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**").

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 85.20%* of the U.S. domestic cigarette market in payment year 2014 (sales year 2013), based upon shipments and measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate, or approximately 84.95%* 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 8.43%* of the U.S. domestic cigarette market in payment year 2014 (sales year 2013), based upon shipments and measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate, or approximately 8.70%* measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate.

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

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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 in future years. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments."

required, in turn, to remit an allocable share of such payments to the parties entitled thereto.

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 2013 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."

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 less than 274 billion cigarettes in 2013. See "SUMMARY OF IHS GLOBAL REPORT" and Appendix D — "IHS GLOBAL REPORT" attached hereto.

IHS Global Report .... IHS Global Inc. ("**IHS Global**"), formerly known as DRI•WEFA, Inc., has prepared a report dated September 9, 2014 on the consumption of cigarettes in the United States from 2014 through 2040 entitled, "A Forecast of U.S. Cigarette Consumption (2014-2040) for the Niagara Tobacco Asset Securitization Corporation" (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.

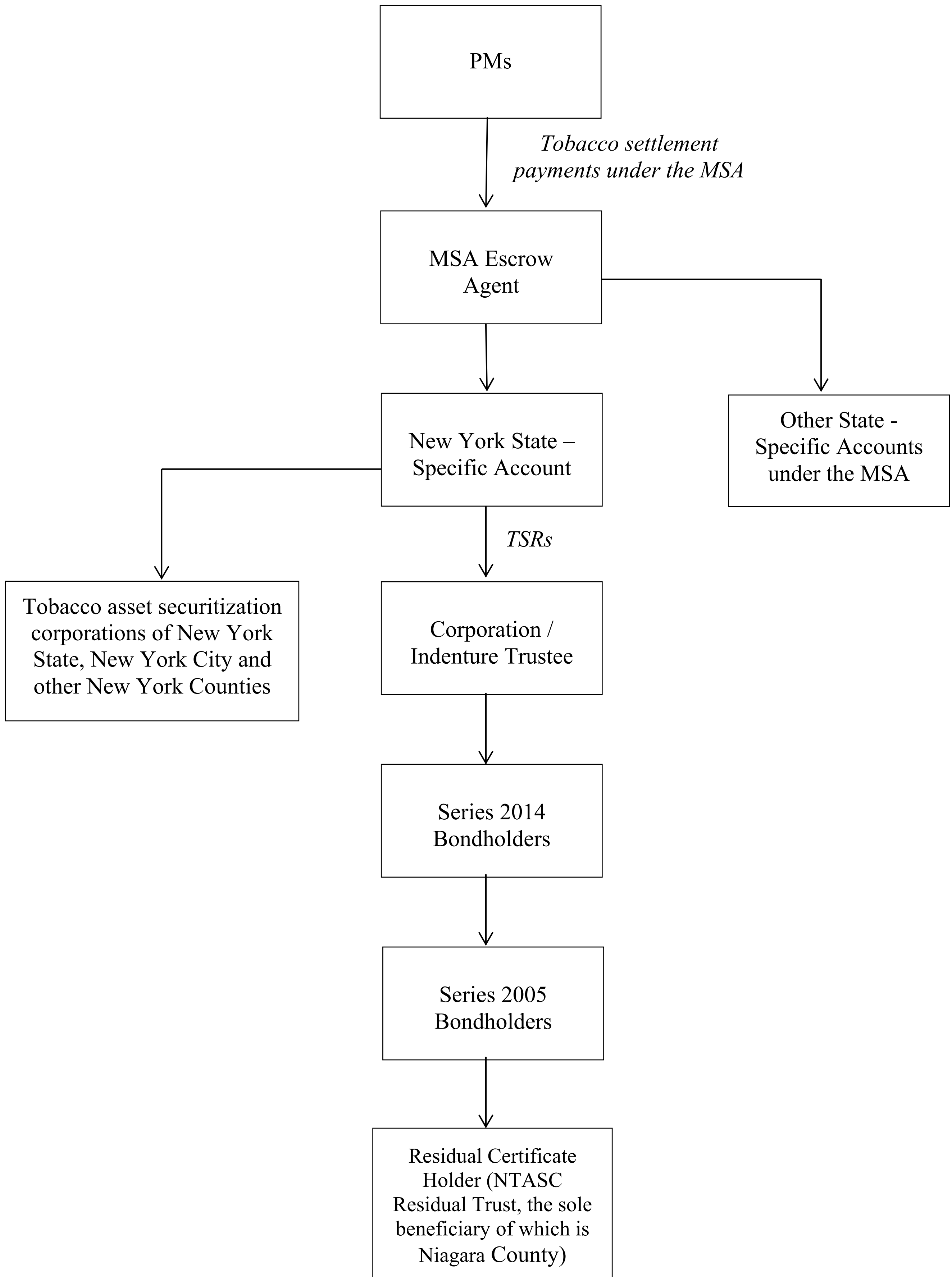
IHS Global has developed a cigarette consumption model based on historical United States data between 1965 and 2013. IHS Global constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising 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 resulted in IHS Global's projection of the average annual rate of decline in U.S. cigarette consumption from 2013 through 2040 to be 3.0% and of total consumption in 2040 to be 121.5 billion cigarettes (a 56% decline from the 2013 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. See also "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

Flow of Funds .... Pursuant to the Purchase and Sale Agreement, the County has directed the State to instruct the MSA Escrow Agent to disburse the amounts constituting the TSRs from the New York State-Specific Account directly to the Indenture Trustee. Promptly (and in no event later than two Business Days) after receipt, the Indenture Trustee will deposit all such amounts in an account established and maintained by the Indenture Trustee under the Indenture (the "**Collection Account**"). As soon as possible but in any event not later than the Deposit Date following each deposit of Revenues to the Collection Account, the Indenture Trustee will withdraw Collections on deposit in the Collection Account (to the extent such Collections are in excess of amounts required to pay the Indenture Trustee fees and expenses for the current Fiscal Year) and transfer such amounts to the parties and accounts and in the order of priority set forth in the Indenture, as described herein. On each Distribution Date, the Indenture Trustee will apply amounts in such accounts in the order of priority set forth in the Indenture. Transfers and applications of amounts following the occurrence and during the continuance of an Event of Default are as specified in the Indenture, as described herein.

As set forth more specifically in the Indenture and summarized herein, any excess of TSRs not needed to pay Bondholders (including Subordinate Bondholders), pay various expenses, or fund Accounts under the Indenture will be paid through the "**Residual Certificate**", which is held by NTASC Residual Trust, the sole beneficiary of which is the County.

See "SECURITY—Application of Revenues" herein. The following diagram depicts the flow of TSRs in accordance with the MSA, the Consent Decree and the Indenture (following the redemption of the Series 2000 Bonds).


PMs
Tobacco settlement payments under the MSA
MSA Escrow Agent
New York State – Specific Account
Other State - Specific Accounts under the MSA
TSRs
Tobacco asset securitization corporations of New York State, New York City and other New York Counties
Corporation / Indenture Trustee
Series 2014 Bondholders
Series 2005 Bondholders
Residual Certificate Holder (NTASC Residual Trust, the sole beneficiary of which is Niagara County)

Additional Bonds .... Additional bonds may be issued under the Indenture after the issuance of the Series 2014 Senior Bonds ("**Additional Bonds**") either (1) as Senior Bonds with a Rating Confirmation with respect to Outstanding Senior Bonds; or (2) as Subordinate Bonds, with a Rating Confirmation with respect to Outstanding Senior Bonds. Additional Bonds may be issued to refund Outstanding Senior Bonds, without a Rating Confirmation with respect to Outstanding Senior Bonds but with written notice to the Rating Agency, if (i) the annual Debt Service, giving effect to the Additional Bonds and calculated based upon principal amounts due on Maturity Dates and Sinking Fund Payments (collectively, "**Required Principal Payments**"), will not increase in any year in which such Additional Bonds are outstanding and (ii) the annual Debt Service, giving effect to the Additional Bonds, would not increase in any year in which such Additional Bonds are outstanding. The proceeds of Additional Bonds that are not refunding Bonds will be paid through the Residual Certificate to its registered holder after paying therefrom all related Costs of Issuance, all necessary deposits to funds and accounts under the Indenture and other required payments.

For so long as there are any Series 2005 Subordinate Bonds Outstanding, Additional Bonds may only be issued under the Indenture upon satisfaction of the following conditions: (i) with a Rating Confirmation with respect to any rated NYCTT V Bonds corresponding to the Outstanding Series 2005 Subordinate Bonds; and (ii) (A) as Subordinate Bonds, subordinate to all of the Series 2005 Subordinate Bonds and Senior Bonds then Outstanding; or (B) (x) to refund some or all of the Senior Bonds (upon the terms and conditions set forth in the Indenture) or Series 2005 Subordinate Bonds Outstanding or (y) to refund some or all of the Senior Bonds (upon the terms and conditions set forth in the Indenture) or Series 2005 Subordinate Bonds Outstanding and to make a payment to the holder of the Residual Certificate in accordance with the Indenture, provided that, in either case, (1) the debt service on the proposed refunding Bonds will be less than or equal to the debt service on the refunded Bonds in all years in which refunded Bonds debt service is payable, and (2) after such Additional Bonds are issued, the weighted average life of each series of Series 2005 Subordinate Bonds remaining Outstanding, after giving effect to the issuance of such Additional Bonds, is not greater than the weighted average life of such series projected at the time such series was issued (adjusted to reflect the passage of time), plus 0.5 years.

The Series 2014 Senior Bonds are being issued pursuant to the Indenture and in accordance with the Consent and Waiver, which evidence the agreement of the Corporation, the holders of all of the outstanding NYCTT V Bonds and Manufacturers and Traders Trust Company, in its capacities as Indenture Trustee and the trustee for the NYCTT V Bonds, to the issuance of the Series 2014 Senior Bonds and the use of the proceeds thereof in the manner described herein notwithstanding any restrictions to the contrary contained in the Series 2005 Supplemental Indenture, including as described in the preceding paragraph. The

Consent and Waiver are applicable only to the issuance of the Series 2014 Senior Bonds.

See "THE SERIES 2014 SENIOR BONDS—Additional Bonds" and Appendix E — "DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS."

Events of Default .... For a description of the Events of Default under the Indenture and the remedies available therefor, see "THE SERIES 2014 SENIOR BONDS—Events of Default and Remedies."

Interest on the Series 2014 Senior Bonds .... Interest on the outstanding principal amount of the Series 2014 Senior Bonds will be payable on each Distribution Date, commencing November 15, 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 2014 Senior Bonds when due is an Event of Default under the Indenture. See "SECURITY—Application of Revenues" and "THE SERIES 2014 SENIOR BONDS—Events of Default and Remedies."

Optional Redemption .... The Series 2014 Senior Bonds maturing on or prior to May 15, 2024 are not subject to optional redemption.

The Series 2014 Senior 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 Corporation at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the date fixed for redemption, without premium.

Maturity Date (May 15)	First Optional Redemption Date (May 15)
2029	2015
2034	2024
2040	2024

Tax Matters .... In the opinion of Harris Beach PLLC, Bond Counsel to the Corporation ("**Bond Counsel**"), based on existing statutes, regulations, administrative rulings and court decisions, and assuming compliance with the tax covenants described herein, interest on the Series 2014 Senior Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Code. Furthermore, Bond Counsel is of the opinion that interest on the Series 2014 Senior Bonds is not an "item of tax preference" for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Series 2014 Senior Bonds is, however, included in the computation of "adjusted current earnings" for purposes of calculating the federal alternative minimum tax imposed on certain corporations. Bond Counsel is further of the opinion that, based on existing law, interest on the Series 2014 Senior Bonds is

exempt from personal income taxes imposed by the State and any political subdivision thereof. See "TAX MATTERS" herein regarding certain other tax considerations.

Continuing Disclosure Undertaking................................ The Corporation 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 UNDERTAKING" herein.

Ratings .... Fitch Ratings ("**Fitch**" or the "**Rating Agency**"), is expected to assign ratings to the Series 2014 Senior Bonds.

Such ratings reflect only the views of Fitch, and explanations of the significance of such ratings may be obtained only from Fitch. The Corporation makes no representation as to the appropriateness of the ratings. The ratings for the Series 2014 Senior Bonds address the payment of principal of and interest on the Series 2014 Senior Bonds 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 2014 Senior Bonds. See "RATINGS."

Legal Considerations .... See "LEGAL CONSIDERATIONS RELATING TO TSRS" for a description of certain legal issues relevant to an investment in the Series 2014 Senior 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 TSRs available to the Corporation, and (b) could lead to a decrease in the market value and or liquidity of the Series 2014 Senior Bonds. Such a determination could result in a complete loss of the TSRs. See "BONDHOLDERS' RISKS," "LEGAL CONSIDERATIONS RELATING TO 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 2014 Senior Bonds.

INTRODUCTORY STATEMENT

This Official Statement sets forth information concerning the issuance by the Niagara Tobacco Asset Securitization Corporation (the "**Corporation**") of $44,295,000 aggregate principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2014 (the "**Series 2014 Senior Bonds**"). The Series 2014 Senior Bonds are being issued pursuant to an Indenture between the Corporation and Manufacturers and Traders Trust Company, as trustee (the "**Indenture Trustee**"), dated as of November 1, 2000 (the "**Original Indenture**"), as amended as of November 1, 2005, and as further amended as of August 14, 2014, and the Series 2014 Supplement between the Corporation and the Indenture Trustee, dated as of August 14, 2014 (as so amended and supplemented, the "**Indenture**"). The Series 2014 Senior Bonds are also being issued in accordance with a certain Consent and Waiver and related Purchase Agreement, Consent and Release, each dated as of July 31, 2014 (collectively, the "**Consent and Waiver**"), which evidence the agreement of the Corporation, the holders of all of the outstanding NYCTT V Bonds (as defined below) and Manufacturers and Traders Trust Company, in its capacities as Indenture Trustee and the trustee for the NYCTT V Bonds, to the issuance of the Series 2014 Senior Bonds and the use of the proceeds thereof in the manner described herein notwithstanding any restrictions to the contrary contained in the Series 2005 Supplemental Indenture (as defined below).

The Corporation is a special purpose, bankruptcy-remote local development corporation organized by the County of Niagara, New York (the "**County**") and incorporated under the provisions of Section 1411 of the Not-For-Profit Corporation Law (the "**Act**") of the State of New York (the "**State**"). The Corporation is an instrumentality of, but separate and apart from, the County. The Corporation is a non-stock, membership corporation, the sole member of which is the Chairman of the Board of Legislators of the County, ex officio, and the Corporation is governed by a board of directors, one director of which shall be independent and the remaining directors of which shall be employees of the County, elected officials of the County or members of the County legislature. For additional information regarding the organization of the Corporation, see "THE CORPORATION."

The Corporation previously purchased from the County, pursuant to the Purchase and Sale Agreement, dated as of November 1, 2000 (the "**Purchase and Sale Agreement**"), by and between the County and the Corporation, all right, title and interest of the County under the MSA and Consent Decree following such purchase (the "**Tobacco Assets**"). The Master Settlement Agreement (the "**MSA**") was entered into by participating tobacco product manufacturers (the "**PMs**"), 46 states (including the State) and six other U.S. jurisdictions (collectively, the "**Settling States**") on November 23, 1998 to settle certain smoking-related litigation. The MSA 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. The Consent Decree and Final Judgment, entered in New York State Supreme Court for New York County in December 1998 (the "**Consent Decree**"), allocates to the County 0.467% of the State's 12.7620310% share of the Initial Payments and Annual Payments (as such terms are defined herein) required to be made by PMs under the MSA, as described further herein. The Consent Decree is attached hereto as Appendix B. The Initial Payments and Annual Payments payable to the Corporation pursuant to the MSA, Consent Decree and Purchase and Sale Agreement are referred to herein as the "**TSRs**", which the Corporation has pledged under the Indenture as security for the Series 2014 Senior Bonds, bonds issued under the Indenture on a parity therewith (together with the Series 2014 Senior Bonds, the "**Senior Bonds**") and any subordinate obligations issued under the Indenture ("**Subordinate Bonds**" and, together with the Senior Bonds, the "**Bonds**"). In 2005 the Corporation issued its Tobacco Settlement Asset-Backed Bonds, Series 2005 S1 (Subordinate Turbo CABs), Series 2005 S2 (Subordinate Turbo CABs), Series 2005 S3 (Subordinate Turbo CABs), Series 2005 S4A (Subordinate Turbo CABs) and Series 2005 S4B (Subordinate Turbo CABs) (collectively, the "**Series 2005 Subordinate Bonds**"), pursuant to the Indenture and the Series 2005 Supplemental Bond Indenture, dated as of November 1,

2005, as amended, by and between the Corporation and the Indenture Trustee (the "**Series 2005 Supplemental Indenture**"). The Series 2005 Subordinate Bonds were issued to secure a like amount of New York Counties Tobacco Trust V's ("**NYCTT**") Tobacco Settlement Pass-Through Bonds, Series 2005 (the "**NYCTT V Bonds**") (which include the NYCTT V/NTASC S4B Bonds, as described below). The Series 2005 Subordinate Bonds are Subordinate Bonds under the Indenture and, as such, are subordinated in right of payment to principal, premium, if any, and interest payments on the Series 2014 Senior Bonds. Payments of debt service to Holders of the Series 2005 Subordinate Bonds constitute Junior Payments under the Indenture. As a result of the Consent and Waiver, there will be no payments of debt service to Holders of the Series 2005 Subordinate Bonds until the Series 2014 Senior Bonds are paid in full. See "SECURITY" herein.

The 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 New York in the 2003 NPM Adjustment Proceedings is attached hereto as Appendix C.

The proceeds of the Series 2014 Senior Bonds will be applied, together with other available funds of the Corporation, to (i) currently refund all of the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2000 (the "**Series 2000 Bonds**"), currently outstanding in the aggregate principal amount of $38,690,000, which were issued to finance the Corporation's purchase of the TSRs from the County, (ii) acquire by negotiated purchase all of the $6,572,480† initial principal amount of outstanding New York Counties Tobacco Trust V Tobacco Settlement Pass-Through Bonds, Series 2005 S4B attributable to the Corporation (collectively, the "**NYCTT V/NTASC S4B Bonds**") for the purpose of cancellation, (iii) cancel the related bond RS4B-1 of the Corporation's Series 2005 Subordinate Bonds, (iv) fund a payment to the owner of the Residual Certificate (as defined herein) in an amount not to exceed $2,000,000 in order to provide the County with funds for capital purposes, and (v) pay the costs of issuance of the Series 2014 Senior Bonds.

Interest on the outstanding principal amount of the Series 2014 Senior Bonds will be payable on each May 15 and November 15 (each, a "**Distribution Date**"), commencing November 15, 2014. Principal of the Series 2014 Senior Bonds is payable as described under "THE SERIES 2014 SENIOR BONDS." Failure to pay principal of and interest on the Series 2014 Senior Bonds 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 2014 Senior Bonds, as described under "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS." The amount and timing of payments on the Series 2014 Senior Bonds may be affected by various factors. See "BONDHOLDERS' RISKS" herein.

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† Issued as capital appreciation bonds, and will be acquired at a price representing a negotiated percentage of the accreted value as of the Closing Date.

SECURITY

Sale of TSRs; Pledge of Trust Estate

Pursuant to the Act and the Purchase and Sale Agreement, the County sold to the Corporation the Tobacco Assets, which are all right, title and interest of the County under the MSA and Consent Decree following such sale. 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 County's share thereof under the Consent Decree that was received by the County.

Pursuant to the Indenture, the Bonds, including the Series 2014 Senior Bonds, will be secured by the "**Trust Estate**," consisting of (a) the "**Revenues**", which consist of the TSRs and all aid, rents, fees, charges, payments, investment earnings and other income and receipts (including bond proceeds other than refunding bond proceeds but only to the extent deposited in an Account) paid to the Corporation or the Indenture Trustee for the account of the Corporation or the Bondholders (and, to the extent specified in the Indenture, the owner of the Residual Certificate and the parties to Ancillary Contracts; collectively with the Bondholders, the "**Beneficiaries**"), (b) all rights to receive the Revenues and the proceeds of such rights, (c) all Accounts and assets thereof, including money, contract rights, general intangibles or other personal property, held by the Indenture Trustee under the Indenture, (d) subject to the following sentence, all rights and interest of the Corporation under the Purchase and Sale Agreement, including the representations, warranties and covenants of the County in the Purchase and Sale Agreement, the Tobacco Assets and payments in respect of Tobacco Assets and (e) any and all other property of every kind and nature from time to time, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture. Revenues deposited in the Collection Account or the Debt Service Account are referred to herein as "**Collections**". Except as specifically provided in the Indenture, the assignment and pledge of the Trust Estate to the Indenture Trustee as security for the Bonds does not include: (i) the rights of the Corporation pursuant to provisions for consent or other action by the Corporation, notice to the Corporation, indemnity or the filing of documents with the Corporation, or otherwise for its benefit and not for that of the Beneficiaries, (ii) any right or power reserved to the Corporation pursuant to the Act or other law or (iii) the provisions of the Purchase and Sale Agreement limiting the County's use of the purchase price of the Series 2000 Bonds; in addition, such assignment and pledge under the Indenture does not preclude the Corporation's enforcement of its rights under and pursuant to the Purchase and Sale Agreement for the benefit of the Beneficiaries as provided in the Indenture. Pursuant to the Indenture, the Trust Estate is pledged and a security interest is therein granted to secure the payment of Bonds and payments in respect of Ancillary Contracts, all with the respective priorities specified in the Indenture, as summarized below. The lien of such pledge and the obligation to perform the contractual provisions made in the Indenture have priority over any or all other obligations and liabilities of the Corporation secured by the Revenues.

One of the Accounts held under the Indenture and pledged as security for the Bonds is the Liquidity Reserve Account. The Corporation is required to maintain a balance in the Liquidity Reserve Account, to the extent of available Collections, equal to the lesser of: (i) the maximum amount of Required Principal Payments and interest on Senior Bonds payable in the then current or any future Fiscal Year; or (ii) the maximum amount that may be held in the Liquidity Reserve Account, in the opinion of Bond Counsel, without adversely affecting the tax-exempt status of the Tax-Exempt Bonds (the "**Liquidity Reserve Requirement**"). The Liquidity Reserve Account will be fully funded on the date of issuance of the Series 2014 Senior Bonds by the Debt Service Reserve Forward Delivery Agreement, dated as of November 9, 2000, as amended as of September 24, 2014 (as so amended, the "**Forward Delivery Agreement**"), by and among the Indenture Trustee, the Corporation and Citigroup Financial Products Inc. (the "**Forward Delivery Agreement Provider**"). Pursuant to the terms of the Forward

Delivery Agreement, the Forward Delivery Agreement Provider is required to deliver to the Indenture Trustee, on the Business Day prior to each Distribution Date, securities, as specified therein, which will mature not later than the Business Day prior to the next succeeding Distribution Date in an aggregate amount equal to the Liquidity Reserve Requirement, and which the Indenture Trustee will purchase from the Forward Delivery Agreement Provider with amounts held in the Liquidity Reserve Account at a purchase price to provide a guaranteed yield on such investments. The Forward Delivery Agreement constitutes an Ancillary Contract under the Indenture, and the Corporation's payments under the Forward Delivery Agreement, if any (other than the Purchase Price, as defined therein, of the securities purchased on the Business Day prior to each Distribution Date), constitute Junior Payments under the Indenture. See "BONDHOLDERS' RISKS—Certain Risks Associated with the Forward Delivery Agreement."

The Series 2005 Subordinate Bonds are Subordinate Bonds (as defined in the Indenture) and, as such, are subordinated in right of payment to principal, premium, if any, and interest payments on the Series 2014 Senior Bonds.

THE SERIES 2014 SENIOR BONDS ARE SPECIAL LIMITED OBLIGATIONS OF THE CORPORATION PAYABLE FROM THE TSRS. THE SERIES 2014 SENIOR BONDS SHALL NOT BE A DEBT OF THE COUNTY OR THE STATE NOR SHALL THE COUNTY OR THE STATE BE LIABLE THEREON. THE CORPORATION SHALL NOT HAVE THE POWER TO PLEDGE THE CREDIT, THE REVENUES OR THE TAXING POWER OF THE COUNTY OR THE STATE, AND NONE OF THE CREDIT, THE REVENUES OR THE TAXING POWER OF THE COUNTY OR THE STATE SHALL BE, OR SHALL BE DEEMED TO BE, PLEDGED TO THE PAYMENT OF ANY OF THE SERIES 2014 SENIOR BONDS. THE CORPORATION HAS NO TAXING POWER.

Payment by MSA Escrow Agent to Indenture Trustee

Upon the sale by the County of the TSRs to the Corporation, the County directed the State to instruct the MSA Escrow Agent to disburse the TSRs directly to the Indenture Trustee. Under the MSA, the disbursement of 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 from the PMs.

Application of Revenues

Transfers to Accounts

Any TSRs received by the Corporation will be promptly (and in no event later than two Business Days after receipt) deposited in the Collection Account. In addition, unless as otherwise specified in the Indenture, the Indenture Trustee will deposit all other Revenues in the Collection Account.

As soon as possible but in any event not later than the Deposit Date following each deposit of Revenues to the Collection Account, the Indenture Trustee will withdraw Collections on deposit in the Collection Account (to the extent such Collections are in excess of amounts required to pay the Indenture Trustee fees and expenses for the then current Fiscal Year) and, subject to the provisions following item (8) below, transfer such amounts to the parties and accounts identified below (after credit for any such amounts previously transferred to an account for such purpose) in the order of priority as follows:

> (1) to the Corporation an amount specified by an Officer's Certificate, not exceeding, with other applicable transfers, the sum of (i) without duplication, Operating Expenses incurred or expected to be incurred in the then current Fiscal Year and the first half of the next ensuing Fiscal Year up to the Operating Cap and (ii) without duplication, the amount necessary to

provide for Priority Payments, in each case for the then current Fiscal Year and first half of the next ensuing Fiscal Year;

(2) to the Debt Service Account an amount sufficient to cause the amount therein to equal the sum of (a) interest on Senior Bonds due on the next succeeding Distribution Date, and (b) Parity Payments as provided in the related Supplemental Indenture;

(3) to the Debt Service Account an amount sufficient to cause the amount therein to equal the amount specified in clause (2) above plus the amount of any Required Principal Payments due on the next succeeding Distribution Date;

(4) to the Liquidity Reserve Account until the amount on deposit therein equals the Liquidity Reserve Requirement;

(5) after giving current effect to the projected amount to be deposited in the Debt Service Account from the Liquidity Reserve Account in accordance with clause (4) under "*Distribution Date Transfers*" below on the next succeeding Distribution Date, to the Debt Service Account an amount sufficient to cause the amount therein to equal the amounts specified in clauses (2) and (3) above plus interest on Senior Bonds and Parity Payments, if any, due on the second succeeding Distribution Date;

(6) to the Corporation to pay Operating Expenses specified in an Officer's Certificate to the extent not paid pursuant to clause (1) above;

(7) *first*, to the Trapping Account, the amount necessary to make the amount therein equal to the Lump Sum Payment Requirement, if any, if a Lump Sum Payment Event has occurred, and *second*, to the Surplus Account, all amounts remaining in the Collection Account (excluding the proceeds of the Series 2014 Senior Bonds) not used for Operating Expenses or deposited into the Debt Service Account, the Liquidity Account, the Trapping Account and the Extraordinary Payment Account of the Bond Fund in each year as provided in the Indenture, as described herein; and

(8) in the amounts and to the Accounts established by a Supplemental Indenture for Junior Payments, if any.

Notwithstanding the foregoing, if an Event of Default has occurred, all Collections remaining in the Collection Account after the applications specified in item (1) above are required to be transferred to the Extraordinary Payment Account.

Investment earnings on the Accounts will be withdrawn from each Account, other than the Debt Service Account, and deposited in the Debt Service Account on each Distribution Date to the extent then held in cash (except as otherwise provided in the Indenture).

Distribution Date Transfers

Subject to clause (8) below and the distributions permitted from the Trapping Account as described below, on each Distribution Date, the Indenture Trustee will apply amounts in the various Accounts in the following order of priority:

(1) from the Collection Account, to the Indenture Trustee to pay the Indenture Trustee fees and expenses pursuant to the Indenture;

(2) from the Debt Service Account, the Liquidity Reserve Account and the Trapping Account, in that order, to pay interest due on the Senior Bonds and Parity Payments then due;

(3) from the Debt Service Account, the Liquidity Reserve Account and the Trapping Account, in that order, to pay the amount of any Required Principal Payments due on such Distribution Date;

(4) from the Liquidity Reserve Account, any amount remaining in excess of the Liquidity Reserve Requirement, to the Debt Service Account;

(5) *first*, from the Trapping Account, any amount remaining in excess of the Lump Sum Payment Requirement, to the Collection Account, and *second*, from the Surplus Account, for the purchase or redemption of Senior Bonds in accordance with the terms of an applicable Series Supplement and, to the extent of any remaining balance, for transfer to the Debt Service Account to pay or provide for the debt service on Senior Bonds on any date in accordance with the terms of such Series Supplement. The Series Supplement with respect to the Series 2014 Senior Bonds provides that amounts deposited in the Surplus Account in any year are required 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:

(i) in chronological order of Maturity Dates, to pay or provide for the payment, if any, of the redemption price of Outstanding Series 2014 Senior Bonds then subject to optional redemption, or to become subject to optional redemption as of the next succeeding Distribution Date, or to effect an open market purchase of such Outstanding Series 2014 Senior Bonds at a price no greater than 100% of the principal amount thereof, plus accrued interest thereon;

(ii) to the extent that, as set forth in an Officer's Certificate, Outstanding Series 2014 Senior Bonds are not available for optional redemption or open market purchase pursuant to clause (i) above, to pay the purchase price of Outstanding Series 2014 Senior Bonds of any Maturity Date as described in "THE SERIES 2014 SENIOR BONDS—Redemption Provisions—*Open Market Purchases of the Series 2014 Senior Bonds*"; or

(iii) 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 (ii) above, to transfer any remaining balance to the Debt Service Account to pay or provide for the debt service on Senior Bonds on any date;

(6) from the Accounts therefor, to make Junior Payments, if any;

(7) after payment of amounts due pursuant to clauses (1) through (6) above, from the Collection Account and the Debt Service Account (excluding any amounts deposited or held therein for any future payments), and only if there are no payments due but unpaid on any Senior Bonds and no Junior Payments are due but unpaid, any amounts remaining to the holder of the Residual Certificate; and

(8) notwithstanding the foregoing, if an Event of Default has occurred, the Indenture Trustee will transfer amounts on deposit in the following Accounts for the following purposes and not from such Accounts for any other purposes unless and until all amounts payable in furtherance of the following purposes have been fully paid and satisfied: from the Extraordinary Payment Account, the Debt Service Account, the Trapping Account and the Liquidity Reserve Account, in that order, to pay in the following order: (a) interest on overdue interest on Senior Bonds, pro rata; (b) overdue interest on Senior Bonds, pro rata; (c) accrued current interest on Senior Bonds, pro rata; (d) overdue Parity Payments; (e) Parity Payments then due and (f) Extraordinary Payments, pro rata.

If not previously applied to other purposes for which amounts in the Trapping Account are to be applied under the Indenture, and if no Event of Default has occurred, amounts remaining on deposit in the Trapping Account as a result of a Partial Lump Sum Payment will be applied at any time and from time to time (whether or not a Distribution Date) in whole or in part, upon a written direction of the Corporation to the Indenture Trustee accompanied by a Rating Confirmation with respect to Outstanding Senior Bonds to (i) effect a redemption of Senior Bonds on the terms and provisions provided for the redemption of Senior Bonds at the option of the Corporation, (ii) make Junior Payments, and/or (iii) make distributions through the Residual Certificate.

Furthermore, if not previously applied to other purposes for which amounts in the Trapping Account are to be applied under the Indenture, and if no Event of Default has occurred, amounts remaining on deposit in the Trapping Account as a result of a Final Lump Sum Payment will be applied at any time (whether or not a Distribution Date) in whole or in part, upon written direction of the Corporation to the Indenture Trustee to effect a redemption of Senior Bonds at a price of 100% of face value without premium, with accrued interest on the principal amount to be redeemed to, but not including the date of redemption, pro rata.

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

The Residual Certificate and the Residual Trust

The Residual Certificate is a security under the Indenture that is payable out of the Trust Estate after all other priorities of payments have been made pursuant to the application of amounts held in the various Accounts under the Indenture as described in "—Application of Revenues" above. The Residual Certificate represents the entitlement to receive all amounts required to be distributed pursuant to the Indenture in respect of the Residual Certificate, including the net proceeds of Bond issues (other than refunding Bonds). Payments on the Residual Certificate from Collections are subordinate to, among other things, payments on the Series 2014 Senior Bonds and the Series 2005 Subordinate Bonds.

The owner of the Residual Certificate is NTASC Residual Trust (the "**Residual Trust**"), which is organized as a Delaware business trust and is currently administered by Kyle R. Andrews and William L. Ross, as Trustees, and The Bank of New York Mellon Trust Company, National Association, as the Delaware Trustee. The sole beneficiary of the Residual Trust is the County.

Delaware law expressly provides that no creditor of the beneficial owner of a Delaware business trust shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of such business trust. The organizational and operative documents of the Residual Trust provide for the distribution to the County as beneficial owner of the Residual Trust of cash available to the Residual Trust from payments made on the Residual Certificate after payment of the expenses of the Residual Trust.

THE SERIES 2014 SENIOR BONDS

The following summary describes certain terms of the Series 2014 Senior 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 2014 Senior Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee.

The Series 2014 Senior 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 2014 Senior Bonds. The Series 2014 Senior 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 2014 Senior Bonds will be entitled to receive a physical certificate representing its ownership interest in such Series 2014 Senior Bonds. See "THE SERIES 2014 SENIOR BONDS—Book-Entry Only System."

Payments of Interest

Interest on the outstanding principal balance of the Series 2014 Senior Bonds will be payable on each Distribution Date. Interest will accrue from and including the Closing Date. Interest on the Series 2014 Senior 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 to pay, in the following order: (a) interest on overdue interest on Senior Bonds, pro rata; (b) overdue interest on Senior Bonds, pro rata; (c) accrued current interest on Senior Bonds, pro rata; (d) overdue Parity Payments; (e) Parity Payments then due and (f) Extraordinary Payments, pro rata. See "SECURITY—Application of Revenues—*Distribution Date Transfers*" and Appendix E — "DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS."

For each Distribution Date, payments will be made to Bondholders of record as of the close of business on the Record Date immediately preceding such Distribution Date. "**Record Date**" means the last Business Day of the calendar month preceding a Distribution Date, or such other date as may be specified by the Indenture or an Officer's Certificate (and the Corporation or the Indenture Trustee may in its discretion establish special record dates for the determination of the Holders of Bonds for various purposes of the Indenture, including giving consent or direction to the Indenture Trustee). "**Business Day**" means any day other than (i) a Saturday or a Sunday or (ii) a day on which banking institutions in New York, New York or either Buffalo, New York or where the principal office of the Indenture Trustee is otherwise located are required or authorized by law to be closed.

Redemption Provisions

Optional Redemption

The Series 2014 Senior Bonds maturing on or prior to May 15, 2024 are not subject to optional redemption.

The Series 2014 Senior 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 Corporation at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the date fixed for redemption, without premium.

Maturity Date (May 15)	First Optional Redemption Date (May 15)
2029	2015
2034	2024
2040	2024

Sinking Fund Payments of Term Bonds

The Series 2014 Senior Bonds maturing on May 15 in the years 2029, 2034 and 2040 are term bonds ("**Term Bonds**"). The "**Sinking Fund Payments**" of Term Bonds represent the amount of principal that the Corporation is required to pay as of the specified Distribution Date (each a "**Sinking Fund Payment Date**"). The Series 2014 Term Bonds are subject to mandatory redemption from Sinking Fund Payments, in the amounts set forth below on the dates set forth below, at a redemption price equal to 100% of the principal amount thereof to be redeemed, plus interest accrued thereon to the date fixed for redemption:

Series 2014 Term Bonds Maturing May 15, 2029

Sinking Fund Payment Date (May 15)	Principal Amount
2025	$1,840,000
2026	1,890,000
2027	2,000,000
2028	2,020,000
2029†	2,200,000

† Final maturity.

Series 2014 Term Bonds Maturing May 15, 2034

Sinking Fund Payment Date (May 15)	Principal Amount
2030	$1,830,000
2031	1,885,000
2032	2,125,000
2033	1,900,000
2034†	1,905,000

Series 2014 Term Bonds Maturing May 15, 2040

Sinking Fund Payment Date (May 15)	Principal Amount
2035	$2,105,000
2036	2,020,000
2037	1,820,000
2038	1,925,000
2039	1,990,000
2040†	1,970,000

† Final maturity.

Special Lump Sum Payment Redemption

The Series 2014 Senior Bonds are subject to redemption from Partial Lump Sum Payments and Final Lump Sum Payments as set forth in the Indenture and described in "SECURITY—Application of Revenues," in whole or in part, at any time, at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the date fixed for redemption, without premium.

Open Market Purchases of the Series 2014 Senior Bonds

In any given year, the Corporation may direct the Indenture Trustee to purchase Outstanding Series 2014 Senior Bonds in the open market from moneys in the Surplus Account (as described under "SECURITY—Application of Revenues—*Distribution Date Transfers*"), *provided* that (A) the purchase price of any such Outstanding Series 2014 Senior Bonds being so purchased as described in clause (5)(i) under "SECURITY—Application of Revenues—*Distribution Date Transfers*" shall not exceed 100% of the principal amount thereof, plus accrued interest thereon, and (B) the purchase price of any such Outstanding Series 2014 Senior Bonds being so purchased as described in clause (5)(ii) under "SECURITY—Application of Revenues—*Distribution Date Transfers*" shall not exceed the sum of 100% of the principal amount thereof, plus a premium not greater than the interest rate payable on such Series 2014 Senior Bonds being so purchased multiplied by a fraction (x) the numerator of which is the number of days from the purchase date thereof to the next date on which such Series 2014 Senior Bonds are subject to optional redemption, and (y) 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 clauses (i) and (ii) of the definition of Defeasance Collateral (as defined in Appendix E hereto) sufficient to defease and redeem such Series 2014 Senior Bonds as of their first optional redemption date as set forth in an Officer's Certificate, which Officer's Certificate may rely on a report of a nationally recognized financial advisory firm or a firm of nationally recognized defeasance escrow verification agents.

Selection of Series 2014 Senior Bonds to be Redeemed

If less than all the Outstanding Series 2014 Senior Bonds of a particular Maturity Date and CUSIP number are to be redeemed, the particular Series 2014 Senior Bonds of the Maturity Date and CUSIP number to be redeemed will be selected by the Indenture Trustee by such method as it deems fair and appropriate, and the Indenture Trustee may provide for the selection for redemption of portions (in authorized denominations) of the principal of a Series 2014 Senior Bond of a denomination larger than the minimum authorized denomination.

Notice of Redemption

When a Series 2014 Senior Bond is to be redeemed prior to its Maturity Date from a Sinking Fund Payment or pursuant to optional redemption, the Indenture Trustee is required to give notice in the name of the Corporation, which notice will identify the Series 2014 Senior Bonds to be redeemed, state the date fixed for redemption and state that such Series 2014 Senior 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 2014 Senior 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 is required to give 30 days' notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions of the Indenture, to the registered owners of any Series 2014 Senior Bonds which are to be redeemed, at their addresses shown on the registration books of the Corporation. Such notice may be waived by any Holder of Series 2014 Senior Bonds to be redeemed. Failure by a particular Holder to receive notice, or any defect in the notice to such Holder, will not affect the redemption of any other Series 2014 Senior Bond.

Additional Bonds

Additional bonds may be issued under the Indenture after the issuance of the Series 2014 Senior Bonds ("**Additional Bonds**") either (1) as Senior Bonds with a Rating Confirmation with respect to Outstanding Senior Bonds; or (2) as Subordinate Bonds, with a Rating Confirmation with respect to Outstanding Senior Bonds. Additional Bonds may be issued to refund Outstanding Senior Bonds, without a Rating Confirmation with respect to Outstanding Senior Bonds but with written notice to the Rating Agency, if (i) the annual Debt Service, giving effect to the Additional Bonds and calculated based upon Required Principal Payments, will not increase in any year in which such Additional Bonds are outstanding and (ii) the annual Debt Service, giving effect to the Additional Bonds, would not increase in any year in which such Additional Bonds are outstanding. The proceeds of Additional Bonds that are not refunding Bonds will be paid through the Residual Certificate to its registered holder after paying therefrom all related Costs of Issuance, all necessary deposits to funds and accounts under the Indenture and other required payments.

For so long as there are any Series 2005 Subordinate Bonds Outstanding, Additional Bonds may only be issued under the Indenture upon satisfaction of the following conditions: (i) with a Rating Confirmation with respect to any rated NYCTT V Bonds corresponding to the Outstanding Series 2005 Subordinate Bonds; and (ii) (A) as Subordinate Bonds, subordinate to all of the Series 2005 Subordinate Bonds and Senior Bonds then Outstanding; or (B) (x) to refund some or all of the Senior Bonds (upon the terms and conditions set forth in the Indenture) or Series 2005 Subordinate Bonds Outstanding or (y) to refund some or all of the Senior Bonds (upon the terms and conditions set forth in the Indenture) or Series 2005 Subordinate Bonds Outstanding and to make a payment to the holder of the Residual Certificate in accordance with the Indenture, provided that, in either case, (1) the debt service on the proposed refunding Bonds will be less than or equal to the debt service on the refunded Bonds in all years in which

refunded Bonds debt service is payable, and (2) after such Additional Bonds are issued, the weighted average life of each series of Series 2005 Subordinate Bonds remaining Outstanding, after giving effect to the issuance of such Additional Bonds, is not greater than the weighted average life of such series projected at the time such series was issued (adjusted to reflect the passage of time), plus 0.5 years.

The Series 2014 Senior Bonds are being issued pursuant to the Indenture and in accordance with the Consent and Waiver, which evidence the agreement of the Corporation, the holders of all of the outstanding NYCTT V Bonds and Manufacturers and Traders Trust Company, in its capacities as Indenture Trustee and the trustee for the NYCTT V Bonds, to the issuance of the Series 2014 Senior Bonds and the use of the proceeds thereof in the manner described herein notwithstanding any restrictions to the contrary contained in the Series 2005 Supplemental Indenture, including as described in the preceding paragraph. The Consent and Waiver are applicable only to the issuance of the Series 2014 Senior Bonds.

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

Events of Default and Remedies

Events of Default

Each of the following is an "**Event of Default**" under the Indenture:

(a) failure to pay interest on any Senior Bonds when due or the failure to pay any Required Principal Payments when due;

(b) failure of the Corporation to observe or perform any other provision of the Indenture which is not remedied within 30 days after written notice thereof is given to the Corporation by the Indenture Trustee or to the Corporation and the Indenture Trustee by the holders of at least 25% in principal amount of the Senior Bonds then Outstanding if a Majority in Interest of the Holders of the Senior Bonds declares such failure to be an Event of Default, provided that, except as specified in clause (a) above, failure to make any payment or provision therefor because of insufficiency of available Collections will not constitute a Default;

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

(d) failure by the County to observe or perform its covenant not to limit or alter the rights of the Corporation to fulfill the terms of the Corporation's agreement with the holders of the outstanding Bonds under the Indenture, or in any way impair the rights and remedies of such holders or the security for the Bonds 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 such holders, are fully met and discharged, which failure is not remedied within 30 days after written notice thereof is given by the Indenture Trustee to the County and the Corporation or by the Corporation to the Indenture Trustee and the County, if a Majority in Interest of the holders of the Senior Bonds declare such failure to be an Event of Default.

Remedies

If an Event of Default occurs and is continuing, the Indenture Trustee may, and upon written request of the Holders of 25% in principal amount of the Senior Bonds Outstanding shall, in its own name: (A) enforce all rights of the Holders and require the Corporation or the County to carry out its agreements with the Corporation and/or the Holders and to perform its duties under the Purchase and Sale Agreement; (B) sue upon such Bonds; (C) require the Corporation to account as if it were the trustee of an express trust for the Holders of such Bonds; and (D) enjoin any acts or things which may be unlawful or in violation of the rights of the Holders of such Bonds.

Upon an Event of Default of the Corporation under clause (a) in "*Events of Default*" above, 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 is required to give written notice thereof to the Corporation. The Indenture Trustee is also required to give notices of a Default under clauses (b) and (d) in "*Events of Default*" above when instructed to do so by the written direction of another Fiduciary or the owners of at least 25% in principal amount of the Outstanding Senior Bonds. The Indenture Trustee is required to proceed with remedies for the benefit of the Holders in accordance with the written direction of a Majority in Interest of the Outstanding Senior Bonds. Furthermore, 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, the Indenture Trustee is required to promptly pursue the remedies provided by the Indenture as may be set forth in a written direction to the Indenture Trustee from the owners of at least 25% in principal amount of any Outstanding Bonds, or if no such direction is received, any such remedies (not contrary to any such direction) as the Indenture Trustee deems appropriate for the protection of the Holders, and must act for the protection of the Holders with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

In addition, if an Event of Default occurs, the Outstanding Senior Bonds are required to be paid or prepaid, in whole or in part, from and to the extent of all available funds in the Extraordinary Payment Account, the Debt Service Account, the Trapping Account and the Liquidity Reserve Account, in accordance with the Indenture as described in "SECURITY—Application of Revenues."

Subject to the prior application of the Accounts to pay Debt Service, to the remedies specified above and to each applicable Series Supplement, the Holders of Subordinate Bonds or the Holder of the Residual Certificate, or a Fiduciary appointed pursuant to the Indenture may enforce the provisions of the Indenture for their benefit by appropriate legal proceedings. The principal, premium, if any, and interest on Subordinate Bonds is subordinated in right of payment to principal, premium, if any, and interest payments on the Senior Bonds (except for any payment in respect of the Subordinate Bonds from the Accounts therefor). If any Event of Default has occurred, holders of Senior Bonds will be entitled to receive payment thereof in full before the holders of the Subordinate Bonds are entitled to receive payment thereof (except for any payment in respect of the Subordinate Bonds from the Accounts therefor); and any payment or distribution of assets otherwise payable to holders of the Subordinate Bonds (except for any payment in respect of the Subordinate Bonds from the Accounts therefor) will be paid to holders of Senior Bonds until all Senior Bonds have been paid in full, and the holders of the Subordinate Bonds will become subrogated to the rights of such holders of Senior Bonds to receive payments or distributions of assets with respect thereto.

The remedies available to the Indenture Trustee and the Holders of any Senior Bonds upon the occurrence of an Event of Default do not include acceleration of any Required Principal Payments or foreclosure on the Trust Estate.

Book-Entry Only System

DTC will act as securities depository for the Series 2014 Senior Bonds. The Series 2014 Senior Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered bond certificate will be issued for each maturity of the Series 2014 Senior Bonds, and will be deposited with DTC.

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 2014 Senior Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2014 Senior Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2014 Senior 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 2014 Senior 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 2014 Senior Bonds, except in the event that use of the book-entry system for the Series 2014 Senior Bonds is discontinued.

To facilitate subsequent transfers, all Series 2014 Senior 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 2014 Senior 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 2014 Senior Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2014 Senior 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 2014 Senior Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2014 Senior Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2014 Senior Bond documents. For example, Beneficial Owners of the Series 2014 Senior Bonds may wish to ascertain that the nominee holding the Series 2014 Senior 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 2014 Senior 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 2014 Senior 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 Corporation as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Series 2014 Senior 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 2014 Senior Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Corporation or the 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 Corporation, 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 Corporation 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 2014 Senior Bonds at any time by giving reasonable notice to the Corporation or the Indenture Trustee. Under such circumstances, in the event that a successor depository is not obtained, bond certificates are required to be printed and delivered.

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

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

In accordance with the Indenture, unless and until Bonds have been issued to Holders other than DTC, the Corporation and each Fiduciary (being the Indenture Trustee, any representative of the Holders of Bonds appointed by Series Supplement, and each Paying Agent), except to the extent specifically provided in Ancillary Contracts, will be entitled to deal with DTC for all purposes of the Indenture (including the payment of principal of and interest on such Bonds and the giving of notices, instructions or directions under the Indenture) as the sole Holder of such Bonds, and the rights of Beneficial Owners will be exercised only through DTC.

If (1) the Corporation advises the Indenture Trustee in writing that DTC is no longer willing or able to properly discharge its responsibilities with respect to the Bonds or a Series of Bonds or other portion thereof, and the Corporation is unable to locate a qualified successor Securities Depository, (2) the Corporation 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 in Interest of the Bonds held by DTC advise the Indenture Trustee in writing that the continuation of a book-entry system through DTC is no longer in the best interests of the Beneficial Owners, then the Indenture Trustee will instruct DTC to notify its participants of the occurrence of any such event and of the availability of Bonds to registered owners requesting the same. Upon surrender to the Indenture Trustee of the typewritten Bonds by DTC, accompanied by registration instructions, the Corporation will execute and provide to the Indenture Trustee, and the Indenture Trustee will authenticate, Bonds in accordance with the instructions of DTC. None of the Corporation, the County or the Indenture Trustee shall be liable for any delay in delivery of such instructions and may conclusively rely on, and shall be fully protected in relying on, such instructions.

AS NOTED ABOVE, BENEFICIAL OWNERS SHOULD MAKE APPROPRIATE ARRANGEMENTS WITH THEIR BROKER OR DEALER TO RECEIVE NOTICES (INCLUDING NOTICES OF REDEMPTION) AND OTHER INFORMATION REGARDING THE SERIES 2014 SENIOR BONDS THAT MAY BE SO CONVEYED TO DIRECT PARTICIPANTS AND INDIRECT PARTICIPANTS.

NONE OF THE CORPORATION, THE INDENTURE TRUSTEE OR THE UNDERWRITER CAN GIVE ANY ASSURANCE THAT DTC OR DIRECT OR INDIRECT PARTICIPANTS WILL DISTRIBUTE PAYMENTS OF INTEREST, PREMIUM, IF ANY, PRINCIPAL, SINKING FUND PAYMENTS OR OTHER REDEMPTIONS WITH RESPECT TO THE SERIES 2014 SENIOR 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 2014 Senior Bonds, as nominee for DTC, references in this Official Statement to Bondholders or registered owners of the Series 2014 Senior Bonds (other than under "TAX MATTERS" and "CONTINUING DISCLOSURE UNDERTAKING" below) will mean Cede & Co., as aforesaid, and will not mean the Beneficial Owners of the Series 2014 Senior Bonds.

THE CORPORATION

The Corporation is a special purpose, bankruptcy-remote local development corporation organized by the County and incorporated under the provisions of Section 1411 of the New York State Not-For-Profit Corporation Law. The Corporation is operated exclusively as an entity described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "**Code**").

The Corporation is a non-stock, membership corporation the sole member of which is the Chairman of the Board of Legislators of the County, ex officio (the "**Sole Member**"). The Corporation is

governed by a board of directors, composed of not more than seven and not less than five directors, as specified and appointed by the Sole Member. One of the directors is required to be independent (the "**Independent Director**") and shall hold, at a minimum, a bachelor's degree from an accredited college or university with concentration or a degree in law, finance or management and have at least five years of professional experience therein, or without such degree, have at least ten years of professional experience in law, finance or management. The remaining directors must each be an employee of the County, an elected official of the County or a member of the County legislature. Each of the directors will serve for a 2 year term or until their successor has been duly appointed and qualified. Directors are eligible to serve an unlimited number of consecutive terms.

The current directors of the Corporation are:

Name	Office	Expiration of Term
Kyle R. Andrews	Member, Board of Directors; County Treasurer	12/31/2014
Clyde L. Burmaster	President, Board of Directors; Vice Chairman of the Niagara County Legislature (1st District)	12/31/2015
Karen S. Castle	Secretary/Treasurer, Board of Directors; Employee of the County	12/31/2015
Samuel M. Ferraro	Member, Board of Directors; Executive Director of the Niagara County Industrial Development Agency	12/31/2015
Jeffrey M. Glatz	Member, Board of Directors; County Manager	12/31/2014
James Hagenbach	Independent Director	N/A
William L. Ross	Vice President and Sole Member of the Corporation; Chairman of the County Board of Legislators (2nd District)	12/31/2015

In addition, John J. Ottaviano, Esq., Of Counsel to Rupp, Baase, Pfalzgraf, Cunningham & Coppola LLC, serves as legal counsel to the Corporation.

The Certificate of Incorporation of the Corporation contains the standard limitation of purposes and corporate separateness criteria to permit Bond Counsel to opine that the Corporation would not be substantively consolidated with the County in the event the County were to become a debtor under the Bankruptcy Code. See "LEGAL CONSIDERATIONS RELATING TO TSRS" herein. Such criteria include a requirement that there will be one Independent Director whose consent is required for, among other things, any bankruptcy filing by the Corporation. The Corporation has authority under Federal tax law to issue tax-exempt bonds.

ESTIMATED SOURCES AND USES OF FUNDS

The Corporation will apply the proceeds of the Series 2014 Senior Bonds, together with certain amounts available under the Indenture, to (i) currently refund all of the Series 2000 Bonds, (ii) acquire by negotiated purchase all of the NYCTT V/NTASC S4B Bonds for the purpose of cancellation, (iii) cancel the related bond RS4B-1 of the Corporation's Series 2005 Subordinate Bonds, (iv) fund a payment to the owner of the Residual Certificate in an amount not to exceed $2,000,000 in order to provide the County with funds for capital purposes, and (v) pay the costs of issuance of the Series 2014 Senior Bonds. The expected application of such amounts is set forth below.

Sources of Funds:	
Principal Amount of the Series 2014 Senior Bonds	$44,295,000.00
Funds Available under the Indenture	1,236,847.66
Old Forward Delivery Agreement	4,053,928.01
Amounts Provided by the Forward Delivery Agreement Provider	300,000.00
Plus Original Issue Premium	3,780,877.65
Total Sources	$53,666,653.32
Uses of Funds:	
Refunding Escrow for the Series 2000 Bonds	$39,782,558.07
Acquisition of NYCTT V/NTASC S4B Bonds	6,887,567.70
Deposit to the Debt Service Account	305,105.73
New Forward Delivery Agreement	3,371,437.50
Distribution to the Residual Certificate Holder	1,998,644.74
Costs of Issuance[1]	717,295.00
Underwriter's Discount	604,044.58
Total Uses	$53,666,653.32

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[1] Includes legal fees, IHS Global's fees, verification agent's fees, transferred proceeds penalty, printing costs, rating fees and certain other expenses related to the issuance of the Series 2014 Senior Bonds.

TABLE OF PROJECTED DEBT SERVICE COVERAGE

Debt Service Coverage

The following table sets forth the projected debt service coverage for the Series 2014 Senior 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 2014 Senior 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, excluding year 2014 the average projected debt service coverage ratio is 1.39x, with a minimum projected debt service coverage ratio of 1.16x in 2024, 2025 and 2027 and a maximum projected debt service coverage ratio of 2.69x in 2040. 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 TSRs received in such period plus amounts held in 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 2014 Senior 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 2014 Senior 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 Corporation to pay the principal of and interest on the Series 2014 Senior Bonds could be adversely affected. See "BONDHOLDERS' RISKS" herein.***

Estimated Series 2014 Senior Bonds Debt Service Coverage
Based on IHS Global Forecast Consumption Decline, 2014-2040

Year (12/31)	Total Collections[1]	Operating Expenses[2]	Principal	Interest	Debt Service & Operating Expenses[3]	Debt Service Coverage
2014	$ 305,106	$ -	$ -	$ 305,106	$ 305,106	1.00x
2015	3,767,737	144,616	730,000	2,139,088	3,013,703	1.25
2016	3,753,116	148,954	795,000	2,108,588	3,052,542	1.23
2017	3,737,513	153,423	855,000	2,071,313	3,079,736	1.21
2018	4,147,847	158,026	1,295,000	2,017,563	3,470,588	1.20
2019	4,127,466	162,766	1,325,000	1,952,063	3,439,829	1.20
2020	4,110,224	167,649	1,400,000	1,883,938	3,451,587	1.19
2021	4,098,532	172,679	1,480,000	1,811,938	3,464,616	1.18
2022	4,090,156	177,859	1,570,000	1,735,688	3,483,547	1.17
2023	4,087,444	183,195	1,660,000	1,654,938	3,498,133	1.17
2024	4,089,772	188,691	1,760,000	1,569,438	3,518,128	1.16
2025	4,097,499	194,352	1,840,000	1,488,638	3,522,989	1.16
2026	4,109,477	200,182	1,890,000	1,414,038	3,504,220	1.17
2027	4,124,372	206,188	2,000,000	1,336,238	3,542,425	1.16
2028	4,141,052	212,373	2,020,000	1,255,838	3,488,211	1.19
2029	4,527,890	218,745	2,200,000	1,171,438	3,590,182	1.26
2030	4,160,729	225,307	1,830,000	1,079,400	3,134,707	1.33
2031	4,177,443	232,066	1,885,000	981,881	3,098,947	1.35
2032	4,525,158	239,028	2,125,000	876,619	3,240,647	1.40
2033	4,199,462	246,199	1,900,000	770,963	2,917,161	1.44
2034	4,214,237	253,585	1,905,000	671,081	2,829,666	1.49
2035	4,421,925	261,192	2,105,000	565,819	2,932,011	1.51
2036	4,529,798	269,028	2,020,000	457,538	2,746,566	1.65
2037	4,238,175	277,099	1,820,000	356,738	2,453,837	1.73
2038	4,289,213	285,412	1,925,000	258,431	2,468,843	1.74
2039	4,386,867	293,974	1,990,000	155,663	2,439,637	1.80
2040	6,252,468	302,794	1,970,000	51,713	2,324,506	2.69
Totals	**$110,710,677**	**$5,575,383**	**$44,295,000**	**$32,141,687**	**$82,012,070**	

(1) Includes TSRs plus amounts held in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement and scheduled reductions in the Liquidity Reserve Requirement beginning in 2029, reflecting scheduled decline in required principal and interest payments on the Series 2014 Senior Bonds.

(2) Includes Operating Expenses at the Operating Cap.

(3) Includes principal, interest and Operating Expenses at the Operating Cap. First interest payment of Series 2014 Senior Bonds funded from a portion of remaining TSRs received by the Indenture Trustee in April 2014.

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 2014 Senior Bonds based on alternative assumptions for annual cigarette consumption in the United States over the term of the Series 2014 Senior Bonds and, with the exception of the forecast of cigarette consumption contained in the IHS Global 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 TSRs under these alternative scenarios, constant year-over-year shipment declines of 4%, 5% and 5.55% (breakeven) were applied to NAAG reported sales year 2013 domestic cigarette shipments of 276.21 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 constant annual rates of decline are shown below:

Cigarette Consumption (in Billions of Cigarettes)

Sales Year	IHS Global Case	4% Decline Case	5% Decline Case	5.55% Decline Case
2013	276.209	276.209	276.209	276.209
2014	268.193	265.160	262.398	260.879
2015	258.959	254.554	249.278	246.400
2016	249.954	244.372	236.814	232.725
2017	240.993	234.597	224.974	219.809
2018	232.399	225.213	213.725	207.609
2019	224.277	216.204	203.039	196.087
2020	216.740	207.556	192.887	185.204
2021	209.628	199.254	183.242	174.925
2022	203.042	191.284	174.080	165.217
2023	196.918	183.633	165.376	156.048
2024	191.245	176.287	157.107	147.387
2025	185.936	169.236	149.252	139.207
2026	180.905	162.466	141.790	131.481
2027	176.082	155.968	134.700	124.184
2028	171.393	149.729	127.965	117.292
2029	166.805	143.740	121.567	110.782
2030	162.328	137.990	115.488	104.633
2031	157.976	132.471	109.714	98.826
2032	153.743	127.172	104.228	93.341
2033	149.516	122.085	99.017	88.161
2034	145.376	117.201	94.066	83.268
2035	141.340	112.513	89.363	78.647
2036	137.380	108.013	84.895	74.282
2037	133.508	103.692	80.650	70.159
2038	129.722	99.545	76.617	66.265
2039	125.971	95.563	72.787	62.588
2040	122.298	91.740	69.147	59.114

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 2014 Senior 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 2014 Senior Bond and each such Series 2014 Senior Bond is paid in full on a timely basis.

Breakeven Consumption Decline Rates by Maturity

Series 2014 Maturity	Breakeven Consumption Decline[1]	Breakeven Consumption Decline[2]
2015	23.87%	100.00%
2016	13.49	56.41
2017	9.86	33.95
2018	7.93	22.97
2019	7.16	17.04
2020	6.44	13.77
2021	5.91	11.55
2022	5.49	10.09
2023	5.18	9.00
2024	4.92	8.20
2025	4.92	6.72
2026	4.92	6.62
2027	4.92	5.71
2028	4.92	5.57
2029	4.92	5.55
2030	4.92	5.55
2031	4.92	5.55
2032	4.92	5.55
2033	4.92	5.55
2034	4.92	5.55
2035	4.92	5.55
2036	4.92	5.55
2037	4.92	5.55
2038	4.92	5.55
2039	4.92	5.55
2040	4.92	5.55

[1] Assumes the Liquidity Reserve Account is maintained at the Liquidity Reserve Requirement.
[2] Assumes the Liquidity Reserve Account is used to pay debt service on or prior to each respective maturity date and each such Series 2014 Senior Bond is paid in full on a timely basis.

The following tables present the projected debt service on the Series 2014 Senior Bonds assuming optional redemptions at the applicable first optional redemption date under the following scenarios: (i) IHS Global Forecast, (ii) 4% year-over-year consumption decline, (iii) 5% year-over-year consumption decline, and (iv) 5.55% year-over-year breakeven consumption decline. The tables further assume that the Series 2014 Senior Bonds bear interest at the rates set forth on the inside cover page hereof and that TSRs are received in accordance with the Collection Methodology and Assumptions (see "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein) and applied as set forth in the Indenture and subject to payment priorities therein. See "SECURITY" herein.

Debt Service Incorporating Early Redemption of Series 2014 Senior Bonds
IHS Global Forecast Consumption Decline

Annual Period (12/31)	Total Available Funds[(1)(2)]	Bond Principal and Early Redemptions	Interest	Total Debt Service[(3)]
2014	$ 305,106	$ -	$ 305,106	$ 305,106
2015	3,577,214	1,450,000	2,126,288	3,576,288
2016	3,604,161	1,535,000	2,066,488	3,601,488
2017	3,584,090	1,580,000	1,999,913	3,579,913
2018	3,989,821	2,070,000	1,916,163	3,986,163
2019	3,964,700	2,145,000	1,818,863	3,963,863
2020	3,942,575	2,220,000	1,717,838	3,937,838
2021	3,925,853	2,310,000	1,612,938	3,922,938
2022	3,912,297	2,405,000	1,503,388	3,908,388
2023	3,904,249	2,515,000	1,388,838	3,903,838
2024	3,901,081	2,630,000	1,268,838	3,898,838
2025	3,903,147	2,750,000	1,149,050	3,899,050
2026	3,909,295	2,895,000	1,013,644	3,908,644
2027	3,918,184	3,060,000	857,325	3,917,325
2028	3,928,678	3,235,000	692,213	3,927,213
2029	3,939,327	3,420,000	517,650	3,937,650
2030	4,312,268	3,985,000	323,400	4,308,400
2031	6,889,965	4,090,000	107,363	4,197,363
Total	**$69,412,010**	**$44,295,000**	**$22,385,299**	**$66,680,299**

(1) Net revenues available for debt service include TSRs, less Operating Expenses, plus amounts held in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement, plus scheduled reductions in the Liquidity Reserve Requirement beginning in 2029, reflecting scheduled decline in required principal and interest payments on the Series 2014 Senior Bonds.

(2) Includes Operating Expenses at the Operating Cap.

(3) Totals may not add to totals due to rounding. First interest payment of Series 2014 Senior Bonds funded from a portion of remaining TSRs received by the Indenture Trustee in April 2014.

Debt Service Incorporating Early Redemption of Series 2014 Senior Bonds
4% Year-Over-Year Consumption Decline

Annual Period (12/31)	Total Available Funds[(1)(2)]	Bond Principal and Early Redemptions	Interest	Total Debt Service[(3)]
2014	$ 305,106	$ -	$ 305,106	$ 305,106
2015	3,537,736	1,410,000	2,127,088	3,537,088
2016	3,545,106	1,475,000	2,069,388	3,544,388
2017	3,507,006	1,500,000	2,005,513	3,505,513
2018	3,887,957	1,960,000	1,925,563	3,885,563
2019	3,846,828	2,010,000	1,833,063	3,843,063
2020	3,806,188	2,065,000	1,737,938	3,802,938
2021	3,766,034	2,125,000	1,639,738	3,764,738
2022	3,726,360	2,185,000	1,538,288	3,723,288
2023	3,687,164	2,250,000	1,433,438	3,683,438
2024	3,648,439	2,320,000	1,324,938	3,644,938
2025	3,610,182	2,385,000	1,222,738	3,607,738
2026	3,572,389	2,450,000	1,118,638	3,568,638
2027	3,535,055	2,535,000	995,138	3,530,138
2028	3,498,176	2,635,000	859,556	3,494,556
2029	3,461,749	2,740,000	718,463	3,458,463
2030	3,788,562	3,225,000	562,144	3,787,144
2031	3,376,181	2,975,000	399,131	3,374,131
2032	3,341,085	3,100,000	239,794	3,339,794
2033	6,251,013	2,950,000	77,438	3,027,438
Total	**$95,053,390**	**$44,295,000**	**$24,133,093**	**$68,428,093**

(1) Net revenues available for debt service include TSRs, less Operating Expenses, plus amounts held in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement, plus scheduled reductions in the Liquidity Reserve Requirement beginning in 2029, reflecting scheduled decline in required principal and interest payments on the Series 2014 Senior Bonds.

(2) Includes Operating Expenses at the Operating Cap.

(3) Totals may not add to totals due to rounding. First interest payment of Series 2014 Senior Bonds funded from a portion of remaining TSRs received by the Indenture Trustee in April 2014.

Debt Service Incorporating Early Redemption of Series 2014 Senior Bonds
5% Year-Over-Year Consumption Decline

Annual Period (12/31)	Total Available Funds[(1)(2)]	Bond Principal and Early Redemptions	Interest	Total Debt Service[(3)]
2014	$ 305,106	$ -	$ 305,106	$ 305,106
2015	3,501,782	1,370,000	2,127,788	3,497,788
2016	3,474,375	1,400,000	2,072,388	3,472,388
2017	3,402,643	1,390,000	2,012,313	3,402,313
2018	3,734,704	1,795,000	1,937,863	3,732,863
2019	3,658,388	1,805,000	1,852,763	3,657,763
2020	3,583,750	1,815,000	1,766,638	3,581,638
2021	3,510,754	1,830,000	1,679,338	3,509,338
2022	3,439,366	1,845,000	1,590,488	3,435,488
2023	3,369,554	1,865,000	1,500,138	3,365,138
2024	3,301,284	1,890,000	1,407,938	3,297,938
2025	3,234,524	1,910,000	1,323,838	3,233,838
2026	3,169,243	1,920,000	1,247,238	3,167,238
2027	3,105,412	1,930,000	1,170,238	3,100,238
2028	3,042,999	1,960,000	1,081,550	3,041,550
2029	2,981,976	2,000,000	977,813	2,977,813
2030	3,285,107	2,420,000	861,919	3,281,919
2031	2,849,933	2,105,000	743,006	2,848,006
2032	2,792,912	2,160,000	631,050	2,791,050
2033	3,061,544	2,550,000	507,544	3,057,544
2034	2,670,259	2,285,000	380,363	2,665,363
2035	2,616,854	2,355,000	258,694	2,613,694
2036	5,184,873	3,695,000	96,994	3,791,994
Total	**$73,277,342**	**$44,295,000**	**$27,532,999**	**$71,827,999**

(1) Net revenues available for debt service include TSRs, less Operating Expenses, plus amounts held in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement, plus scheduled reductions in the Liquidity Reserve Requirement beginning in 2029, reflecting scheduled decline in required principal and interest payments on the Series 2014 Senior Bonds.

(2) Includes Operating Expenses at the Operating Cap.

(3) Totals may not add to totals due to rounding. First interest payment of Series 2014 Senior Bonds funded from a portion of remaining TSRs received by the Indenture Trustee in April 2014.

Debt Service Incorporating Early Redemption of Series 2014 Senior Bonds
5.55% (Breakeven) Year-Over-Year Consumption Decline

Annual Period (12/31)	Total Available Funds[1][2]	Bond Principal and Early Redemptions	Interest	Total Debt Service[3]
2014	$ 305,106	$ -	$ 305,106	$ 305,106
2015	3,482,008	1,350,000	2,128,188	3,478,188
2016	3,435,789	1,360,000	2,073,988	3,433,988
2017	3,346,171	1,330,000	2,015,913	3,345,913
2018	3,652,452	1,705,000	1,944,363	3,649,363
2019	3,558,074	1,690,000	1,863,363	3,553,363
2020	3,466,300	1,680,000	1,782,238	3,462,238
2021	3,377,062	1,675,000	1,700,838	3,375,838
2022	3,290,291	1,670,000	1,618,588	3,288,588
2023	3,204,857	1,670,000	1,534,538	3,204,538
2024	3,212,983	1,760,000	1,448,638	3,208,638
2025	2,950,386	1,575,000	1,375,038	2,950,038
2026	2,966,584	1,655,000	1,310,438	2,965,438
2027	2,891,209	1,645,000	1,244,438	2,889,438
2028	2,817,925	1,635,000	1,178,838	2,813,838
2029	2,746,685	1,635,000	1,106,569	2,741,569
2030	3,040,226	2,025,000	1,013,381	3,038,381
2031	2,596,068	1,675,000	915,863	2,590,863
2032	2,530,642	1,700,000	827,400	2,527,400
2033	2,791,428	2,060,000	728,700	2,788,700
2034	2,392,830	1,760,000	628,163	2,388,163
2035	2,332,627	1,795,000	534,975	2,329,975
2036	2,463,875	2,025,000	434,700	2,459,700
2037	2,498,732	2,170,000	324,581	2,494,581
2038	2,143,941	1,925,000	216,956	2,141,956
2039	2,127,463	2,010,000	113,663	2,123,663
2040	4,141,870	1,115,000	29,269	1,144,269
Total	**$77,763,584**	**$44,295,000**	**$30,398,724**	**$74,693,724**

(1) Net revenues available for debt service include TSRs, less Operating Expenses, plus amounts held in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement, plus scheduled reductions in the Liquidity Reserve Requirement beginning in 2029, reflecting scheduled decline in required principal and interest payments on the Series 2014 Senior Bonds.
(2) Includes Operating Expenses at the Operating Cap.
(3) Totals may not add to totals due to rounding.

BONDHOLDERS' RISKS

Potential purchasers of the Series 2014 Senior 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 2014 Senior Bonds.

*The discussion of the risks facing the domestic tobacco industry and potentially impacting the 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 domestic 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 TSRs and the Series 2014 Senior Bonds, 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 2014 Senior Bonds, a downward revision or withdrawal of ratings on the Series 2014 Senior 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 risk factors will not become material in the future. Further information regarding these risk factors can be found under "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" and "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" herein. See also Appendix D — "IHS GLOBAL REPORT" attached hereto.

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 TSRs available to the Corporation. Any such adjustments could trigger the Offset for Miscalculated or Disputed Payments and lead to significant reductions in 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 (not including the State) 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 $9.4 billion, for the sales years 2003 through 2013 according to NAAG; including moneys withheld outright, moneys deposited to the Disputed Payments Account or, as in the case of the largest OPM (Philip Morris), 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 with respect to which the OPMs have stated that they

have filed dispute notices and significant additional amounts that the OPMs have indicated 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 such offsets may materially adversely affect the amount and timing of the payment of 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 adversely affect the amount and/or timing of TSRs. Amounts held in the Disputed Payments Account with respect to a sales year could be released to the PMs if any Settling State is found to have not diligently enforced its Qualifying Statute during such sales year, or could be released to those Settling States which are found to have diligently enforced their respective Qualifying Statutes during such sales year. The State received as part of the April 2014 MSA payment amounts attributable 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, and the County received its 0.467% allocation in accordance with the Consent Decree. No assurance can be given as to the future payment of amounts recovered with respect to the NPM Adjustment for sales 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 and April 2014 in connection with the partial settlement (which the State did not join) regarding the NPM Adjustment, as discussed below. See "—NPM Adjustment" below. Amounts released from the Disputed Payments Account to the County are TSRs and could be used to optionally redeem, purchase, pay or defease Series 2014 Senior Bonds pursuant to the Indenture. See "SECURITY—Application of Revenues—*Distribution Date Transfers*" above.

The cash flow assumptions used to prepare the coverage tables herein do not factor in any offset for miscalculated or disputed payments. Any adjustments made in the form of a credit against future MSA payments could lead to material reductions in the TSRs available to pay principal and interest on the Series 2014 Senior 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 County in the year following such determination could be as great as the amount of Annual Payments that could otherwise have been received by the County 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 TSRs available to the Corporation to pay debt service on the Series 2014 Senior Bonds. The Collection Methodology and Assumptions (described herein) and debt service coverage tables for the

Series 2014 Senior Bonds do not include any NPM Adjustments, based on the assumptions that the State has diligently enforced and will diligently enforce its Qualifying Statute and that such Qualifying Statute is not held to be unenforceable. No assurance can be given as to whether the State will be subject to NPM Adjustments for sales years subsequent to 2003.

Results of 2003 NPM Adjustment Arbitration; Future NPM Adjustment Arbitrations. The PMs have disputed MSA payments in sales years 2003 through 2013 on the basis that certain Settling States, including the State, did not diligently enforce their respective Qualifying Statutes in each of those years. 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**"). After some Settling States settled their disputes with the PMs in March 2013, the State was one of 15 contested states that continued 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 (along with 8 other states) 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 did 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. Two of the six states that were held to be non-diligent for 2003 subsequently joined the NPM Adjustment Settlement Term Sheet in June 2014, as discussed below. According to Lorillard, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, the OPMs are entitled to receive $458 million plus interest and earnings as a result of the Arbitration Panel's ruling.

All six of the states that were determined by the Arbitration Panel's final awards not to have diligently enforced their Qualifying Statutes in 2003 filed motions to vacate such final awards with respect to those states. In April 2014, the MSA court in Pennsylvania upheld the Arbitration Panel's non-diligence finding for Pennsylvania, but also ruled that the states that signed the NPM Adjustment Settlement Term Sheet (discussed below) and had been contested in the 2003 NPM Adjustment arbitration would be deemed non-diligent for purposes of calculating Pennsylvania's share of the 2003 NPM Adjustment, resulting in a partial reduction of Pennsylvania's share of the 2003 NPM Adjustment allocation. In May 2014, the Missouri MSA court (in a decision similar to the Pennsylvania court) upheld the Arbitration Panel's non-diligence finding for Missouri but ruled that Missouri's share of the 2003 NPM Adjustment must be reduced because the states that signed the NPM Adjustment Settlement Term Sheet and had been contested in the 2003 NPM Adjustment arbitration should be deemed non-diligent for purposes of calculating Missouri's share of the 2003 NPM Adjustment. On June 10, 2014, Kentucky joined the NPM Adjustment Settlement Term Sheet, and on June 26, 2014, Indiana joined the NPM Adjustment Settlement Term Sheet, each on modified terms, as discussed herein. According to Altria in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, in connection with these settlements, Kentucky and Indiana are in the process of staying their motions to vacate or modify the Arbitration Panel's NPM Adjustment Stipulated Partial Settlement and Award and the Arbitration Panel's rulings as to their diligence, while the other four non-diligent states continue to pursue their motions.

The April 2014 MSA payment, as calculated by the MSA Auditor (defined below), accounted for the Arbitration Panel's findings with respect to the 2003 NPM Adjustment, as modified by the Pennsylvania court's ruling, and implemented the 2003 NPM Adjustment through the non-diligent states receiving reductions in MSA payments and the OPMs and diligent states (including non-contested states) receiving amounts due to them through payments from the Disputed Payments Account and/or adjustments associated with future payments. According to Reynolds American's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, until such time as the various remaining state motions challenging the rulings of the Arbitration Panel have been resolved, including any necessary

appeals, uncertainty exists as to the timing, process and amount of ultimate recovery with respect to the remaining share of the 2003 NPM Adjustment claim. The Missouri Attorney General instructed the MSA Auditor to recalculate Missouri's 2003 NPM Adjustment liability and issue a special payment to Missouri in light of the Missouri MSA court's decision, and according to Lorillard, Inc.'s Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, on June 23, 2014 the MSA Auditor issued revised final calculations for the April 2014 MSA payments that implement the Missouri ruling. Altria stated in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that if Philip Morris is not successful in its appeal of the Missouri court's ruling modifying the NPM Adjustment Stipulated Partial Settlement and Award, it will be required to return to Missouri approximately $12 million (subject to confirmation by the MSA Auditor) of the $116 million credit that Philip Morris received against its April 2014 MSA payment in respect of the 2003 NPM Adjustment, plus applicable interest on that amount. According to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, Philip Morris has also appealed the Pennsylvania court's ruling to modify the NPM Adjustment Stipulated Partial Settlement and Award. It is expected that Indiana and Kentucky will also receive additional payments in 2014 with respect to the 2003 NPM Adjustment and that the PMs will receive an additional share of their remaining 2003 NPM Adjustment claims pursuant to agreements by which Kentucky and Indiana joined the NPM Adjustment Settlement Term Sheet.

Proceedings to determine state diligent enforcement claims for sales years 2004 through 2013 have not yet been scheduled. Reynolds American has reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that preliminary discussions are underway with the Term Sheet Non-Signatories (as defined below) to initiate arbitration proceedings with respect to the 2004 NPM Adjustment.

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. 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 TSRs for such future sales years. For a more complete description of the 2003 NPM Adjustment arbitration and the 2004 through 2013 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 2013 NPM Adjustment Claims Generally," "—2003 NPM Adjustment; Arbitration Results," and "—Ongoing 2004 through 2013 NPM Adjustment Claims." A copy of the Arbitration Final Award Re: State of New York in the 2003 NPM Adjustment Proceedings is attached hereto as Appendix C.

<u>Stipulated Partial Settlement and Award</u>. On December 17, 2012, terms of a settlement agreement (the "**NPM Adjustment Settlement Term Sheet**") were agreed to by 19 jurisdictions (which did 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. Five additional jurisdictions (Oklahoma, Connecticut, South Carolina, Indiana and Kentucky) 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 Indiana and Kentucky did not opt into

the settlement until June 2014) 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 received certain reductions in April 2013 and will receive reductions to subsequent 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. The April 2014 MSA payment also reflected the terms of the NPM Adjustment Settlement Term Sheet, as discussed herein.

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 and April 2014 MSA payments (over the objections of the Term Sheet Non-Signatories with respect to the April 2013 MSA payment). In total, fourteen Term Sheet Non-Signatories filed motions to vacate and/or modify the NPM Adjustment Stipulated Partial Settlement and Award. According to Lorillard, Inc.'s Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of July 25, 2014 eleven of these motions were still pending, as discussed herein, with one state withdrawing its opposition and two states later joining the NPM Adjustment Settlement Term Sheet. In addition, according to Altria in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, Kentucky and Indiana (both of whom joined the NPM Adjustment Settlement Term Sheet in June 2014) are in the process of staying their motions to vacate or modify the NPM Adjustment Stipulated Partial Settlement and Award. 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 TSRs available to the Corporation to pay debt service on the Series 2014 Senior 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 approved by order of the Second Circuit on August 10, 2012, rendering the case final before the Second Circuit. 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 "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Litigation Challenging the MSA, the Qualifying Statute and Related Legislation."

The MSA and related state legislation may continue to be challenged in the future. A determination by a court having jurisdiction over the State, the County and the Corporation 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 TSRs available to the Corporation. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT." For a description of the opinion of Harris Beach PLLC addressing such matters, see "LEGAL CONSIDERATIONS RELATING TO 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 approximately 7,500 tobacco-related lawsuits (according to Lorillard), 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 approximately 5,000 cases (involving approximately 6,000 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. In August 2013 Philip Morris, Reynolds Tobacco and Liggett Group filed a petition for writ of certiorari with the U.S. Supreme Court with respect to that ruling, which the U.S. Supreme Court denied on October 7, 2013. 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. Reynolds American moved for rehearing of the cases and on October 31, 2013 the Eleventh Circuit vacated its opinion and issued a new opinion that again concluded that the use of phase I *Engle* findings does not violate a tobacco manufacturer's due process rights. On November 7, 2013, the Eleventh Circuit denied defendant's petition for rehearing, and on January 6, 2014 the Eleventh Circuit denied the defendant's second petition seeking review of the October 31, 2013 opinion. On March 28, 2014 the defendant filed a petition with the U.S. Supreme Court seeking to answer the question of whether the phase I *Engle* findings can be applied to establish certain elements of plaintiffs' claims. On June 9, 2014, the U.S. Supreme Court denied this petition for writ of certiorari. 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"

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, Inc.'s Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, there are approximately 17 such "lights" class actions pending in various courts. Notably, on April 29, 2014, the Illinois Appellate Court, Fifth Judicial District, in an appeal of the "lights" class action case *Price, et al. v. Philip Morris Inc*., based on the *Good* decision, reinstated a $10.1 billion 2003 verdict against Philip Morris, who appealed this decision to the Illinois Supreme Court on May 13, 2014. The verdict has been stayed pending appeal. 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 material 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 material pending tobacco-related litigation. It is possible that their results of operations, cash flows and financial positions could be materially 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 TSRs available to the Corporation. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation" and "LEGAL CONSIDERATIONS RELATING TO 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 TSRs actually received by the Corporation

If a PM were to discontinue making payments under the MSA for any reason, the 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 Corporation.

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. The final judgment and remedial order has not yet been fully implemented. 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. 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, claiming a violation of free speech rights, and 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 in February 2013. On January 10, 2014, the U.S. government and the defendant tobacco companies issued a joint status report confirming that the parties reached an agreement following the negotiations regarding implementation of the corrective statements. For specified time periods following the date when all appeals are exhausted, corrective statements would be disseminated in newspapers (print and online), on television, on the tobacco companies' websites, and on "onserts" affixed to cigarette packs. On June 2, 2014, the U.S. District Court for the District of Columbia approved the Joint Motion for Consent Order Implementing the Corrective Statements Remedy Under Order #1015 and Order #34-Remand, which motion was filed and agreed to on April 22, 2014 by the Department of Justice, Altria, Philip Morris, Reynolds Tobacco and Lorillard. The Consent Order approved by the U.S. District Court modifies various provisions of Order #1015 and provides that the parties thereto do not waive or abandon any appeal, appellate rights or argument and that the defendants reserve the right to challenge on appeal the content of the Court-ordered corrective statements and the requirement that the Court-ordered corrective statements appear in the multiple media referenced in the Court's Remedial Order and in the Consent Order. The Consent Order did not resolve outstanding issues as to corrective statements in retail point-of-

sale displays. The Consent Order further provides that defendants will not challenge on appeal the specific implementation executions in the Consent Order, that plaintiffs will not invoke defendants' agreement to the specific implementation executions in response to defendants' appellate challenge to the Court-ordered corrective statements, and that should the language of the corrective statements be changed as a result of further litigation, the parties reserve the right to seek different requirements than those in the Consent Order. In addition, the Consent Order stays implementation until the exhaustion of the defendants' appeal challenging the constitutionality of the corrective statements. On June 25, 2014, the defendants filed a notice of appeal of the Consent Order solely for the purpose of perfecting the U.S. Court of Appeals' jurisdiction over the pending appeal relating to the content of the corrective statements and, on July 2, 2014, moved to consolidate this appeal with the appeal filed in January 2013. The District Court has not yet entered an amended final judgment addressing all of the directions from the Court of Appeals. It is possible that the remedial order, including the 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 TSRs available for the Series 2014 Senior 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**") in December 2013, the smoking rate for adults in the United States fell to 17.4% for January to June 2013, after hovering at approximately 20% to 21% for more than seven years, approximately 19% in 2010 and 2011 and approximately 18% in 2012. Results of the National Risk Behavior Survey released by the CDC in June 2014 found that the number of high school students who had smoked a cigarette in the previous month had dropped to 15.7% in 2013 from 18.1% in 2011, 21.9% in 2003 and 36.4% in 1997. According to Reynolds American in its Form 10-K filed with the SEC for calendar year 2013, total industry domestic cigarette shipment volume declined to 273.3 billion cigarettes as of December 31, 2013 (as compared to shipments of approximately 400 billion in 2003, according to the IHS Global Report). See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Cigarette Shipment Trends."

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, the raising of the minimum age to possess or purchase tobacco products, 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 curtailments in the chain of distribution (on September 3, 2014, the national pharmacy chain CVS reportedly stopped selling all cigarettes and other tobacco products in all its stores; no assurance can be given that other pharmacy chains, and other retail vendors, will not voluntarily cease selling cigarettes and other tobacco products). Continuing declines in cigarette consumption could adversely impact the amount and timing of the TSRs available to the Corporation to pay debt service on the Series 2014 Senior 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 2014 Senior 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 TSRs available to the Corporation.

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 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.*, 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. It is likely that future regulations promulgated by the FSPTCA, including regulation of menthol short of an outright ban thereof, as discussed below, 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 TSRs available to the Corporation to pay debt service on the Series 2014 Senior Bonds.

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 and the incidence of smoking among youth. Such plaintiffs and constituencies may seek restrictions or a ban on the production and sale of mentholated cigarettes. On November 8, 2013, twenty-seven states (including the State) sent a letter to the FDA in support of a ban on menthol flavored 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. It is expected that Reynolds American will acquire the Newport brand in the first half of 2015 as part of its acquisition of Lorillard, Inc. According to Lorillard, mentholated cigarettes are reported to have comprised 31.4% and 31.1% of the U.S. domestic cigarette market in the calendar years 2013 and 2012, respectively, and 31.7% and 31.3% in the first six months of 2014 and 2013, respectively.

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 non-menthol 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 was to 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. As discussed in "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues—*FSPTCA Litigation*," on July 21, 2014, the U.S. District Court for the District of Columbia ruled in favor of Lorillard and Reynolds Tobacco in a case that challenged the TPSAC's membership, finding that three of the panel's members had conflicts of interest that biased them against the tobacco industry and that "the FDA's appointment of those members was arbitrary and capricious, in violation of the APA, and fatally tainted the composition of the TPSAC and its work product, including the Menthol Report." The court ordered the FDA to reconstitute the committee so that it complies with the applicable ethics laws and barred the FDA from using the committee's findings in the 2011 menthol report, which it found to be, "at a minimum suspect, and at worst untrustworthy."

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 TSRs available to the Corporation to pay debt service on the Series 2014 Senior Bonds.

The volume of cigarettes sold by PMs in the U.S. cigarette market is expected to continue to decline as a result of increases in cigarette excise taxes

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 by $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 2013 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. 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, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, combined state and local excise taxes ranged from $0.17 to $5.85 per pack in the calendar year 2013. According to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of June 30, 2014 the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.29, compared with the 12-month rolling average of $1.30 as of December 31, 2013. According to Philip Morris, between the end of 1998 (the year that the MSA was executed) and July 18, 2014, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.48 per pack. Altria has reported that during 2013, Massachusetts, Minnesota, Oregon and Puerto Rico had enacted legislation to increase their cigarette taxes, and Altria further reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as of July 18, 2014, Vermont is the only state to have enacted a cigarette excise tax increase in 2014.

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. President Obama's 2015 federal budget proposal, released in early March 2014, includes a proposed increase in the federal excise tax on a pack of cigarettes to $1.95 per pack (and proposed proportionate increases in all other tobacco product tax rates). 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 TSRs available to the Corporation.

The volume of cigarettes sold by PMs in the U.S. cigarette market is expected to continue to decline because of efforts to raise the minimum age for purchase and possession of cigarettes

U.S. cigarette consumption is expected to continue to decline due to legislative efforts to raise the minimum age to possess or purchase tobacco products. On October 30, 2013, the New York City Council voted to ban the sale of both cigarettes and e-cigarettes to anyone under 21 years old; the Mayor of New York City signed the bill on November 19, 2013. The minimum age to purchase tobacco products rose to 21 in Hawaii County, Hawaii on July 1, 2014, and will rise to 21 in Suffolk County, New York, on January 1, 2015. Similar proposals to raise the smoking age have also been introduced in the Colorado, Missouri, New York State, New Jersey, Utah and Vermont legislatures, and in the Council of the District of Columbia. Four states, Alabama, Alaska, New Jersey, and Utah, and three New York counties currently set the minimum age at 19. Declines in consumption could lead to reductions of payments under the MSA and could have an adverse effect on the amount and/or timing of TSRs available to the Corporation to pay debt service on the Series 2014 Senior Bonds.

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 do not result in payments under the MSA

Certain of the major cigarette makers have developed (or acquired) 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, and more than 7,000 available flavors of e-cigarettes, with, by one estimate, the number of flavors increasing every month. Lorillard, Inc. acquired the blu eCig brand in April 2012, and reported in its Form 10-Q filed with the SEC for the three-month period ended March 31, 2014 that the blu eCigs brand was carried in approximately 149,000 retail outlets as of March 31, 2014. The blu eCigs brand makes up approximately 40% of the U.S. market in e-cigarettes, according to Lorillard, Inc.'s Form 10-Q filed with the SEC for the six-month period ended June 30, 2014. The blu eCigs brand is expected to be sold to Imperial Tobacco Group PLC as part of the proposed merger of Reynolds American and Lorillard, Inc. Altria's Nu Mark LLC introduced an electronic cigarette under the "MarkTen" brand with distribution in Indiana and Arizona in 2013, and Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that it began the national expansion of MarkTen products in June 2014. 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 has 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. On April 1, 2014 Altria, through its Nu Mark subsidiary, acquired the e-vapor business of Green Smoke, Inc., an e-cigarette maker that sells both disposable and reusable products. Reynolds American launched a revamped version of its e-cigarette, VUSE, in Colorado retail outlets in July 2013 and expanded distribution into Utah in the first quarter of 2014. Reynolds American reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that the initial phase of the national expansion of VUSE began in June 2014, the next wave of distribution is scheduled for the third quarter of 2014, and expansion is expected to continue in phases through March 2015, when VUSE will be available in most retail outlets. Reynolds American has stated that it intends to remain focused on VUSE's growth and expansion nationwide and that it is targeting existing smokers with VUSE and expects some smokers to give up traditional cigarettes in favor of VUSE.

The fastest growth in e-cigarettes comes from devices called "vaporizers", which are larger, customizable devices. They have larger batteries and cartridges, hold more liquid, produce larger vapor clouds and last longer. They allow users to mix and match hardware and refill cartridges with liquid bought in bulk, so that they are cheaper than e-cigarettes. None of the OPMs have launched their own vaporizer product. It has been estimated that sales of vaporizers are growing twice as fast as traditional e-cigarettes. Vaporizers (as well as e-cigarettes) come in a wide variety of flavors.

On April 24, 2014, the FDA released proposed rules that would extend its regulatory authority to electronic cigarettes and certain other tobacco products under the FSPTCA. The proposed rules would require that electronic cigarette manufacturers (i) register with the FDA and report electronic cigarette product and ingredient listings; (ii) market new electronic cigarette products only after FDA review; (iii) only make direct and implied claims of reduced risk if the FDA confirms that scientific evidence supports the claim and that marketing the electronic cigarette product will benefit public health as a whole; (iv) not distribute free samples; (v) implement minimum age and identification restrictions to prevent sales to individuals under age 18; (vi) include a health warning; and (vii) not sell electronic cigarettes in vending machines, unless in a facility that never admits youth. Notably, the proposed rules do not restrict flavored products, online sales or advertising. It has been reported that the White House's Office of Management and Budget, which analyzes the potential economic consequences of proposed regulations, modified language in the proposed rules that would have permitted the FDA to prevent online sales of e-cigarettes, and deleted or modified language regarding FDA concerns about the safety of e-cigarettes, including manufacturing quality. The proposed regulation is subject to a 75-day public comment period, which was extended an additional 30 days and closed on August 8, 2014, following which the FDA will finalize the proposed regulation. It is not known how long this regulatory process to finalize and implement the rules may take. No assurance can be given that any regulation of e-cigarettes by the FDA will stop the trend of increased sales of e-cigarettes.

The CDC in February 2013 reported results of a survey that indicated that in 2011 approximately 6.2% of the adult population, and 21% 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. Altria has reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that Nu Mark estimates that total consumer expenditures for e-vapor products were approximately $1 billion in the United States in 2013 and believes that expenditures on these products continue to grow in 2014. 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 will be more than $2 billion in 2014. Certain reports have predicted that sales of e-cigarettes could outpace traditional cigarettes before 2050. It has also been reported that e-cigarettes will capture more than half the smoking market within a decade.

Numerous jurisdictions have banned the use of electronic cigarettes where traditional cigarettes are banned. For example, three U.S. states (North Dakota, New Jersey and Utah) and 188 municipalities have banned the use of e-cigarettes in smoke-free venues (according to the American Nonsmokers' Rights Foundation ("**ANRF**") as of July 3, 2014). On December 19, 2013 the New York City Council approved legislation that prohibits the use of electronic cigarettes in indoor public places and in places of employment (where smoking of traditional cigarettes is already prohibited). Chicago, Los Angeles, San Francisco and Philadelphia passed similar legislation in 2014.

On February 12, 2014, Senator Tom Harkin and Representatives Henry Waxman and Peter Welch sent a letter to the Attorneys General of three states urging them to classify electronic cigarettes as cigarettes under the MSA in order to prevent e-cigarette companies from targeting youth and getting them addicted to their products. Such classification could mitigate potential decreases in payments under the MSA due to declining consumption of traditional cigarettes if electronic cigarettes gain market share over traditional cigarettes. There can be no assurance that such classification will occur, and the nature and timing of any future amendments to the MSA, or interpretations under the MSA, cannot be predicted. In addition, on February 26, 2014, Senators Barbara Boxer, Dick Durbin, Tom Harkin, Richard Blumenthal and Edward Markey introduced legislation that would permit the FTC to determine what constitutes marketing e-cigarettes to children, and would allow the FTC to work with state attorneys general to enforce a ban on such marketing. There can be no assurance that such legislation will be enacted. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY".

Cigarette manufacturers also market other types of alternative products that do not fall under the scope of the MSA. Philip Morris developed an alternative cigarette, called Accord, in which the tobacco is heated rather than burned. In addition, Altria reported in its Form 10-K filed with the SEC for calendar year 2013 that in December 2013 it entered into an agreement with Philip Morris International Inc. providing for an exclusive license to Altria subsidiaries to sell two of Philip Morris International Inc.'s heated tobacco product technologies in the United States. Furthermore, Philip Morris has developed a hybrid of a cigarette and an e-cigarette it refers to as a "potentially reduced-risk product", which Philip Morris hopes to get approved for sale in test markets before the end of 2014. 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 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 in June 2013, Altria announced that it intended to expand its distribution of Verve discs from 60 stores to about 1,200

stores throughout Virginia in the second half of 2013. On June 10, 2014, Swedish Match submitted an application to the FDA to approve its snus products as "modified risk." Swedish Match is proposing to say that the product is addictive but is "substantially less risky than smoking" and would like permission to remove one of the required health warnings from its packages. The FDA has one year to evaluate the application. A report by the CDC found that smokeless tobacco use among U.S. workers has remained relatively steady since 2005, with 2.7% of U.S. workers using smokeless tobacco products in 2005 and 3.0% of U.S. workers using smokeless tobacco products in 2010, while cigarette use has declined since 2005.

It has also been reported that increases in cigarette taxes have caused an increase in the sale of e-cigarettes and other alternatives to cigarettes. While such alternative cigarette products continue to be deemed not to constitute "cigarettes" under the MSA and gain market share of the domestic cigarette market to the detriment of traditional cigarettes, payments under the MSA and thus amounts of TSRs available to the Corporation may decrease. 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 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 currently subject to the advertising restrictions to which tobacco products are subject, and the FDA did not include advertising restrictions in its proposed regulations. Therefore, electronic cigarettes, which can currently be marketed more extensively than traditional 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. In January 2014 the CDC released further results indicating that quit rates had increased to 52.9% for attempts made in the past year. To the extent that existing smoking cessation 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 TSRs available to the Corporation. 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. The Corporation is not a party to the MSA; accordingly, the Corporation has no right to challenge any such amendment, waiver or termination. The County is also not a party to the MSA. The State, which is a party to the MSA but is not a party to the Purchase and Sale Agreement, has not made any covenants for the benefit of Bondholders or the Corporation. 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 TSRs by the Corporation. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Amendments and Waivers."

Reliance on State Enforcement of the MSA and Non-Impairment

The State may not convey and has not conveyed to the County, the Corporation or the Bondholders any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Although the State is entitled under the Consent Decree to a substantial portion of the State's allocable share of each Annual Payment under the MSA, no assurance can be given that the State will enforce any particular provision of the MSA. Failure by the State to enforce the MSA may have a material adverse effect on the receipt of TSRs by the Corporation. The Consent Decree provides that the County is a member of the class certified for settlement, and that the County may enforce its payment rights thereunder, but only against the City, the other counties of the State and the State. Only the State may enforce the payment provisions of the Consent Decree against the PMs. In the Purchase and Sale Agreement, the County has covenanted that it will take all actions as may be required by law fully to preserve, maintain, defend, protect and confirm the interests of the Corporation and the interests of the Indenture Trustee on behalf of the Bondholders in the Tobacco Assets and the proceeds thereof and that it will not limit or alter the rights of the Corporation to fulfill the terms of its agreements with Bondholders or in any way impair the rights and remedies of such Bondholders or the security for Bonds until the Bonds, together with the interest due thereon or payable in respect thereof and all costs and expenses in connection with any action or proceeding by or on behalf of such Bondholders are fully met and discharged. See "LEGAL CONSIDERATIONS RELATING TO TSRS" and Appendix E — "DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS."

It is also possible that the State could attempt to claim some or all of the TSRs for itself or otherwise interfere with the security for the Series 2014 Senior Bonds. In that event, the Bondholders, the Indenture Trustee or the Corporation may assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims. See "LEGAL CONSIDERATIONS RELATING TO 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 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 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 TSRs, and the Bondholders and the beneficial owners of the Series 2014 Senior Bonds could incur losses on their investments.

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 County, the Corporation, the Indenture Trustee, the Bondholders or the Beneficial Owners of the Series 2014 Senior Bonds to collect any TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying the TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code then the PM may be unable to make further payments of TSRs. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to reject the MSA and stop making payments under it.

Furthermore, payments previously made to the Bondholders or the Beneficial Owners of the Series 2014 Senior Bonds could be avoided as preferential payments, so that the Bondholders and the Beneficial Owners of the Series 2014 Senior 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 County, the Corporation, the Indenture Trustee, the Bondholders or the Beneficial Owners of the Series 2014 Senior 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 MSA"), 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 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 TSRs and thus could have an adverse effect on the liquidity and market value of the Series 2014 Senior Bonds. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS RELATING TO TSRS—Bankruptcy Considerations."

Recharacterization of the Transfer of TSRs as a Secured Borrowing Would Invalidate Sale of TSRs

The County is authorized by statute to file a voluntary petition for relief under the Bankruptcy Code. If the County were to become a debtor under the Bankruptcy Code or other similar federal or state laws, a creditor of the County might argue that the transfer of the TSRs from the County to the Corporation under the Purchase and Sale Agreement was (or should be recharacterized as) a pledge of the TSRs to secure a borrowing by the County, rather than an absolute sale thereof to the Corporation. A determination that the sale by the County of the TSRs was a secured borrowing by the County would invalidate such sale, since the County is not authorized to make such a secured borrowing. If the sale were invalidated, the Corporation would have no source of funds or assets from which to pay the Series 2014 Senior Bonds. If, in the event of the County's bankruptcy, transfer to the Corporation of the TSRs other than those payable to the holder of the Residual Certificate in accordance with the terms of the Residual Certificate and the Indenture were treated as a sale, however (and not invalidated or recharacterized), such TSRs would not be part of the County's estate in bankruptcy and would not be available to the creditors of the County. For additional description of certain bankruptcy issues and a description of certain legal opinions to be delivered by Bond Counsel with regard to bankruptcy matters, see "LEGAL CONSIDERATIONS RELATING TO TSRS."

Substantive Consolidation of the County and the Corporation May Result in Losses

The Corporation and the County have taken steps intended to ensure that a voluntary petition for relief by the County under the Bankruptcy Code will not result in the substantive consolidation of the assets and liabilities of the Corporation with those of the County. Nevertheless, a court may determine that the activities of the Corporation will result in the assets and liabilities of the Corporation being substantively consolidated with those of the County in a bankruptcy or insolvency proceeding of the County. Any such order would adversely affect the Corporation's ability to receive TSRs, and Bondholders could therefore incur losses on their investment. For an additional description of certain legal opinions to be delivered by Bond Counsel with respect to bankruptcy matters, see "LEGAL CONSIDERATIONS RELATING TO TSRS."

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. Standard & Poor's Ratings Services ("**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. 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 ("**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 3 tranches of the Series 2000 Bonds of the Corporation) 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). On February 20, 2014 Moody's reported that it had updated its methodology for rating tobacco settlement revenue securitizations based upon the NPM Adjustment Settlement Term Sheet, and consequently upgraded the ratings of 55 tranches (including 3 tranches of the Series 2000 Bonds), downgraded the ratings of 7 tranches, confirmed the ratings of 73 tranches that were placed on review with direction uncertain in January 2013 (including 3 tranches of the Series 2000 Bonds), and affirmed the ratings of 3 tranches, stating that it made two assumption changes for all states, including the states that did not join the NPM Adjustment Settlement Term Sheet (including the State): (i) that the tobacco companies will continue making NPM Adjustments for the entire duration of the transactions, and (ii) that the states will recover the NPM Adjustments 8 to 12 years later.

Series 2014 Senior Bonds Secured Solely by the TSRs and Moneys in the Accounts Pledged Under the Indenture; Limited Resources of the Corporation

Investors in the Series 2014 Senior Bonds must look solely to the 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 2014 Senior 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, the County or any municipal corporation, subdivision, or agency of the State is pledged to the payment of the principal of, interest on and premium, if any, on the Series 2014 Senior Bonds. The Corporation has no taxing power.**

The Series 2014 Senior Bonds are payable only from the assets of the Corporation pledged under the Indenture. In the event that such assets of the Corporation have been exhausted, no amounts will thereafter be available to be paid on the Series 2014 Senior Bonds. The Series 2014 Senior Bonds are not legal or moral obligations of the State or the County and no recourse may be had with respect thereto for payment of amounts owing on the Series 2014 Senior Bonds. Investors in the Series 2014 Senior Bonds must look solely to the assets of the Corporation pledged under the Indenture for repayment of their investment. The Corporation's only source of funds for payments on the Series 2014 Senior Bonds is the Trust Estate. The Corporation has no taxing power and no assets are available to pay Series 2014 Senior Bonds other than the assets acquired pursuant to the Purchase and Sale Agreement and pledged under the Indenture. **No assets of the State or the County are pledged to secure or will be available to pay debt service on the Series 2014 Senior Bonds.**

Certain Risks Associated with the Forward Delivery Agreement

Pursuant to the terms of the Forward Delivery Agreement with respect to the Series 2014 Senior Bonds, Citigroup Financial Products Inc., the Forward Delivery Agreement Provider, is required to deliver to the Indenture Trustee, on the Business Day prior to each Distribution Date, securities, as specified therein, which will mature not later than the Business Day prior to the next succeeding Distribution Date in an aggregate amount equal to the Liquidity Reserve Requirement, and which the Indenture Trustee will purchase from the Forward Delivery Agreement Provider with amounts held in the Liquidity Reserve Account at a purchase price to provide a guaranteed yield on such investments. If the Forward Delivery Agreement Provider defaults on its obligations under the Forward Delivery Agreement, earnings on the securities held thereunder would be at market rates, which could be lower than the guaranteed yield specified in the Forward Delivery Agreement. Such event could have an adverse effect on amounts available to pay debt service on the Series 2014 Senior Bonds.

Limited Remedies

The Indenture Trustee is limited under the terms of the Purchase and Sale Agreement to enforcing the terms of the agreement and to receiving the TSRs and applying them in accordance with the Indenture. If an Event of Default occurs, the Indenture Trustee cannot sell its rights under the Purchase and Sale Agreement. The Corporation is not a party to the MSA and has not made any representation or warranty that the MSA is enforceable. Remedies under the Purchase and Sale Agreement do not include the repurchase by the County of the 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 Bondholders are no greater than those afforded to the Indenture Trustee.

Limited Liquidity of the Series 2014 Senior Bonds; Price Volatility

There is currently a limited secondary market for securities such as the Series 2014 Senior Bonds. The Underwriter is under no obligation to make a secondary market for the Series 2014 Senior Bonds. There can be no assurance that a secondary market for the Series 2014 Senior 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 2014 Senior Bonds. Tobacco settlement revenue bonds generally have also exhibited greater price volatility than traditional municipal bonds. Any purchaser of the Series 2014 Senior 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 2014 Senior Bonds will be assigned ratings by Fitch. Any rating assigned to the Series 2014 Senior Bonds by Fitch will reflect its assessment of the likelihood of the payment of principal of and interest on the Series 2014 Senior Bonds. The rating of the Series 2014 Senior 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 Fitch 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 2014 Senior Bonds.

LEGAL CONSIDERATIONS RELATING TO TSRS

The following discussion summarizes some, but not all, of the possible legal issues that could affect the Series 2014 Senior Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the 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 under the MSA (and thus the County under the Consent Decree, and Corporation, the Indenture Trustee and the Bondholders under the Indenture) 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 County and/or the Corporation) 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, TSRs available to the Corporation 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 Liquidation

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.

On the date of delivery of the Series 2014 Senior Bonds, Harris Beach PLLC will render an opinion to the Corporation, the County, the Underwriter, the Trustee 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 to Section 365 of the Bankruptcy Code and (b) approve a decision by an OPM to assume or reject the MSA as an executory contract. See "—Limitations on Certain Opinions" below.

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 County, the Corporation, the Indenture Trustee and the Bondholders) 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 County, the Corporation, 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 County, the Corporation, 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 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 Corporation, the Indenture Trustee and the Bondholders).

Bankruptcy of the County

True Sale. If the County were to become a debtor under the Bankruptcy Code or other similar federal or state laws, a creditor of the County might argue that the transfer of the TSRs from the County to the Corporation under Purchase and Sale Agreement was (or should be recharacterized as) a pledge of the TSRs to secure a borrowing by the County, rather than a true sale. A determination that the sale by the County of the TSRs was a secured borrowing by the County would invalidate such sale, since the County is not authorized to make such a secured borrowing. If the sale were invalidated, the Corporation would have no source of funds or assets from which to pay the Series 2014 Senior Bonds. The County has warranted to the Corporation that the sale by it of the TSRs to the Corporation is a true sale. In addition, the County and the Corporation have treated, and have covenanted that they will treat, the transactions described in the Purchase and Sale Agreement as a true sale and will take all actions that are required by the Purchase and Sale Agreement to evidence such true sale.

On the date of delivery of the Series 2014 Senior Bonds, Harris Beach PLLC will render an opinion to the Corporation, the County, the Underwriter, the Trustee and the Rating Agency, based upon the analysis therein and subject to all the facts, representations, warranties, covenants, assumptions and limitations stated therein and the law as it currently exists, that a court, upon proper motion by a party in interest made in a case commenced by or against the County under chapter 9 of the Bankruptcy Code, would hold that the transfer of the Tobacco Assets by the County to the Corporation pursuant to the

Purchase and Sale Agreement constituted a true sale of, and not a loan secured by, the Tobacco Assets (other than the portion thereof that is payable to the holder of the Residual Certificate in accordance with the terms and provisions of the Indenture and the Residual Certificate (such Tobacco Assets that are so payable being referred to as the "**Excluded Tobacco Assets**"), as to which no opinion will be expressed), and therefore that the Tobacco Assets (other than the Excluded Tobacco Assets, as to which no opinion will be expressed) would not constitute property of the County under section 902(1) of the Bankruptcy Code and such assets, or the proceeds thereof, would not be subject to the automatic stay of sections 362(a) and 922(a) of the Bankruptcy Code. See "—Limitations on Certain Opinions" below.

Non-Consolidation. In the event of a bankruptcy or insolvency proceeding with respect to the County, a court could determine that the assets and liabilities of the Corporation should be consolidated with those of the County. The Corporation and the County have taken and will take steps that are intended to ensure that a voluntary petition for relief by the County under the Bankruptcy Code, or similar applicable federal or state laws, will not result in the substantive consolidation of the assets and liabilities of the Corporation and the County.

On the date of delivery of the Series 2014 Senior Bonds, Harris Beach PLLC will render an opinion to the Corporation, the County, the Underwriter, the Trustee and the Rating Agency, subject to all the facts, representations, warranties, covenants, assumptions and limitations stated therein and the law as it currently exists, that, in the event that the County were to become the debtor under the Bankruptcy Code, a court of competent jurisdiction would not disregard the separate existence of the Corporation so as to order the substantive consolidation of the assets and liabilities of the Corporation with those of the County. See "—Limitations on Certain Opinions" below.

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 2014 Senior 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. 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 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 a 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 opinion described below, Harris Beach PLLC 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. On the date of delivery of the Series 2014 Senior Bonds, Harris Beach PLLC will render an opinion to the Corporation, the County, the Underwriter, the Trustee and the Rating Agency that, subject to certain qualifications and assumptions expressed therein, the MSA is a valid, binding and enforceable obligation of the signatories thereto and that the State's Qualifying Statute is constitutional and enforceable. 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. See "—Limitations on Certain Opinions" below.

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 TSRs

It is possible that the State could in the future attempt to claim some or all of the TSRs for itself, or otherwise interfere with the security for the Series 2014 Senior Bonds. In that event, the County, the Bondholders, the Indenture Trustee or the Corporation could assert claims based on contractual or constitutional rights.

Contractual Remedies. Under New York 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 County's right to receive the TSRs and to bring suit against the State to enforce its right to receive the TSRs. Although the State has not contracted directly with the Bondholders, it has entered into the Consent Decree allocating its share of the benefits of the MSA among itself, the City and the State's other counties (including the County). The TSRs and money derived therefrom are the sole source of payment for the Series 2014 Senior Bonds. If the State violates the provisions of the Consent Decree so as to impair the County's right to the TSRs, the Indenture Trustee, as assignee of the Corporation's rights under the Purchase and Sale Agreement, could seek to compel the County to enforce its payment rights under the Consent Decree. In general, as interested parties, the Corporation on its own behalf, and the Indenture Trustee on behalf of the Bondholders, could also seek to enforce the County's rights under the Consent Decree, although, as third parties to the Consent Decree, 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 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 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.

Fiduciary Relationship Remedies. As the lead New York plaintiff in the class action lawsuit underlying the Consent Decree, the State stands in a relationship of faith and trust with the other class members, including the County. Among other fiduciary obligations, the State as the lead plaintiff bears a duty to protect faithfully the settlement interest of the other class members. Consequently, action by the

State, either unilaterally or by agreement with the OPMs, to amend the Consent Decree, or otherwise impair the County's rights to the TSRs without its consent, could constitute a breach of the State's fiduciary duties.

Constitutional Claims. 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 TSRs for itself, or otherwise interferes with the security for the Series 2014 Senior 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 TSRs or otherwise filed in connection with the tobacco industry, or (iii) involving arbitration with respect to the NPM Adjustment, the outcome of such litigation or arbitration proceedings, 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 arbitration panels and (B) the courts or panels, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation or arbitration and any such adverse outcome could have a material and adverse impact on the amount of TSRs available to the Corporation to pay the principal of and interest on the Series 2014 Senior 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 current reference date cited by NAAG), 55 PMs are parties to the MSA. The chart below identifies each of such PMs that are parties to the MSA as of such date:

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OPMs	SPMs	
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)	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.
[††] Acquired by 22nd Century Group, Inc., with 22nd Century Group, Inc. and its subsidiaries reportedly becoming PMs in September 2014.

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" below.

The release inures to the benefit of all PMs and their past, present and future affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, tobacco-related organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any PM or any such affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). They are

referred to in the MSA individually as a "**Released Party**" and collectively as the "**Released Parties**." However, the term "Released Parties" does not include any person or entity (including, but not limited to, an affiliate) that is an NPM at any time after the MSA execution date, unless such person or entity becomes a PM.

Overview of Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Annual Payments, as discussed below.* Annual Payments are subject to various adjustments and offsets, some of which could be material. See "Adjustments to Payments" and "Subsequent Participating Manufacturers" below. Thus far, most of the PMs† have made Annual Payments for 2000 through and including 2014 (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" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Potential Payment Decreases Under the Terms of the MSA"). See "Payments Made to Date" below.

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 are to be made to Citibank, N.A., as Escrow Agent (the "**MSA Escrow Agent**"), which in turn will disburse the funds to the parties entitled thereto. Pursuant to the Purchase and Sale Agreement, the County has directed the State to instruct the MSA Escrow Agent to transfer all TSRs directly to the Indenture Trustee.

Beginning with the payments due in the year 2000, PricewaterhouseCoopers LLP, the independent auditor under the MSA (the "**MSA Auditor**") has, among other things, calculated and determined the amount of all payments owed pursuant to the MSA, the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), 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; SPMs were not required to make Initial Payments. In December 1998, the OPMs collectively made an up-front Initial Payment of $2.40 billion.

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* Other payments that are required to be made by the PMs, such as Strategic Contribution Payments (which are not allocated to the County under the Consent Decree) and payments of attorneys' fees and payments to a national foundation established pursuant to the MSA (which are not allocated to the Settling States under the MSA and thus not allocated to the County), 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.

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. No Initial Payments were due after the 2003 Initial Payment.

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 fifteen Annual Payments due April 15 in each of the years 2000 through 2014. 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	Not Reported
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 2014 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 2014, as discussed below under "—Payments Made to Date."

Adjustments to Payments

The base amounts of the Initial Payments were, and the Annual 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 amounts of the Annual 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 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, 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, after application of the Inflation Adjustment) is decreased by 98% of the percentage by which the Actual Volume is less than the Base Volume, multiplied by such base

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

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

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 dated August 4, 1999, as affected by a letter dated September 27, 1999, counsel to the OPMs confirmed that the OPMs will not dispute that the State's Qualifying Statute constitutes a Model Statute under the MSA. See "—MSA Provisions Relating to Model/Qualifying Statues—*New York 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 Claims; 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, 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, which are made at the same times as the Annual Payments to be made by OPMs. Annual Payments for SPMs are calculated differently, however, from Annual 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, each SPM is required to pay an amount equal to the base amount of the Annual 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 to be made by the SPMs are calculated in a manner different from the calculations for Annual 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 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 the MSA Escrow Agent has disbursed to the County its allocable portions thereof under the MSA. The computation of Annual Payments by the MSA Auditor under the MSA is confidential and may not be used for purposes other than those stated in the MSA. The following table sets forth the County's share of unadjusted payments due to the County pursuant to the MSA and the amounts actually received by the County in the payment years indicated, which may reflect adjustments attributable to prior years' payments.

Payments Made to Date[1]

	County Unadjusted Allocable Share of MSA Base Payment Amount	Actual Receipts[2]
Up-Front Initial Payment	$1,430,000	$1,472,000
2000 Initial Payment	1,472,000	1,282,000
2001 Initial Payment	1,520,000	1,154,000
2002 Initial Payment	1,561,000	1,192,000
2003 Initial Payment	1,609,000	1,276,000
2000 Annual Payment	$2,682,000	$2,061,000
2001 Annual Payment	2,980,000	2,420,000
2002 Annual Payment	3,874,000	3,271,000
2003 Annual Payment	3,874,000	3,189,000
2004 Annual Payment	4,768,000	3,747,000
2005 Annual Payment	4,768,000	3,799,000
2006 Annual Payment	4,768,000	3,476,000
2007 Annual Payment	4,768,000	3,618,000
2008 Annual Payment	4,851,000	4,037,000
2009 Annual Payment	4,851,000	3,751,000
2010 Annual Payment	4,851,000	3,390,000
2011 Annual Payment	4,851,000	3,214,000
2012 Annual Payment	4,851,000	3,277,000
2013 Annual Payment	4,851,000	3,275,000
2014 Annual Payment	4,851,000	3,705,000

(1) Rounded to the nearest thousand.

(2) Reflects adjustments. The Up-Front Initial Payment, the 2000 Initial Payment and the 2000 Annual Payment were paid to the County. Following the execution of the Purchase and Sale Agreement, all subsequent payments (commencing with the 2001 Initial Payment and 2001 Annual Payment) were paid to the Corporation.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the headings "—Initial Payments," "—Annual Payments" and "—Adjustment to Payments." 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 2014, 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 Corporation or the Bondholders.

Disbursement of the funds by the MSA Escrow Agent from the escrow accounts shall occur within ten business days of receipt of the particular funds. The MSA Escrow Agent will disburse the

funds due to, or as directed by, each Settling State in accordance with instructions received from that state.

Advertising and Marketing Restrictions; Educational Programs

The MSA prohibits the PMs from certain advertising, marketing and other activities that may promote the sale of cigarettes and smokeless tobacco products ("**Tobacco Products**"). Under the MSA, the PMs are generally prohibited from targeting persons under 18 years of age within the Settling States in the advertising, promotion or marketing of Tobacco Products and from taking any action to initiate, maintain or increase smoking by underage persons within the Settling States. Specifically, the PMs may not: (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 within the Foundation. The main purpose of the Foundation will be to support programs to reduce the use of Tobacco Products by underage persons and to prevent diseases associated with the use of Tobacco Products. 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 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 the Model Statute, which is a Qualifying Statute.

The MSA provides that if a Settling State enacts a Qualifying Statute that is the 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 on "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)).

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. In recent years legislation has been enacted in the State and all of the other 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—If Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation Were Successful, Payments under the MSA Might be Suspended or Terminated."

Complementary Legislation

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. See "—New York Complementary Legislation" below.

New York Qualifying Statute

Both houses of the New York State Legislature passed a Qualifying Statute, codified as Article 13-G of the Public Health Law, which was signed by the Governor on September 28, 1999 and became effective 60 days after such date. By letter dated August 4, 1999, as affected by a letter dated September 27, 1999, counsel to the OPMs confirmed that the OPMs will not dispute that the State's Qualifying Statute constitutes a Model Statute under the MSA.

In October 2003, the State enacted an Allocable Share Release Amendment to amend Article 13-G by eliminating the provision authorizing an NPM to obtain the release of the amount by which its annual escrow deposit exceeds 12.7620310% of the total payments that the NPM would have made as a PM for that year. Under the State's Allocable Share Release Amendment, an NPM would have been entitled to the release of its escrow deposit only to the extent that it exceeded the total amount that the NPM would have paid as a PM. 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 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.

New York Complementary Legislation

Pursuant to the provisions of Sections 480-b, 481(i)(c) and 1846(a-1) of the State Tax Law (collectively, the "**Complementary Legislation**"), tobacco product manufacturers whose cigarettes are sold in the State are required to annually certify that either (i) they are PMs that have complied with requirements of the MSA or (ii) they have complied with the Public Health Law requirement (the State's Qualifying Statute) to deposit money in a qualified escrow fund. No cigarette tax stamps may be affixed to the cigarettes of any tobacco product manufacturers that do not make such certification. In addition to any other penalties that may be imposed by law, a civil penalty can be imposed on any tobacco product manufacturer who files a false certification or any cigarette tax agent who affixes a cigarette tax stamp in violation of the Complementary Legislation, and such cigarettes can be seized and are subject to forfeiture.

State Statutory Enforcement Framework and Enforcement Agencies for New York

The following information under this subheading "State Statutory Enforcement Framework and Enforcement Agencies for New York" appeared in the Official Statement, dated December 5, 2013, of the Tobacco Settlement Financing Corporation, a public benefit corporation of the State established as a subsidiary of the State of New York Municipal Bond Bank Agency. Although the Corporation has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Corporation has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. Further, neither the State nor the Tobacco Settlement Financing Corporation is making any representation that such information is accurate or complete in connection with the Corporation's issuance and sale of the Series 2014 Senior Bonds. The Series 2014 Senior Bonds are not a debt of the State or the Tobacco Settlement Financing Corporation.

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 New York includes the New York Qualifying Statute and Complementary Legislation (as amended, including the Allocable Share Release Amendments previously described herein), *N.Y. Pub. Health Law §§ 1399-nn–1399-pp*, as well as:

- Imposition of Cigarette Excise and Use Taxes (including New York cigarette tax stamping requirements and tax rates), *N.Y. Tax Law §§ 471, 471-a*;

- Imposition of Tobacco Products Excise and Use Taxes (including tobacco products such as cigars, roll-your-own, other smoking tobacco, snuff and pipe tobacco), *N.Y. Tax Law §§ 471-b, 471-c*;

- Public Health Laws regulating the Sales of Tobacco Products, *N.Y. Pub. Health Law §§ 1399-cc (prohibiting sale of tobacco products, rolling papers, and other accessories to minors), 1399-dd (prohibiting sale of tobacco products and herbal cigarettes in vending machines), 1399-ll (prohibiting sale of bidis), 1399-mm (prohibiting sale of gutka)*;

- Public Health Law banning the retail shipment of cigarettes to New York State residents, *N.Y. Pub. Health Law § 1399-ll*;

- Fire Safe Cigarettes (requiring self-extinguishing cigarettes), *N.Y. Exec. Law § 156-c*; and

- Various implementing regulations promulgated by the Office of the New York Attorney General and the New York State Department of Taxation and Finance.

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 Family Smoking Prevention and Tobacco Control Act of 2009 ("**FSPTCA**") (amending the FDA's Food, Drug and Cosmetics Act).

This statutory enforcement framework is administered and enforced by the Office of the New York Attorney General's Tobacco Compliance Bureau and by the New York State Department of Taxation and Finance's office, including its Transaction Desk Audit Bureau - Cigarette Tax Unit and its Criminal Investigations Division ("**CID**"), among other agencies and divisions.

Attorney General Tobacco Compliance Bureau. The Tobacco Compliance Bureau of the Office of the New York Attorney General (the "**Bureau**") is responsible for enforcing the MSA, maintaining files of compliant NPMs by manufacturer and brand-name, and for receiving and approving the annual compliance certifications from PMs and NPMs. Senior officers or directors of the tobacco products manufacturers must file with the Bureau, under penalty of perjury, annual certifications of compliance. New York State licensed cigarette stamping agents must file with the State Department of Taxation and Finance a monthly report of all sales of cigarettes, including the NPM brands, and such sales must bear New York cigarette tax stamps. Tobacco products distributors that are appointed to pay the tobacco products tax must file monthly reports for sales of roll-your-own. Cigarette and roll-your-own brands and manufacturers that are not properly certified and, in the case of cigarettes, do not bear New York cigarette tax stamps, may not be sold in New York. The State's Qualifying Statute provides an automatic statutory enforcement mechanism that complements the Model Statute and which allows the State to immediately ban the stamping and selling of cigarettes from non-compliant NPMs without the delay of waiting for two

known violations and then obtaining a judgment. Consequently, litigation is not necessary to enforce NPM escrow compliance.

The Bureau and its predecessor units have 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 New York for all "units sold" in the State during the preceding year. As noted above, a "unit sold" is defined as a cigarette upon which State excise tax has been paid and which bears the State's excise tax stamp.

The Bureau 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, the Bureau 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 $6,486,510.53 for the State of New York. 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 Bureau also has participated actively in various multi-state initiatives against certain OPMs to enforce the advertising and promotion restrictions in the MSA.

Department of Taxation and Finance Enforcement Actions. The New York State Department of Taxation and Finance, Criminal Investigations Division coordinates with the U.S. Bureau of Alcohol Tobacco and Firearms in investigating and seizing unstamped cigarettes. The New York State Department of Taxation and Finance may revoke or suspend the license of any New York State licensed cigarette stamping agent and the appointment of any tobacco products distributor that violates Articles 20, 20-A and 37 of the Tax Law in regards to any cigarettes and roll-your-own tobacco that have been sold, offered for sale or possessed for sale in the State or imported into the State.

Department of Taxation and Finance Transaction Desk Audit Bureau Actions. The New York State Department of Taxation and Finance's Transaction Desk Audit Bureau - Cigarette Tax and Registration and Bond Units are responsible for licensing all New York State cigarette stamping agents and appointing all tobacco product distributors, receiving returns filed by agents and distributors of purchases of cigarette and roll-your-own shipments from inside and outside of the State of New York, and enforcing state and federal laws, among other duties. The State also shares data with the U.S. Treasury's Alcohol and Tobacco Tax Bureau and with other state revenue departments and has used the provisions of the Federal Jenkins Act.

Internet Sales Prohibition. New York State Public Health Law prohibits the sale of cigarettes over the Internet to New York State consumers. In February 2011, the Bureau filed suits against six Internet sites for violating New York Public Health Law § 1399-ll. Prior to enactment of the PACT Act in 2010, New York, on behalf of all states, including itself, entered into voluntary compliance agreements with several major national package delivery firms, including FedEx, UPS and DHL, prohibiting the private package delivery to consumers of cigarettes into New York and in other states nationwide. The PACT Act broadens this prohibition to include a prohibition of the delivery of cigarettes by U.S. Mail except to licensed distributors. Because New York State law prohibits internet sales to New York State consumers, Jenkins Act reports are not relevant to internet enforcement in New York.

Nation or Tribal Reservation Cigarette Sales. Under federal case law, Indian nations and tribes are exempt from the 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). For a number of years, the State sought, unsuccessfully, to tax Indian cigarette sales to non-

tribal members. In 2010, the New York State Legislature amended the Tax Law to facilitate the collection of the cigarette excise tax required under New York Tax Law§ 471(1) as to sales of cigarettes to non-Indians and non-nation or tribal members on reservations. With limited exceptions, the 2010 amendments require stamping agents to prepay the tax and affix tax stamps on all cigarette packs sold in New York, including those intended for resale to qualified Indians on the reservation.

Several Indian tribes and nations challenged these amendments and corresponding regulations. In May 2011, the Court of Appeals for the Second Circuit affirmed the denial of the preliminary injunction by the District Court for the Western District of New York as to four Indian nations and tribes and vacated the injunction issued by the District Court for the Northern District of New York as to the remaining challenging Indian nation. *Oneida Nation of New York v. Cuomo*, 645 F.3d 154 (2nd Cir. 2011). In State court, the Seneca Nation was granted a temporary restraining order (a "**TRO**") in Supreme Court, Erie County, in its challenge to the promulgation of the permanent regulations under the State Administrative Procedures Act ("**SAPA**"), pending the outcome of the motion and cross-motions for summary judgment. On June 8, 2011, State Supreme Court, Erie County denied the Seneca Nation's motion for summary judgment, granted the State's summary judgment motion and lifted the TRO. *Seneca Nation of Indians v. New York State Dept. of Taxation and Finance,* 91 Misc.3d 1242 (A) (N.Y. Sup. June 8, 2011). On June 9, 2011, the Appellate Division, Fourth Department issued a TRO enjoining enforcement of the 2010 amendments until a decision on the Seneca Nation's motion for a preliminary injunction pending appeal of the Supreme Court's June 8th Order. On June 10, 2011, the TRO was extended to enjoin enforcement against any Indian nation or tribe in the State. On June 21, 2011, the Appellate Division vacated the TRO. On September 20, 2011, the New York Court of Appeals denied motion for leave to appeal and the motion for a stay. On November 18, 2011, the State Supreme Court, Erie County, modified its judgment to note that the State had complied with necessary legislation and affirmed judgment so modified. On February 21, 2012, the Court of Appeals of New York denied motion for leave to appeal.

On June 21, 2011, the New York State Department of Taxation and Finance began implementing the Indian tax exemption coupon and prior approval systems. Wholesale dealers (including agents) are required to collect the cigarette excise tax and prepaid sales tax on all cigarettes sold for resale on an Indian reservation to non-Indians and non-members of such Indian nation or tribe. All packs of cigarettes sold by wholesale dealers to Indian nations and tribes and reservation cigarette sellers are required to have State tax stamps affixed to them. Wholesale dealers may sell stamped packs of cigarettes to Indian nations and tribes and reservation cigarette sellers exempt from tax to the extent Indian tax exemption coupons are provided or to the extent prior approval is received from the Tax Department. These systems continue to be available.

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, Settling States' Qualifying Statutes, Complementary Legislation and related 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, as well as injunctions against the enforcement of

the Qualifying Statutes and the related legislation. 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. To date, such challenges to the MSA, Qualifying Statutes, Complementary Legislation and related legislation have not been ultimately successful. The MSA, Qualifying Statutes, Complementary Legislation and related legislation may also continue to be challenged in the future.

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 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 Status

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

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

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 general, 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 constitutional claims. As to the Commerce Clause claim, the Second Circuit held that the plaintiffs "stated 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 approved by order of the Second Circuit on August 10, 2012, rendering the case final 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 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 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*; the Ninth Circuit, in *Sanders v. Brown*; and multiple lower courts.

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, the County and the Corporation 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 TSRs available to the Corporation and could ultimately result in the complete cessation of the TSRs available to the Corporation. 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 2014 Senior Bonds. See "LEGAL CONSIDERATIONS RELATING TO TSRS" for a further discussion of these matters as well as a description of the opinion of Harris Beach PLLC, Bond Counsel to the Corporation, 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 TSRs available to the Corporation below the respective amounts required to pay the Series 2014 Senior Bonds and could lead to a decrease in the market value and/or the liquidity of the Series 2014 Senior 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 recent settlement entered into by 24 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 by the PMs due to application of the Volume Adjustment, even for Settling States (including the State) that have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and are thus exempt from the NPM Adjustment. In addition, tobacco product manufacturers have introduced a number of alternative cigarette products, including electronic cigarettes, which do not constitute "cigarettes" within the meaning of the MSA. If consumers use these products in lieu of smoking traditional cigarettes, it could reduce the size of the traditional cigarette market. See "BONDHOLDERS' RISKS—Declines in Cigarette

Consumption May Materially Adversely Affect TSRs available for the Series 2014 Senior Bonds." Furthermore, 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, but 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 TSRs available to the Corporation.

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 recent settlement entered into by 24 jurisdictions (which did not include the State), the OPMs and certain of the SPMs, and the calculation and application of the NPM Adjustment under such settlement.

<u>Description of the NPM Adjustment</u>. 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. As noted above under "—Adjustments to Payments," 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 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 for Annual Payments applied to any Settling State in any given year exceed the amount of Annual 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 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 for Annual Payments applied to the County in the year following such determination could be as great as the amount of Annual Payments that could otherwise have been received by the County in such year, and could have a material adverse effect on the amount and/or timing of TSRs available to the Corporation.

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 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

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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.

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, the State 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 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 TSRs available to the Corporation.

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 2014 Senior Bonds do not include any NPM Adjustments or withholdings or Disputed Payments Account deposits relating to PM claims of entitlement to NPM Adjustments, based on the assumptions that the State has diligently enforced 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 TSRs available to the Corporation. See "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

<u>Settlement of 1999 through 2002 NPM Adjustment Claims</u>. 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 2013 NPM Adjustment Claims," 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 2013 NPM Adjustment Claims Generally. 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 $9.4 billion, for the sales years 2003 through 2013 as part of the NPM Adjustment. 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 2013, which could lead to offsets against the TSRs paid in future years. 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 certain states' 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.

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. According to Reynolds American's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, 47 of the 48 courts that had addressed the question whether the dispute concerning the 2003 NPM Adjustment is arbitrable had ruled that arbitration is required under the MSA. The Montana Supreme Court ruled that Montana did not agree to arbitrate the question of whether it diligently enforced a Qualifying Statute and that diligent enforcement claims of that state must be litigated in state court, rather than in arbitration. Subsequently, in June 2012, Montana and the PMs reached an agreement whereby the PMs agreed not to contest Montana's claim that it diligently enforced the Qualifying Statute during 2003 and therefore Montana would 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 non-contested states that did not enter into the NPM Adjustment Settlement Term Sheet 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 were 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, the nine states, including the State, that were determined to have diligently enforced their respective Qualifying Statutes, as well as the jurisdictions that were either not contested or were not subject to the arbitration proceedings, were not to be subject to the 2003 NPM Adjustment, and their share of the 2003 NPM Adjustment was to 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. Indiana and Kentucky, two of the six states that were held to be non-diligent for 2003, subsequently joined the NPM Adjustment Settlement Term Sheet in June 2014, as discussed herein. According to Lorillard, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, the OPMs are entitled to receive $458 million plus interest and earnings as a result of the Arbitration Panel's ruling.

All six of the states that were determined by the Arbitration Panel's final awards not to have diligently enforced their Qualifying Statutes in 2003 filed motions in their state courts to vacate such final awards with respect to those states. On April 10, 2014, the MSA court in Pennsylvania denied Pennsylvania's motion to vacate the Arbitration Panel's award that found that Pennsylvania had not diligently enforced its Qualifying Statute during 2003, thereby upholding the Arbitration Panel's non-diligence finding for Pennsylvania. However, the court granted Pennsylvania's motion to modify, with respect to Pennsylvania, that portion of the Arbitration Panel's NPM Adjustment Stipulated Partial Settlement and Award (discussed below) that specified the reduction method for the 2003 NPM Adjustment, and ruled that the states that signed the NPM Adjustment Term Sheet (discussed below) and had been contested in the 2003 NPM Adjustment arbitration would be deemed non-diligent for purposes of calculating Pennsylvania's share of the 2003 NPM Adjustment, resulting in a partial reduction of Pennsylvania's share of the 2003 NPM Adjustment allocation. As a result, the credits that the PMs received against their April 2014 MSA payment in respect of the 2003 NPM Adjustment were reduced. The OPMs appealed this ruling on May 7, 2014. On May 2, 2014, the Missouri state court issued a similar ruling, holding that Missouri's penalty had been wrongly enhanced by redistributing the share of the penalty that otherwise would have been paid by the Term Sheet Signatories. On June 3, 2014, Missouri appealed the court's decision in which the court upheld the non-diligence finding, challenging

the fairness of the hearings and seeking a ruling that Missouri's future arbitration hearings be held in a separate venue. The OPMs have appealed the Missouri court's ruling to modify the Arbitration Panel's NPM Adjustment Stipulated Partial Settlement and Award, and if they are unsuccessful they will be required to return to Missouri a portion of the credits received against their April 2014 MSA payments in respect of the 2003 NPM Adjustment, plus applicable interest. Altria stated in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that if Philip Morris is not successful in its appeal of the Missouri court's ruling modifying the NPM Adjustment Stipulated Partial Settlement and Award, it will be required to return to Missouri approximately $12 million (subject to confirmation by the MSA Auditor) of the $116 million credit that Philip Morris received against its April 2014 MSA payment in respect of the 2003 NPM Adjustment, plus applicable interest on that amount. On April 11, 2014, a Kentucky state court denied Kentucky's motion for an order staying and enjoining (a) the Arbitration Panel's NPM Adjustment Stipulated Partial Settlement and Award with respect to the judgment reduction method applicable to Kentucky for the 2003 NPM Adjustment and (b) the Arbitration Panel's award that Kentucky did not diligently enforce its Qualifying Statute during 2003. On June 10, 2014, Kentucky joined the NPM Adjustment Settlement Term Sheet, and on June 26, 2014 Indiana joined the NPM Adjustment Settlement Term Sheet, each on different and less advantageous financial terms than those obtained by previous Term Sheet Signatories, as discussed below. According to Altria in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, in connection with these settlements, Kentucky and Indiana are in the process of staying their motions to vacate or modify the Arbitration Panel's NPM Adjustment Stipulated Partial Settlement and Award and the Arbitration Panel's rulings as to their diligence, while the other four non-diligent states continue to pursue their motions.

According to Lorillard, Inc. in its Form 10-Q filed with the SEC for the three-month period ended March 31, 2014, the MSA Auditor (defined below) issued final calculations on March 31, 2014 for the April 2014 MSA payment that implement the 2003 NPM Adjustment through the non-diligent states receiving reductions in future MSA payments they receive and the OPMs and diligent states receiving amounts due to them through payments from the Disputed Payments Account and/or adjustments associated with future payments, and on April 14, 2014 the MSA Auditor issued revised final calculations for the April 2014 MSA payments that implement the Pennsylvania court's ruling. The April 2014 MSA payment as it relates to the states and the PMs accounted for the Arbitration Panel's findings with respect to the 2003 NPM Adjustment, as modified by the Pennsylvania court's ruling, through adjustments to the MSA payment amounts and a release from the Disputed Payments Account, but according to Reynolds American's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, until such time as the various remaining state motions challenging the rulings of the Arbitration Panel have been resolved, uncertainty exists as to the timing, process and amount of ultimate recovery with respect to the remaining share of the 2003 NPM Adjustment claim. On May 2, 2014, Missouri sent a letter to the MSA Auditor instructing the MSA Auditor to recalculate Missouri's 2003 NPM Adjustment liability and issue a special payment to Missouri in light of the Missouri MSA court's decision. On June 23, 2014 the MSA Auditor issued revised final calculations for the April 2014 MSA payments that implement the Missouri ruling, according to Lorillard, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

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 New York in the 2003 NPM Adjustment Proceedings is attached hereto as Appendix C.

Ongoing 2004 Through 2013 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 – 2012 (the "**significant factor agreement**"). This agreement became effective for sales years 2007, 2008, 2009, 2010 and 2011 on February 1, 2010, 2011, 2012, 2013 and 2014 respectively, and will become effective for sales year 2012 on February 1, 2015. According to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, a significant factor proceeding for 2013 cannot be commenced until April 2015.

According to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, Philip Morris believes that the MSA requires state claims of diligent enforcement for 2004 - 2013 to be determined in a national arbitration, although a number of Term Sheet Non-Signatories, which did not join the NPM Adjustment Settlement Term Sheet described below, have filed motions in their state MSA courts contending, or have reserved rights to contend, that such claims for those years are to be determined either in separate arbitrations for each state or in state court on a state-by-state basis. Proceedings with respect to diligent enforcement claims for the sales years 2004 through 2013 have not yet been scheduled, but Reynolds American reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that preliminary discussions are underway with the Term Sheet Non-Signatories to initiate arbitration proceedings with respect to the 2004 NPM Adjustment. Altria has reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that no assurance can be given as to if and when proceedings for 2004-2013 will be scheduled or the precise form those proceedings will take. In addition, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, the amounts of the NPM Adjustments for 2004-2013 that have been calculated by the MSA Auditor will be reduced in light of the NPM Adjustment Settlement Term Sheet described below to determine the maximum amount of such adjustments potentially available from the Term Sheet Non-Signatories (the NPM Adjustment Stipulated Partial Settlement and Award did not specify the reduction method applicable to the 2004-2013 NPM Adjustment claims); the amounts of the NPM Adjustments for 2004 through 2013 that have been calculated by the MSA Auditor 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 its calculations, including, among other things, if it receives revised sales volumes from any PM; disputes among the manufacturers could also affect the amounts; and the availability and amount of any NPM Adjustment for 2004 - 2013 obtained through arbitration proceedings against the Term Sheet Non-Signatories (as opposed to the NPM Adjustment Settlement

Term Sheet described below) will not be finally determined in the near term. Altria has further stated in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that it continues to reserve all rights regarding the NPM Adjustments with respect to the Term Sheet Non-Signatories and intends to continue to pursue vigorously the disputed NPM Adjustments for sales years 2004 - 2013 against the Term Sheet Non-Signatories. It is possible that Term Sheet Non-Signatories (such as the State) could enter into settlements with regard to the NPM Adjustments for sales years 2004 and beyond.

The approximate maximum principal amounts of the PMs' aggregate share of the disputed NPM Adjustment for the sales years 2003 through 2013 (payment years 2004 through 2014), as reported by NAAG, and without regard to the effects of the NPM Adjustment Settlement Term Sheet and the Stipulated Partial Settlement and Award discussed below, are as follows:

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OPM and SPM Maximum Potential NPM Adjustment Amounts

Sales Years 2003-2013 (Payment Years 2004-2014) [(1)]

	Sales Year 2003 (Payment Year 2004)	Sales Year 2004 (Payment Year 2005)	Sales Year 2005 (Payment Year 2006)	Sales Year 2006 (Payment Year 2007)	Sales Year 2007 (Payment Year 2008)	Sales Year 2008 (Payment Year 2009)	Sales Year 2009 (Payment Year 2010)	Sales Year 2010 (Payment Year 2011)	Sales Year 2011 (Payment Year 2012)	Sales Year 2012 (Payment Year 2013)	Sales Year 2013 (Payment Year 2014)
OPMs											
Annual Payment	$1,061,158,548.39	$1,061,288,733.95	$702,715,076.82	$646,394,781.27	$626,577,960.85	$733,259,041.08	$704,682,906.24	$720,900,101.29	$601,918,327.47	$650,595,746.07	$677,336,376.22
SPMs											
Annual Payment	$86,407,516.48	$76,107,191.03	$50,630,561.09	$53,949,636.76	$42,733,823.61	$60,378,182.91	$62,807,562.71	$59,097,501.45	$46,626,494.22	$48,875,804.10	$44,639,809.41
Totals for Annual Payments[(2)]	$1,147,566,064.87	$1,137,395,924.98	$753,345,637.91	$700,344,418.03	$669,311,784.46	$793,637,223.99	$767,490,468.95	$779,997,602.74	$648,544,821.69	$699,471,550.17	$721,976,185.63

[(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)] N.B.: Strategic Contribution Payments are not reflected in this table.

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.

Altria has stated in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that the MSA Auditor calculated the following approximate amounts as Philip Morris's maximum potential share of the NPM Adjustments for the years 2003 - 2013 (exclusive of interest or earnings): $337 million for 2003, $388 million for 2004, $181 million for 2005, $154 million for 2006, $185 million for 2007, $250 million for 2008, $211 million for 2009, $219 million for 2010, $165 million for 2011, $207 million for 2012 and $215 million for 2013. Philip Morris further reported 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 from such MSA payments. Philip Morris paid its share of the amount of the disputed 2008, 2009, 2010 and 2011 NPM Adjustments into the Disputed Payments Account in connection with its MSA payments due in 2011, 2012, 2013 and 2014, respectively. Philip Morris has further reported through Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that Philip Morris deposited the allocable share of the 2011 NPM Adjustment for the Term Sheet Signatories (as defined below) into the Disputed Payments Account in connection with its April 2014 MSA payment and then, following such deposit, authorized the release of such share to the Term Sheet Signatories as provided in the NPM Adjustment Stipulated Partial Settlement and Award, discussed below. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that Philip Morris also authorized the release of additional funds from the Disputed Payments Account to Kentucky and Indiana after those two states joined the NPM Adjustment Settlement Term Sheet in June 2014. Altria had also reported in its Form 10-K filed with the SEC for calendar year 2013 that Philip Morris will deposit the Term Sheet Signatories' allocable share of its portion of the 2012 NPM Adjustment into the Disputed Payments Account in connection with its April 2015 MSA payment and then, following such deposit, will authorize the release of such share to the Term Sheet Signatories as provided in the NPM Adjustment Stipulated Partial Settlement and Award.

Philip Morris has reported its expectation of receiving its share of any NPM Adjustments for 2004 - 2007 likely in the form of a credit against future MSA payments and its share of any NPM Adjustments for 2008 - 2013 in the form of either a withdrawal from the Disputed Payments Account and/or a credit against future MSA payments. Any adjustments made in the form of a credit against future MSA payments could lead to material reductions in the TSRs. However, Altria noted in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that the receipt by Philip Morris of a credit against its April 2014 MSA payment in respect of the 2003 NPM Adjustment and interest thereon does not provide any assurance that Philip Morris will receive any NPM Adjustment amounts (or associated interest or earnings) for 2004 or any subsequent year.

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, 2014 that Reynolds Tobacco has disputed a total of approximately $3.69 billion for the payment years 2004 through 2011 in connection with the NPM Adjustment, and has also filed dispute notices with respect to its 2012 and 2013 annual MSA payments relating to the NPM Adjustments potentially applicable to those years, aggregating for those two years approximately $880 million.

In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, Lorillard, Inc. reported that during April 2014, it deposited $93 million into the Disputed Payments Account for the 2011 NPM Adjustment and for adjustments related to Disputed Payments Account payments for other years. In April of 2013, 2012, 2011, 2010, 2009, 2008, 2007 and 2006, Lorillard, Inc. had previously

deposited $119 million, $106 million, $104 million, $83 million, $73 million, $72 million, $111 million and $109 million, respectively, in the Disputed Payments Account, based on a loss of market share in 2010, 2009, 2008, 2007, 2006, 2005, 2004 and 2003 to NPMs. In February 2009, Lorillard, Inc. directed the release of $72 million from the Disputed Payments Account to the MSA states, related to the loss of market share in 2005. In addition, Lorillard, Inc. reported in its SEC filing that in April 2013, October 2013, April 2014 and June 2014, it directed the release of $298 million, $22 million, $40 million and $12 million, respectively, from the Disputed Payments Account to the Term Sheet Signatories. In addition, in April 2014, Lorillard directed the release of $62 million to itself from the Disputed Payments Account in connection with the 2003 NPM Adjustment arbitration decisions.

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 (which did 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. The 19 jurisdictions that signed the NPM Adjustment Settlement Term Sheet on December 17, 2012 were 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, on May 24, 2013, Connecticut and South Carolina joined the NPM Adjustment Settlement Term Sheet, on June 10, 2014, Kentucky joined the NPM Adjustment Settlement Term Sheet (on modified terms), and on June 26, 2014, Indiana joined the NPM Adjustment Settlement Term Sheet (on modified terms), bringing the total number of jurisdictions that have joined the settlement to 24, representing approximately 50% 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 will 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 April 2013 MSA payments, 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 April 2013 MSA payments. The MSA Auditor also implemented the NPM Adjustment Stipulated Partial Settlement and Award as it related to the April 2014 MSA payment, as discussed herein. It is expected that, pursuant to the terms of settlements between Kentucky and the PMs, and Indiana and the PMs, respectively, by which Kentucky and Indiana each became Term Sheet Signatories, the PMs will receive additional credits with respect to the April 2015 MSA payment and Kentucky and Indiana will each receive releases from the Disputed Payments Account in 2014.

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 directed 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 directed 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), would be on a *pro rata* basis: the dollar amount of the 2003 NPM Adjustment would 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 and April 2014 following the NPM Adjustment Stipulated Partial Settlement and Award, the OPMs and certain SPMs have received certain reductions in 2013 and 2014 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 the Form 10-Q filed with the SEC by Altria for the six-month period ended June 30, 2014, except for Kentucky and Indiana, which joined in the NPM Adjustment Settlement Term Sheet in June 2014, the settlement provides for the OPMs to receive reductions to their MSA payments in an amount equal to 46% of the

Term Sheet Signatories' aggregate allocable share of the OPMs' aggregate 2003-2012 NPM Adjustments, plus interest, and that 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. Altria further reported in its Form 10-Q that, based on the Term Sheet Signatories as of April 15, 2013, the reduction under the NPM Adjustment Settlement Term Sheet in Philip Morris's April 2013 MSA payment obligation was approximately $483 million, and that Philip Morris received all of such amount through a credit against that MSA payment. Philip Morris also reported that it received an additional credit of $36 million against its April 2014 MSA payment as a result of the two additional states joining the NPM Adjustment Settlement Term Sheet in 2013 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, 2014, Reynolds American reported that, based on the jurisdictions bound by the NPM Adjustment Settlement Term Sheet through December 31, 2013, Reynolds Tobacco and Reynolds American's subsidiary Santa Fe Natural Tobacco Company, Inc., an SPM, will receive credits that they currently estimate to total approximately $1.1 billion 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, which commenced with the April 2013 MSA payment. As a result of the two states, Indiana and Kentucky, that joined the NPM Adjustment Settlement Term Sheet in June 2014, Reynolds Tobacco and Santa Fe Natural Tobacco Company, Inc. collectively will receive credits that they currently estimate to total approximately $170 million with respect to their NPM Adjustment claims from 2003 through 2012, to be applied against annual payments under the MSA over a five-year period. In addition, Reynolds American reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as a result of meeting the various performance obligations associated with the NPM Adjustment Settlement Term Sheet, Reynolds American (for both Reynolds Tobacco and Santa Fe Natural Tobacco Company, Inc.) recognized additional credits of $154 million and $132 million for the six months ended June 30, 2014 and 2013, respectively. According to Reynolds American's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, Reynolds Tobacco expects to recognize additional credits through 2017. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, Lorillard, Inc. reported that it currently expects to receive credits over six years of approximately $254 million on its outstanding claims, with $165 million having occurred in April 2013, $36 million having occurred in April 2014 (including $14 million received in April 2014 related to the 2003 NPM Adjustment award from the two states, Kentucky and Indiana, that joined the NPM Adjustment Settlement Term Sheet in June 2014) and approximately $53 million over the following five 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. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that in such context Philip Morris authorized the release to the Term Sheet Signatories of their allocable share of the $658 million that Philip Morris paid into the Disputed Payments Account (plus the accumulated earnings thereon), which amounted to approximately $272 million. In addition, Philip Morris authorized the release of additional funds from the Disputed Payments Account to the two signatory states that joined the NPM Adjustment Settlement Term Sheet in 2013 after the date of the April 2013 MSA payment, in an amount of approximately $22 million. As noted above under "Ongoing 2004 Through 2013 NPM Adjustment Claims", Philip Morris reported that it deposited the Term Sheet Signatories' Allocable Share of their portion of the 2011 NPM Adjustment into the Disputed Payments Account in connection with the April 2014 MSA payment and then, following such deposit, authorized the release of such share to the Term Sheet Signatories as provided in the NPM Adjustment Stipulated Partial Settlement and Award. Furthermore, it is expected that under the terms of settlement agreed to between Kentucky and the PMs, Kentucky will receive an additional payment in 2014 of approximately $83 million from the Disputed Payments Account attributable to the 2004 through 2011 NPM Adjustments, and it is expected that under

the terms of settlement agreed to between Indiana and the PMs, Indiana will receive over the two years following the settlement approximately $217 million. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that Philip Morris authorized the release of additional funds from the Disputed Payments Account to Kentucky and Indiana in an amount of approximately $31 million.

The NPM Adjustment Settlement Term Sheet provided for the Term Sheet Signatories to 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 is 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.

Pursuant to the agreements by which Kentucky and Indiana joined the NPM Adjustment Settlement Term Sheet in June 2014, the settlement with respect to those states includes the modified terms that the OPMs are to receive reductions to their MSA payments in an amount equal to the sum of (i) 65% of the amount of the 2003 NPM Adjustment applicable to those states under the Arbitration Panel's award, plus 65% of interest and earnings on that amount as was calculated by the MSA Auditor, and (ii) 55% of those states' aggregate allocable share of the OPMs' aggregate 2004 - 2012 NPM Adjustments plus interest. All other terms of settlement as discussed above apply to Kentucky and Indiana.

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. As an initial step, 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 objected to and would 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.

Subsequently, motions were filed by 14 Term Sheet Non-Signatories (including the State) in their respective MSA courts to vacate and/or modify the NPM Adjustment Stipulated Partial Settlement and Award. Lorillard, Inc. reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as of July 25, 2014, claims in 11 states remain pending, as one state (Massachusetts) withdrew its opposition and two states (Connecticut and South Carolina) joined the NPM Adjustment Settlement Term Sheet. According to Altria in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, Kentucky and Indiana (both of whom joined the NPM Adjustment Settlement Term Sheet in June 2014) are in the process of staying their motions to vacate or modify the NPM Adjustment Stipulated Partial Settlement and Award. Two of the states (Colorado and Ohio) had also unsuccessfully sought to preliminarily enjoin the implementation of the NPM Adjustment Stipulated Partial Settlement and Award (the MSA Auditor carried out the implementation of the NPM Adjustment Stipulated Partial Settlement and Award over the objections of the Term Sheet Non-Signatories, as discussed above). 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 TSRs available to the Corporation to pay debt service on the Series 2014 Senior Bonds.

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

Disputes concerning Annual 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. 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 TSRs available to the Corporation. 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 are found to have diligently enforced their Qualifying Statutes, or pursuant to a settlement of the disputes among the Settling States and the PMs, all as discussed above under "—*NPM Adjustment*". The Collection Methodology and Assumptions and debt service coverage tables for the Series 2014 Senior Bonds do not include any NPM Adjustments 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, and do not factor in any release of funds currently held in the Disputed Payments Account. 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 the "roll-your-own" tobacco conversion of 0.0325 ounces for one individual cigarette should continue to be used for purposes of calculating the downward Volume Adjustments to the MSA payments, 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 continue to be determined based on the "net" number of cigarettes on which federal excise tax is paid, or, rather, an "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. In the "net vs. gross" dispute, PMs contended that the MSA requires calculations based on a gross approach, while the Settling States contended 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, 2014 that it is unclear precisely which past and future MSA payments may be affected by this ruling.

NEW YORK CONSENT DECREE

The following summary describes certain provisions of 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, which is attached hereto as Appendix B.

Introduction and Overview

On December 23, 1998, the Consent Decree and Final Judgment (as corrected on April 14, 1999, the "**Consent Decree**"), which governs the class action portion of New York State's action against the tobacco companies, was entered in the Supreme Court of the State of New York for New York County. The Consent Decree contains provisions governing, among other things: (i) the jurisdiction of the court over the parties; (ii) the scope of the Consent Decree; (iii) the required monetary payments by the PMs; (iv) the marketing restrictions and other equitable relief; and (v) the mechanism for enforcing the provisions of the MSA and the Consent Decree. With respect to the intra-state matters, the Consent Decree provides for: (i) the allocation of the amounts in the New York state-specific account among the State, the City, the County and the other counties of New York; (ii) limitations on the rights of the City, the County and the other counties to enforce the provisions of the Consent Decree; and (iii) the release and dismissal of claims by the City, the County and the other counties. The Consent Decree was affirmed by the Appellate Division and is not subject to further appeal.

Calculating the County's Share

According to the formula set forth in the MSA, the State is entitled to 12.7620310% of the total amount of Annual Payments deposited in the national escrow account. The allocation of the State's share of Annual Payments to be made pursuant to the MSA to the State, the City, the County and the other counties of New York is set forth in the Consent Decree, which provides that the County is to receive 0.467% of the State's share of Annual Payments.

Under the MSA, the State is also entitled to receive a specified percentage of Strategic Contribution Payments. The Consent Decree allocates all of such Strategic Contribution Payments to the State. Therefore, the County, pursuant to the Consent Decree, is not entitled to any portion of the Strategic Contribution Payments.

Rights to Enforce Provisions of the Consent Decree

In addition to allocating the Annual Payments among the State, the City, the County and the other counties, the Consent Decree defines who may enforce the provisions of the Consent Decree. The Consent Decree expressly states that it only confers rights upon, and may be enforced only by, the State or a PM (or other Released Party under the MSA). As a result, only the State is entitled to enforce the PMs' payment obligations, and the State is prohibited expressly from assigning or transferring its enforcement rights. The Consent Decree does provide, however, that the City, the County or the other counties of the State may enforce their payment rights against the State, the City or the other counties.

Release and Dismissal of Claims

The Consent Decree further provided that, effective upon the occurrence of State-Specific Finality in the State (which was achieved on February 25, 2000), the City, the County and the other counties unconditionally released and discharged all released claims against all Released Parties to the same extent that the State released its claims pursuant to the MSA. The City, the County and the other counties of New York have agreed that, after the occurrence of State-Specific Finality, they would not seek to establish civil liability against any Released Party upon any released claim and that such agreement would be a complete defense to any such civil action or proceeding.

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 Corporation has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Corporation has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. Prospective investors in the Series 2014 Senior Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2014 Senior Bonds is consistent with their investment objectives.

MSA payments are computed based in part on cigarette shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The 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. 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" and "—Annual 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 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 85.20% of the U.S. domestic cigarette market in sales year 2013 measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate and approximately 84.95% measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate. However, according to publicly available documents of the OPMs, at year-end 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), as discussed in "Industry Market Share" below. The market for cigarettes in the U.S. divides generally into premium and discount sales. As reported by Lorillard, at December 31, 2013, the discount segment of the domestic tobacco industry represented approximately 26.5% of domestic tobacco sales (and 26.1% for the six months ended June 30, 2014).

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-Q filed with the SEC for the six-month period ended June 30, 2014, Altria reported that Philip Morris's domestic cigarette market share for the six months ended June 30, 2014 was 50.8% (based on retail sales data from IRI/MSAI, a tracking service that uses a sample of stores and certain wholesale shipments to project market share and depict share trends), which represents an increase from its reported domestic market share of 50.6% for the six months ended June 30, 2013. In its Form 10-K filed with the SEC for calendar year 2013, Altria reported that Philip Morris's domestic cigarette market share for calendar year 2013 was 50.6% (based on retail sales data from IRI/MSAI), which represents an increase from its reported domestic market share (based on retail sales) of 50.3% for calendar year 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 2013 as well as for the six months ended June 30, 2014, according to Altria's Form 10-K filed with the SEC for calendar year 2013 and Form 10-Q for the six-month period ended June 30, 2014, respectively). Marlboro is also the largest selling cigarette brand in the U.S., with approximately 43.8% and 43.7% of the U.S. domestic retail share at June 30, 2014 and June 30, 2013, respectively, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, 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.

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-Q filed with the SEC for the six-month period ended June 30, 2014, Reynolds American reported that Reynolds Tobacco's domestic retail cigarette market share at June 30, 2014 was

26.5% (measured by sales volume), which represents a decrease from the 26.6% market share at June 30, 2013. In its Form 10-K filed with the SEC for calendar year 2013, Reynolds American reported that Reynolds Tobacco's domestic retail cigarette market share at December 31, 2013 was 26.0%, which represents a decrease from the 26.5% market share at December 31, 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 an IRI/Capstone model ("**IRI/Capstone**"), which was designed to measure retail share in stores representing trade channels where the majority of tobacco industry products are sold and resource investments are made.

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-Q filed with the SEC for the six-month period ended June 30, 2014, Lorillard, Inc. reported that its domestic retail cigarette market share for the six months ended June 30, 2014 was 15.1% (measured by wholesale shipment volume), which represents an increase from 14.8% for the six months ended June 30, 2013. In its Form 10-K filed with the SEC for calendar year 2013, Lorillard, Inc. reported that its domestic retail cigarette market share in 2013 was 14.9%, which represents an increase from 14.4% for calendar year 2012. Lorillard's principal brands are Newport, Kent, True, Maverick and Old Gold. Its largest selling brand is Newport, which accounted for approximately 88.6% of Lorillard's cigarette segment net sales for the six months ended June 30, 2014, an increase from 88.2% for the six months ended June 30, 2013 (and approximately 88.3% of Lorillard's cigarette segment net sales for the fiscal year ended December 31, 2013, an increase from 87.8% for the year 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 database administered by MSAI, which reflects shipments from wholesalers to retailers.

Reynolds American and Lorillard, Inc. announced on July 15, 2014 that the two companies have entered into a definitive agreement in which Reynolds American will acquire Lorillard, Inc. for approximately $27.4 billion, creating the second largest tobacco company in the United States, which will control approximately one-third of the U.S. tobacco market. The terms of the transaction have been approved by the boards of directors of both companies. British American Tobacco Plc ("**British American**"), which owns 42% of Reynolds American, has agreed to vote its shares in favor of the transaction and will maintain its 42% ownership of Reynolds American through an investment of approximately $4.7 billion. Reynolds American expects to benefit from the addition of Lorillard's Newport brand as a key component of its growth-brand strategy in the U.S. menthol category. In addition, Reynolds American and British American have agreed in principle to pursue an ongoing technology-sharing initiative for the development and commercialization of next-generation tobacco products, including heat-not-burn cigarettes and vapor products. Shareholders of both Lorillard, Inc. and Reynolds American have filed suit to block the proposed merger, claiming breach of fiduciary duties by the respective companies.

Reynolds American stated that it has also reached a deal for Imperial Tobacco Group PLC ("**Imperial Tobacco**") to purchase Reynolds American's Kool, Salem and Winston cigarette brands, Lorillard's Maverick cigarette brand and blu eCig electronic cigarette brand, and other assets, for $7.1 billion, in an effort to ease the antitrust scrutiny that the Reynolds American merger with Lorillard, Inc. may face. The addition of these brands to Imperial Tobacco's U.S. operations will more than triple its share of the U.S. cigarette market, improve its position in the traditional tobacco products and e-cigarette categories, and elevate it to the status of a major U.S. competitor in the tobacco industry. Pursuant to Section XVIII(c) of the MSA, which states that "[n]o 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 … 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," the OPM payment obligations under the MSA with respect to the cigarette brands, brand names, cigarette product formulas and businesses acquired by Imperial Tobacco will be assumed and continued by Imperial Tobacco. These transactions are subject to various closing conditions, including regulatory approval. The companies expect the closings to take place in the first half of 2015, and at substantially the same time.

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market for calendar year 2013 (and for the six-month period ended June 30, 2014) 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, which markets deep discount brands. Liggett, Vector Tobacco and CBI are SPMs under the MSA.

In its Form 10-K filed with the SEC for calendar year 2013, Vector Group Ltd. reported that its subsidiary Liggett's domestic market share in calendar year 2013 was 3.3%, measured by MSAI shipment volume data (compared to 3.5% during 2012 and 3.8% during 2011). Vector Group Ltd. also reported in its Form 10-K filed with the SEC for calendar year 2013 that its subsidiary 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 1.63% of the U.S. cigarette market, and that its subsidiary 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 calendar year 2013 (and all years since 2004) were in the discount segment (and Liggett's share of the discount segment was 11.6% during 2013, 12.1% during 2012 and 12.8% during 2011, according to Vector Group Ltd.'s Form 10-K filed with the SEC for calendar year 2013). Vector Group Ltd.'s brands include Liggett Select, Grand Prix, Eve, Pyramid, Eagle 20's (relaunched as a deep discount brand in January 2013) and USA. Vector Group Ltd.'s subsidiary Vector Tobacco is focused on developing reduced risk cigarette products.

Imperial Tobacco is listed on the London Stock Exchange and does not file quarterly or annual reports with the SEC. In its annual report for the fiscal year ended September 30, 2013, Imperial Tobacco did not disclose its market share of the U.S. cigarette market, but indicated in such annual report that the U.S. market posed challenges, and had 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. The brands of Imperial Tobacco's subsidiary CBI include USA Gold, Sonoma and Fortuna. As noted above, following the Reynolds American and Lorillard, Inc. merger, and the related divestiture of assets, Imperial Tobacco would gain the Kool, Salem, Winston and Maverick cigarette brands and the blu eCigs electronic cigarette brand.

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	2013
Philip Morris	49.9%	49.8%	49.0%	49.8%	50.6%
Reynolds Tobacco	28.3	28.1	27.6	26.5	26.0
Lorillard**	11.8	12.9	14.1	14.4	14.9
Other***	10.0	9.2	9.3	9.3	8.5

*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 seven years ended December 31, 2013. 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
2013	273.3	(4.6)%
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 the parent companies 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 under the MSA.

According to data from NAAG, overall shipments dropped approximately 4.86% to 276.209 billion cigarettes in sales year 2013 from 290.307 billion cigarettes in sales year 2012 measuring roll-your-own tobacco sales at 0.0325 ounces per cigarette conversion rate (or approximately 4.80% to 275.021 billion cigarettes in sales year 2013 from 288.874 billion cigarettes in sales year 2012 measuring roll-your-own tobacco sales at 0.09 ounces per cigarette conversion rate). According to NAAG data, domestic U.S. cigarette shipments over the past 10 reported sales years was approximately as set forth in the table below.

Sales Year	No. of Cigarettes (in billions) (with 0.0325 oz. RYO conversion)	% Change From Prior Year (with 0.0325 oz. RYO conversion)[1]	No. of Cigarettes (in billions) (with 0.09 oz. RYO conversion)	% Change From Prior Year (with 0.09 oz. RYO conversion)[1]
2013	276.209	(4.86)%	275.021	(4.80)%
2012	290.307	(1.97)	288.874	(1.90)
2011	296.129	(2.77)	294.454	(2.65)
2010	304.551	(6.36)	302.461	(5.83)
2009	325.226	(9.08)	321.180	(8.42)
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

(1) Percentage change calculated after rounding of shipment volume.

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 4.77% to 273.785 billion cigarettes in 2013 from 287.487 billion cigarettes in 2012. According to the TTB, the quantity of cigarettes shipped domestically for the past 10 reported calendar years was approximately as set forth in the table below.

Calendar Year	No. of Cigarettes (in billions)	Percent Change From Prior Year[1]
2013	273.785	(4.77)%
2012	287.487	(1.80)
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)

(1) Percentage change calculated after rounding of shipment volume.

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 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. However, certain stores have ceased the sale of tobacco products. On September 3, 2014, the national pharmacy chain CVS reportedly stopped selling all cigarettes and other tobacco products in all its stores (following a February 2014 announcement), citing that such sales were inconsistent with its mission. A group of U.S. Attorneys General have pressured large retail stores with pharmacies to take similar action, and in April 2014 several members of Congress called on these retailers to stop selling cigarettes and other items containing tobacco. The retail chain store Target had stopped selling tobacco products in 1996. Costco has also reportedly gradually removed tobacco products from approximately half of its U.S. locations. In addition, in March 2014, the U.S. Navy reported that it was considering banning tobacco sales on all naval bases, but in May 2014 Congressional lawmakers approved a measure that would protect tobacco sales on military bases and ships. Cigarette manufacturers 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, which are not "cigarettes" within the meaning of the MSA, 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 intended to expand distribution of its Verve discs from 60 stores to about 1,200 stores throughout Virginia in the second half of 2013. Furthermore, Altria has reported in its Form 10-K filed with the SEC for calendar year 2013 that in December 2013 it entered into an agreement with Philip Morris International Inc. providing for an exclusive license to Altria subsidiaries to sell two of Philip Morris International Inc.'s heated tobacco product technologies in the United States. 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.

On June 10, 2014, Swedish Match submitted an application to the FDA to approve its snus products as "modified risk." Swedish Match is proposing to say that the product is addictive but is "substantially less risky than smoking." It also wants permission to remove one of the required health warnings from its packages. The FDA has one year to evaluate the application.

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-K filed with the SEC for calendar year 2013, U.S. moist snuff retail volumes grew approximately 5% in each of 2013, 2012 and 2011, and grew approximately 4% in the first six months of 2014 (compared with the same period in 2013), according to Reynolds American's Form 10-Q for the six-month period ended June 30, 2014. Reynolds American further reported in such Form 10-Q 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, 2014, smokeless tobacco products accounted for approximately 7.68% of Altria's tobacco product net revenues for the six months ended June 30, 2014, compared with approximately 7.38% for the six months ended June 30, 2013. A report by the CDC found that smokeless tobacco use among U.S. workers has remained relatively steady since 2005, with 2.7% of U.S. workers using smokeless tobacco products in 2005 and 3.0% of U.S. workers using smokeless tobacco products in 2010, while cigarette use has declined since 2005.

E-Cigarettes

Numerous manufacturers have recently developed (or acquired) and are marketing "electronic cigarettes" (or "**e-cigarettes**"), which, while not tobacco products, are battery powered devices in the shape of a cigarette that vaporize liquid nicotine, which is then inhaled by the consumer. Because they do not contain or burn tobacco, e-cigarettes do not constitute "cigarettes" within the meaning of the MSA. There are currently over 250 e-cigarette brands on the market, and more than 7,000 available flavors of e-cigarettes, with, by one estimate, the number of flavors increasing every month.

The parent companies of all three OPMs have launched e-cigarette brands. Lorillard's parent company 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 provided Lorillard, Inc. with the blu eCigs brand and an e-cigarette product line. (Lorillard also acquired the electronic cigarette business SKYCIG in October 2013, but distribution of SKYCIG e-cigarettes is currently limited to the United Kingdom.) Lorillard, Inc. reported in its Form 10-K filed with the SEC for calendar year 2013 that it sells the blu eCigs electronic cigarettes to distributors as well as directly to consumers over the internet, and reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that the method of distribution for many competing e-cigarette brands is predominately over the internet, with only a small number of competitors currently having a significant presence at retail. Lorillard, Inc. reported in its Form 10-Q filed with the SEC for the three-month period ended March 31, 2014 that its blu eCigs brand was carried in approximately 149,000 retail outlets as of March 31, 2014. The blu eCigs brand makes up approximately 40% of the U.S. market in e-cigarettes, according to Lorillard, Inc.'s Form 10-Q filed with the SEC for the six-month period ended June 30, 2014. As discussed above under "—Industry Overview", it is expected that Imperial Tobacco will purchase the blu eCigs brand in the first half of 2015. Reynolds American reported in October 2012 that it introduced an electronic cigarette, VUSE, in limited distribution. Reynolds American launched a revamped version of VUSE in Colorado retail outlets in July 2013 and expanded distribution into Utah in the first quarter of 2014. According to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, the initial phase of the national expansion of VUSE began in June 2014, the next wave of distribution is scheduled for the third quarter of 2014, and expansion is expected to continue in phases through March 2015, when VUSE will be available in most retail outlets. Reynolds American has stated that it intends to remain focused on VUSE's growth and expansion nationwide, and that it is targeting existing smokers with VUSE and expects some smokers to give up traditional cigarettes in favor of VUSE. Altria's subsidiary Nu Mark LLC introduced an electronic cigarette under the "MarkTen" brand into a lead market in Indiana

in August 2013 and expanded distribution of MarkTen electronic cigarettes in Arizona in December 2013. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that Nu Mark began the national expansion of MarkTen products in June 2014. MarkTen is an e-cigarette that can be reused with a separate battery recharging kit and additional cartridges in both tobacco and menthol flavors. Altria has 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. On April 1, 2014 Altria, through its Nu Mark subsidiary, acquired the e-vapor business of Green Smoke, Inc., an e-cigarette maker that sells both disposable and reusable products. In addition, Vector Group Ltd. reported in its Form 10-K filed with the SEC for calendar year 2013 that its subsidiary Zoom E-Cigs LLC recently entered the domestic electronic cigarette market in limited retail distribution outlets and that it intends to expand distribution of the Zoom brand in 2014.

On April 24, 2014, the FDA released proposed rules that would extend its regulatory authority to electronic cigarettes and certain other tobacco products under the FSPTCA. The proposed rules would require that electronic cigarette manufacturers (i) register with the FDA and report electronic cigarette product and ingredient listings; (ii) market new electronic cigarette products only after FDA review; (iii) only make direct and implied claims of reduced risk if the FDA confirms that scientific evidence supports the claim and that marketing the electronic cigarette product will benefit public health as a whole; (iv) not distribute free samples; (v) implement minimum age and identification restrictions to prevent sales to individuals under age 18; (vi) include a health warning; and (vii) not sell electronic cigarettes in vending machines, unless in a facility that never admits youth. Notably, the proposed rules do not restrict flavored products, online sales or advertising. It has been reported that the White House's Office of Management and Budget, which analyzes the potential economic consequences of proposed regulations, modified language in the proposed rules that would have permitted the FDA to prevent online sales of e-cigarettes, and deleted or modified language regarding FDA concerns about the safety of e-cigarettes, including manufacturing quality. The proposed regulation is subject to a 75-day public comment period, which was extended an additional 30 days and closed on August 8, 2014, following which the FDA will finalize the proposed regulation. It is not known how long this regulatory process to finalize and implement the rules may take. No assurance can be given that any regulation of e-cigarettes by the FDA will stop the trend of increased sales of e-cigarettes.

Because electronic cigarettes are not tobacco products, they are not subject to the advertising restrictions to which tobacco products are subject, and the FDA did not include advertising restrictions in its proposed regulations, as noted above. The NJOY, Vapor, Logic and blu eCigs electronic cigarette brands have recently been marketing and advertising extensively across the U.S. Lorillard, Inc. reported in its Form 10-K filed with the SEC for calendar year 2013 that the predominant forms of advertising and promotion in the electronic cigarette industry are television, print advertising, sampling events and web based advertising.

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 will be more than $2 billion in 2014. Altria has reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that Nu Mark estimates that total consumer expenditures for e-vapor products were approximately $1 billion in the United States in 2013 and believes that expenditures on these products continue to grow in 2014. The CDC in February 2013 reported results of a survey that indicated that in 2011 6.2% of the adult population, and 21% 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 taxes on traditional cigarettes 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. It has also been reported that e-cigarettes will capture more than half the smoking market

within a decade. Growth in the electronic cigarette market may have an adverse effect on the tobacco-cigarette market.

The fastest growth in e-cigarettes comes from devices called "vaporizers", which are larger, customizable devices. They have larger batteries and cartridges, hold more liquid, produce larger vapor clouds and last longer. They allow users to mix and match hardware and refill cartridges with liquid bought in bulk, so that they are cheaper than e-cigarettes. None of the OPMs have launched their own vaporizer product. It has been estimated that sales of vaporizers are growing twice as fast as traditional e-cigarettes. Vaporizers (as well as e-cigarettes) come in a wide variety of flavors.

Electronic cigarettes are generally not subject to federal, state or local excise taxes; however, according to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, one state (Minnesota) has imposed an excise tax on electronic cigarettes (at the same rate it taxes smokeless tobacco products), and a law was signed in North Carolina to tax e-cigarettes at the rate of $0.05 per fluid ounce, effective June 1, 2015. Bills have been introduced in various other states that, if approved, would apply a tax to e-cigarettes and would ban the sale of e-cigarettes to minors. According to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of June 30, 2014 bills remain pending in two states to tax e-cigarettes at a similar rate as in the North Carolina law, and 13 states had proposed taxing e-cigarettes on the same basis as other tobacco products, with such legislation failing in ten states and remaining pending in three states. In February 2014, several U.S. Senators introduced a bill that would bar companies from marketing e-cigarettes to minors and would give the Federal Trade Commission the authority to determine which advertisements target children. Furthermore, three U.S. states (North Dakota, New Jersey and Utah) and 188 municipalities have banned the use of e-cigarettes in smoke-free venues, according to the American Nonsmokers' Rights Foundation ("**ANRF**") as of July 3, 2014. On December 19, 2013, the New York City Council approved legislation that prohibits the use of electronic cigarettes in indoor public places and in places of employment (where smoking of traditional cigarettes is already prohibited). Chicago, Los Angeles, San Francisco and Philadelphia passed similar legislation in 2014. A smokers' advocacy group, NYC Citizens Lobbying Against Smoker Harassment (NYC C.L.A.S.H.), filed a lawsuit in March 2014 challenging New York City's ban. On June 10, 2014, seven U.S. Senators sent a letter urging the Department of Transportation to finalize rules proposed almost three years ago that would ban e-cigarette use on domestic flights and those to or from the United States.

On February 12, 2014, Senator Tom Harkin and Representatives Waxman and Welch sent a letter to the Attorneys General of three states urging them to classify electronic cigarettes as cigarettes under the MSA in order to prevent e-cigarette companies from targeting youth and getting them addicted to their products. The nature and timing of any future amendments to the MSA, or interpretations under the MSA, cannot be predicted.

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. In January 2014 the CDC released further results indicating the quit rates had increased to 52.9% for attempts made in the past year. According to a report issued by the CDC in January 2013, the smoking rate for adults in the United States fell in 2012 to 18%.

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 and Hawaii County, Hawaii, which have raised the minimum age from 18 to 21; Suffolk County, New York, where the minimum age will rise to 21 in 2015; and Missouri, New York State, the District of Columbia, New Jersey, Utah, Vermont and Colorado, which are considering proposals to raise the minimum age 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 premiums than non-smokers, and several large corporations are now charging smokers higher premiums. More 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 Prevent All Cigarette Trafficking (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 and be located at the top 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 but has announced that it would undertake research to support and propose a new rulemaking on different warning labels consistent with the FSPTCA.

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 non-menthol 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 was to 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. As discussed below under "*FSPTCA Litigation*", the court in *Lorillard, Inc. v. U.S. Food and Drug Administration* barred the FDA from relying on the TPSAC report on menthol.

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. As discussed above under "—Industry Overview", it is expected that Reynolds American will acquire the Newport brand in the first half of 2015 as part of its acquisition of Lorillard, Inc. According to Lorillard, mentholated cigarettes are reported to have comprised 31.4% and 31.1% of the U.S. cigarette market for the year ended December 31, 2013 and 2012, respectively, and 31.7% and 31.3% of the U.S. cigarette market for the six months ended June 30, 2014 and 2013, 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.

Since the FSPTCA's enactment, the FDA has received thousands of applications for products that tobacco companies claimed were "substantially equivalent" to ones already on the market. Reynolds American reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that in 2013 the FDA, based on the substantial equivalence submissions, authorized the marketing of 17 tobacco products and denied the marketing of 13 others. In particular, the FDA announced on June 25, 2013 that it approved the applications and authorized the sale of two new non-menthol Newport cigarettes made by Lorillard (after determining that the cigarettes, while slightly different than previous products, would not pose new health issues) and rejected four other new tobacco products, 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. In February 2014, the FDA issued orders to prevent the further sale and distribution of four of the "not substantially equivalent" tobacco products that were currently on the market, marking the first time the FDA has used its authority to order a tobacco manufacturer to stop selling and distributing currently available tobacco products. Through June 2014, the FDA has issued 71 "substantially equivalent" orders, 17 "not substantially equivalent" orders, 16 "refusal to accept" letters with respect to substantial equivalence, and 36 refusal to accept letters for exemption requests. In addition, 224 reports regarding tobacco products were withdrawn by manufacturers.

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.

On April 24, 2014, the FDA released proposed rules that would extend its regulatory authority to electronic cigarettes and certain other tobacco products under the FSPTCA. See "—E-Cigarettes" above.

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 second amended complaint on October 12, 2012, and the case proceeded before the U.S. District Court for the District of Columbia. On June 21, 2013, the FDA filed a motion for summary judgment, and on July 19, 2013 Lorillard and Reynolds Tobacco filed a motion for summary judgment. On July 21, 2014, the district court granted plaintiffs' summary judgment motion, in part, and denied defendants' summary judgment motion, finding that three of the panel's members had conflicts of interest that biased them against the tobacco industry and that "the FDA's appointment of those members was arbitrary and capricious, in violation of the APA, and fatally tainted the composition

of the TPSAC and its work product, including the Menthol Report." The court ordered the FDA to reconstitute the TPSAC so that it complies with the applicable ethics laws and barred the FDA from relying on the TPSAC 2011 report on menthol, which the court found to be, "at a minimum suspect, and at worst untrustworthy." The time for the FDA to appeal the decision has not yet expired.

On August 16, 2011, five tobacco companies (including OPMs Reynolds Tobacco and Lorillard as well as SPMs 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 the FDA issues regulations "that are permissible under the United States Constitution and federal laws." The plaintiffs alleged 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 contended 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 argued 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 alleged that the FDA's final rule "contravenes core requirements" of the APA. Furthermore, the plaintiffs asserted 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 announced its plans for an integrated anti-smoking campaign that targets teenagers, with a combined budget of up to $600 million over five years. As part of this campaign, the FDA announced in February 2014 that advertisements would run for at least one year under the $115 million "Real Cost" campaign that targets young people aged 12-17 years and shows the costs and health consequences associated with tobacco use. According to the FDA, future campaigns will target young adults aged 18-24 years and people who influence teens, including parents, family members and peers. Other audiences of special interest that are planned to be targeted in future campaigns include minorities, gays, people with disabilities, the military, pregnant women, people living in rural areas, and low-income people.

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 was 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's fiscal year 2014 budget submission included approximately $212 million for tobacco prevention and control, representing an increase of approximately $13.8 million from the prior fiscal year. The CDC reported that it plans to use this increase in resources to expand the national mass-media campaign to raise awareness of the health effects of tobacco use and prompt smokers to quit, as well as increase tobacco cessation quitline capacity to respond to those smokers who wish to quit. In January 2014 the CDC announced the launch of another graphic anti-smoking campaign, showing in stark terms the negative health effects of smoking, which began in July 2014.

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.

It has been reported that the U.S. Defense Department is reviewing its tobacco policies. The review is expected to finish within the next few months, with officials hoping to make proposals to the U.S. Defense Secretary sometime in the fall of 2014. A March 14, 2014 Defense Department memo encourages the services to eliminate tobacco sales and tobacco use on military bases, although it does not order specific actions. Defense Secretary Hagel has stated his support for a forcewide review of tobacco use and sales on military installations. The U.S. Navy is also reportedly pushing towards eliminating tobacco sales on all of its ships and bases, as well as Marine Corps facilities, but in May 2014 Congressional lawmakers approved a measure that would protect tobacco sales on military bases and ships. In July 2014, the Senate Appropriations defense subcommittee approved a defense spending bill that would eliminate the 25% discount that members of the armed services enjoy when buying tobacco products at commissaries and elsewhere.

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, through 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 by $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 in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, 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. According to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of June 30, 2014 25 states also had passed legislation classifying retailers operating roll-your-own machines as 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. President Obama's 2015 federal budget proposal, released in early March 2014, includes a proposed increase in the federal excise tax on a pack of cigarettes to $1.95 per pack (and proposed proportionate increases in all other tobacco product tax rates).

All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2013 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. Altria has reported that during 2013, Massachusetts, Minnesota, Oregon and Puerto Rico had enacted legislation to increase their cigarette taxes. Specifically, Minnesota increased its cigarette excise tax in July 2013 by $1.60 per pack, and 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 also increased by $0.10 on August 1, 2013 due to legislation enacted in 2011. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as of July 18, 2014, Vermont is the only state to have enacted a cigarette excise tax increase in 2014. The legislatures in Florida, Maryland and Rhode Island are also considering cigarette excise tax increases. In addition, according to the IHS Global Report, Ohio's Governor proposed a cigarette excise tax increase in March 2014 as part of a budget plan. Lorillard, Inc. reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that during 2013, combined state and local excise taxes ranged from $0.17 to $5.85 per pack. According to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of June 30, 2014 the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.29, compared with the 12-month rolling average of $1.30 as of December 31, 2013. Philip Morris reported that between the end of 1998 (the year in which the MSA was executed) and July 18, 2014, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.48 per pack. It is expected that states will continue to raise excise taxes on cigarettes in 2014 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, is considering such a tax during its 2014 legislative session, but no decision has yet been reached, according to Reynolds American in its Form 10-Q filed with the SEC for the six-month

period ended June 30, 2014. In May 2013, Minnesota approved an increase in its excise tax on smokeless tobacco, which took effect on January 1, 2014, and according to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, during the second quarter of 2014, one other state increased its smokeless tobacco tax effective July 1, 2014.

In 2004, Michigan imposed an equity assessment on NPMs selling cigarettes in that 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. In addition, 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. In November 2013, a district court judge in *Texas Small Tobacco Coalition. v. Combs* (Tex. Dist. Ct., Travis Cnty.) ruled that the tax violated the Equal and Uniform Taxation clause of the Texas Constitution. The Texas Comptroller of Public Accounts appealed this decision on November 13, 2013, and on August 15, 2014 the Texas Court of Appeals affirmed the district court judge's decision, holding that the tax violates the Texas Constitution. Reynolds American has reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that a total of six states require NPMs to pay a fee on each pack of cigarettes sold in their state. 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's petition for writ of certiorari.

Furthermore, in November 2013, New York City passed an ordinance that set a minimum price of $10.50 for every pack of cigarettes sold in the City and prohibited the use of coupons or other promotional discounts to lower that price. On February 16, 2014, tobacco companies and trade groups representing cigarette retailers filed a motion for preliminary injunction in federal court to block that portion of the ordinance that prohibited the use of coupons and other promotional discounts (*National Association of Tobacco Outlets Inc. et al. v. City of New York et al.*), but in June 2014 the court upheld that portion of the ordinance.

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 the cited reference date 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 July 3, 2014, 40 states and territories have laws that require either 100% smoke-free non-hospitality workplaces or restaurants or bars (and 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). On September 4, 2014, Kentucky banned all uses of tobacco products on most government properties. Also according to ANRF, as of July 3, 2014, 26 states and territories have laws that require 100% smoke-free non-hospitality workplaces and restaurants and bars: Arizona, Delaware, 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. Restrictions in many jurisdictions also include a ban on outdoor smoking within a specified number of 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 July 3, 2014, there were 1,135 municipalities with local laws that require 100% smoke-free non-hospitality workplaces or restaurants or bars, of which 646 municipalities (including the District of Columbia) have local laws that require 100% smoke-free non-hospitality workplaces and restaurants and 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 July 3, 2014:

- Puerto Rico prohibits smoking on beaches, Maine prohibits smoking on beaches in its state parks, and 209 municipalities specified that all city beaches and/or specifically named city beaches are smoke-free (in addition, on January 1, 2014 a smoking ban went into effect on beaches in Oahu, Hawaii, and state lawmakers have introduced a bill to expand the ban to every island of Hawaii);

- Iowa, New York, Wisconsin, Guam and the U.S. Virgin Islands prohibit smoking in outdoor public transit waiting areas, and there are 344 municipalities with smoke-free 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 299 municipalities have enacted laws for 100% smoke-free outdoor dining, while 152 municipalities have enacted laws for 100% smoke-free outdoor dining and bar patios; and

- Oklahoma prohibits smoking on state lands, Puerto Rico prohibits smoking in all parks, and 967 municipalities specified that all city parks and/or specifically named city parks are smoke-free. On October 8, 2013 in *NYC C.L.A.S.H. Inc. v. New York State Office of Parks, Recreation & Historic Preservation et al* (N.Y. Sup. Ct., Albany County) the New York Supreme Court for Albany County invalidated a New York regulation that banned smoking in certain outdoor areas and in State parks.

Smoking bans have also been enacted for smaller governmental and private entities. According to the ANRF, as of July 3, 2014, there are at least 1,372 100% smoke-free university and college campuses with no exemptions, including dormitory housing, and of these, 938 have a 100% tobacco-free policy and 176 prohibit the use of e-cigarettes anywhere on campus. The University of California implemented its system-wide smoke-free and tobacco-free policy effective January 1, 2014. ANRF further reports, as of July 3, 2014, that complete smoking bans, indoor and outdoor, have been implemented on the campuses of four national hospitals, clinics, insurers and health service companies and at least 3,658 local and/or state hospitals, healthcare systems and clinics; that in July 2013 New York State enacted a law requiring 100% smokefree grounds of general hospitals; and that 28 municipalities have enacted laws specifically requiring 100% smokefree hospital grounds. In addition, ANRF reports as of July 3, 2014 that all federal correctional facilities are completely smoke-free (indoor and outdoor), as well as those in 21 states and in Puerto Rico, and that 28 other states ban smoking indoors in correctional facilities but allow smoking in outdoor areas. ANRF reports that as of July 3, 2014, six states and 105 municipalities have laws requiring that all hotel and motel rooms be 100% smoke-free. Finally, ANRF reports as of July 3, 2014 that 37 municipalities restrict or prohibit smoking in private units of market-rate multi-unit housing and 228 municipalities restrict or prohibit smoking in private units of public/affordable multi-unit housing.

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." On January 17, 2014, the Surgeon General issued an additional report that contends that smoking is linked to a higher number of deaths to Americans than previous estimates, that filtered cigarettes may increase the risk of certain diseases, and that cigarettes are a causal factor in certain conditions and diseases that had not previously been linked to cigarette smoking. 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 refusing to hire people who do 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 announced in June 2013 a ban on smoking in all its apartments across the country.

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 in February 2005. According to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, 178 countries, as well as the European Community, have become party to the FCTC. In November 2012, parties to the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products, which was open for signature between January 2013 and January 2014. While the United States is a signatory of the FCTC, it is not currently a party to the agreement, as the agreement has not been submitted to, or ratified by, the United States Senate.

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 2014 Senior Bonds payable from tobacco settlement payments made under the MSA. Lorillard, Inc. reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that, as of July 25, 2014, 7,474 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).

Altria, Philip Morris's parent company, reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that after exhausting all appeals in cases resulting in adverse verdicts associated with tobacco-related litigation, since October 2004 Philip Morris has paid in the aggregate judgments (and related costs and fees) totaling approximately $263 million and interest totaling

approximately $143 million as of July 18, 2014. Reynolds American reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that Reynolds Tobacco as of June 30, 2014 had paid approximately $193 million since January 1, 2012 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.

West Virginia 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. 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.

Tobacco-Related Antitrust Cases. 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, Inc.'s Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, since January 1, 2010 verdicts have been returned in eleven 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. In December 2011 the court entered a final judgment that awarded compensatory damages of $25 million to the deceased smoker and $10 million to the deceased smoker's son, $81 million of punitive damages (the court did not reduce the punitive damages verdict), approximately $2.6 million of attorneys' fees and costs, and interest on the damages awards at the rate of 12% per year from the date the case was filed in 2004. On June 11, 2013, the Massachusetts Supreme Judicial Court affirmed the $35 million compensatory damages award but remanded the case to the trial court for a new trial on the issue of punitive damages, finding that the jury had been inadequately instructed regarding the application of various theories of negligence. Lorillard filed a petition for rehearing, which was denied on July 26, 2013. In September 2013, the plaintiff filed a motion seeking immediate entry of judgment on the compensatory damages award. At a status conference on September 17, 2013, the trial judge rejected the defendant's proposed procedures for retrial of plaintiff's claims. Consequently, Lorillard Tobacco incurred a charge of $79 million, including $35 million for compensatory damages plus statutory interest of 12% per year since June 28, 2004. The amount was paid in October 2013, and the case has been dismissed in its entirety and is now concluded.

According to Lorillard, juries found in favor of the plaintiffs in five of the other ten Conventional Product Liability Case trial verdicts rendered since January 1, 2010. The verdict in one case was affirmed on appeal in July 2013 and judgment has been satisfied; the second case's appeal remains pending; the third case concluded with an agreement between the parties; and an appeal is pending in the fourth case. In the fifth 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, and 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 in September 2012 Philip Morris filed a notice of appeal from the trial court's judgment with the Oregon Court of Appeals. On January 27, 2014, the plaintiff filed a motion to certify the appeal to the Oregon Supreme Court, which the Oregon Court of Appeals denied in March 2014. Oral argument at the Oregon Court of Appeals is scheduled for September 9, 2014, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

Juries found in favor of the defendants in the five other Conventional Product Liability Cases, according to Lorillard. Three of these five cases have concluded. Plaintiffs in two of the cases did not pursue appeals, and the plaintiff in the third case noticed an appeal, and in February 2013 the appellate Court affirmed the verdict and the plaintiff did not seek any further review. 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, and the plaintiff's appeal of the order denying the motion for a new trial remains pending. Oral argument of plaintiff's appeal is scheduled for September 9, 2014, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014. The plaintiff in the fifth case has filed a motion for a new trial, which was denied in August 2013; this case is currently on appeal.

According to Lorillard, in rulings addressing cases tried in earlier years, some appellate courts have reversed verdicts returned in favor of the plaintiffs in whole or in part, 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 fifteen individual cases since 2001. Punitive damages were paid to the smokers in six of these cases.

Lorillard, Inc. reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that one trial is underway, and that as of July 25, 2014, no cases were scheduled for trial in the remainder of 2014, but trial dates are subject to change.

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. 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. On August 1, 2013, Judge William G. Young of the District of Massachusetts took over responsibility for the *Engle* Progeny Cases in the Middle District of Florida, Jacksonville Division. Judge Young issued an order that day that called for three groups of cases to be prepared for trial on the following schedule: approximately 50 cases to be made trial ready by January 2, 2014, approximately 107 cases to be made trial ready by May 2014, and approximately 120 cases to be made trial ready by September 2, 2014. On January 17, 2014, Judge Young issued an order calling for an additional three groups of cases to be prepared for trial on the following schedule: approximately 200 cases to be made trial ready by January 2, 2015, approximately 150 cases to be made trial ready by April 1, 2015 and approximately 150 cases to be made trial ready by July 1, 2015. On April 15, 2014, the Court granted a motion to withdraw filed by counsel for plaintiffs in 49 of the cases that are to be made trial ready pursuant to the Court's January 17, 2014 order. The plaintiffs in these 49 cases have six months to come forward in order to avoid dismissal. On June 23, 2014 Judge Young issued an order calling for an additional three groups of cases to be prepared for trial on the following schedule: approximately 146 cases to be made trial ready by January 4, 2016, approximately 144 cases to be made trial ready by May 1, 2016 and approximately 139 cases to be made trial ready by September 1, 2016. Since the issuance of these three orders, according to Lorillard, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, 226 of the cases to be prepared for trial have been dismissed in their entirety.

Lorillard reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that since January 2010 and through July 25, 2014, the United States District Court for the Middle District of Florida has dismissed a total of approximately 3,489 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 January 2013, the court granted a motion by defendants and dismissed approximately 520 cases in which the plaintiffs were deceased at the time their personal injury lawsuits were filed. Plaintiffs appealed the dismissals of these 520 cases to the United States Court of Appeal for the Eleventh Circuit, and as of July 25, 2014, the appeal remains pending, according to Lorillard. 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. On June 5, 2014 the Court heard oral

argument on these cases consolidated appeals. On July 7, 2014 plaintiffs filed a notice of appeal to the United States Court of Appeals for the Eleventh Circuit from an order dismissing 14 cases for failure to produce signed authorizations. Other courts, including state courts, have entered orders dismissing additional cases.

Reynolds American reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as of June 30, 2014, 4,865 *Engle* Progeny cases were pending against Reynolds Tobacco or its affiliates or indemnitees, 1,744 of which were pending in federal court and 3,121 of which were pending in state court, together including approximately 5,973 plaintiffs. Lorillard, Inc. reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that 3,875 *Engle* Progeny Cases were pending against Lorillard or Lorillard, Inc. as of July 25, 2014. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as of July 18, 2014, approximately 3,100 state court *Engle* Progeny Cases were pending against Philip Morris or Altria asserting individual claims by or on behalf of approximately 4,200 state court plaintiffs, and approximately 1,000 *Engle* Progeny Cases were pending against Philip Morris as of such date in federal district court asserting individual claims by or on behalf of a similar number of federal court plaintiffs.

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. The Florida Supreme Court granted review in the *Douglas* case, in which a verdict awarding compensatory damages to the plaintiff was affirmed by an intermediate state Florida appellate court, to address the issue of whether a tobacco manufacturer's due process rights are violated by reliance upon the *Engle* Phase I findings. On March 14, 2013, the Florida Supreme Court ruled that application of the *Engle* Phase I findings to establish certain elements of plaintiffs' claims is not a violation of the *Engle* defendants' due process rights. In order to prevail on either strict liability or negligence claims, the Court found that an *Engle* plaintiff must establish (i) membership in the *Engle* class; (ii) that addiction to smoking the *Engle* defendants' cigarettes containing nicotine was a legal cause of the injuries the plaintiff alleged; and (iii) damages. On August 12, 2013, defendants filed a petition with the United States Supreme Court seeking review of the Florida Supreme Court's decision. This petition for review was denied on October 7, 2013. The due process issue was also on appeal in the United States Court of Appeals for the Eleventh Circuit in two cases that had been consolidated for appeal: *Duke* and *Walker*. On September 6, 2013, the United States Court of Appeals for the Eleventh Circuit affirmed the verdicts in these cases, holding that the judgment of the Florida Supreme Court in *Douglas* should be given full faith and credit, and that deference to the decision in *Douglas* did not violate the due process rights of the defendant. The defendant filed a petition for rehearing of the decision in *Duke* and *Walker* with the United States Court of Appeals for the Eleventh Circuit, and on October 31, 2013 the Eleventh Circuit again ruled on this petition that the use of Phase I *Engle* findings does not violate a tobacco manufacturer's due process rights. On November 7, 2013, the Court denied the defendant's petition for rehearing. On November 13, 2013, the defendant filed a second petition, seeking review of the October 31, 2013 opinion, and on January 6, 2014, the Court denied this petition. On March 28, 2014, the defendant in *Duke* and *Walker* filed a petition with the U.S. Supreme Court seeking to answer the question of whether the *Engle* Phase I findings can be applied to establish certain elements of plaintiffs' claims. On the same date, defendants filed similar petitions in the *Brown* case (an appeal from a Florida state court trial), as well as in eight other state court cases. The defendants requested that these petitions be held pending disposition of the *Duke*, *Walker* and *Brown* cases, and resolved in a similar manner. On June 9, 2014, the U.S. Supreme Court declined to accept review of the *Duke* and *Walker* cases, and declined to accept review of the *Brown* case and the eight other state court cases.

According to Lorillard, various courts, including appellate courts, have issued rulings that have addressed the conduct of the cases prior to trial. One intermediate Florida 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. 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 one case affirmed the judgment awarding compensatory damages only; 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 February 28, 2014 the Florida Supreme Court announced that it would grant review of this case. In June 2013, 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. Defendants did not seek further review of this decision, according to Lorillard. In December 2013, the Florida First District Court of Appeal affirmed the summary judgments in favor of the defendants regarding three plaintiffs who had opted out of the *Engle* class and subsequently reapplied for admission. The court held that the Florida Supreme Court's decision in *Engle* did not provide any basis for the readmission of a former class member in the event that they had timely opted out of the class and did not initiate an individual action until after the statute of limitations had run.

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, whether a judgment based on a claim of intentional conduct should be reduced by a jury's findings of comparative fault, whether damages can be awarded jointly and severally, and whether plaintiffs' strict liability and negligence claims are preempted by federal law. Lorillard reports that various intermediate Florida appellate courts and Florida federal courts have issued rulings on these issues.

Lorillard, Inc. reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as of July 25, 2014, verdicts had been returned in 17 *Engle* Progeny Cases in which Lorillard was a defendant and 113 *Engle* Progeny Cases in which neither Lorillard nor Lorillard, Inc. was a defendant at trial. Juries awarded compensatory damages to the plaintiffs in 12 of the 17 cases in which Lorillard was a defendant (and in 4 of these 12 cases, juries also awarded punitive damages), and in another case, the court entered an order following trial that awarded plaintiff compensatory damages. In one case in which Lorillard is the only defendant, *Alexander v. Lorillard Tobacco Co., et al*., the jury awarded plaintiff $20,000,000 in compensatory damages and $25,000,000 in punitive damages in February and March 2012. The jury apportioned 20% of the fault for the smoker's injuries to the smoker and 80% to Lorillard. In May 2012, the court granted a motion by Lorillard to lower the amount of compensatory damages and reduced the amount awarded to $10,000,000 from Lorillard, entering an amended final judgment that applied the jury's comparative fault determination to the court's award of compensatory damages, awarding the plaintiff $8,000,000 in compensatory damages and $25,000,000 in punitive damages, plus the statutory rate of interest. Lorillard noticed an appeal from the amended final judgment to the Florida Third District Court of Appeal. On September 4, 2013, the Florida Third District Court of Appeal affirmed the amended final judgment awarding compensatory and punitive damages. Lorillard's motion for rehearing of this decision was denied in October 2013. On November 27, 2013, Lorillard filed a petition with the Florida Supreme Court seeking review of the intermediate appellate court decision. Lorillard reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as of July 25, 2014, the Florida Supreme Court had not announced whether it would grant review of this case.

Also according to Lorillard, of the 113 *Engle* Progeny Cases in which neither Lorillard nor Lorillard, Inc. was a defendant at trial, juries awarded compensatory damages and punitive damages in 34 of the trials. In 33 of those 34 trials, the amount of punitive damages awarded have totaled approximately $727.5 million and have ranged from $20,000 to $244 million. The trial in the other of those cases, *Robinson*, is discussed below. In 34 other cases of the 113 *Engle* Progeny Cases in which neither Lorillard nor Lorillard, Inc. was a defendant at trial, juries' awards were limited to compensatory damages. In the 45 remaining trials of the 113 cases, 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, Inc. reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that as of July 25, 2014, 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 ten 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's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of July 18, 2014, 59 state and federal *Engle* Progeny Cases involving Philip Morris have resulted in verdicts since the Florida Supreme Court's *Engle* decision, 29 of which were returned in favor of plaintiffs and 30 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 Reynolds Tobacco, 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. The plaintiff filed a notice of cross-appeal, and briefing with the Florida Fourth District Court of Appeal is underway, according to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

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. In December 2012, the Fourth District 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. In December 2012, plaintiff filed a motion for rehearing en banc or for certification to the Florida Supreme Court, which was denied in January 2013. In February 2013, plaintiff and Philip Morris each filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. In May 2013, the Florida Supreme Court consolidated the parties' petitions and ordered Philip Morris to show cause as to why the Florida Supreme Court's decision in *Douglas* is not controlling in this case. Philip Morris filed its response to the order in June 2013. Upon retrial on the question of damages, on October 16, 2013, the new jury awarded approximately $3.7 million in compensatory damages and $7.5 million in punitive damages. On May 16, 2014, Philip Morris filed a notice of appeal to the Fourth

District Court of Appeal and on May 21, 2014, plaintiff cross-appealed, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

Recently, in yet another *Engle* Progeny Case, *Robinson v. R.J Reynolds*, on July 18, 2014 a jury in Escambia County, Florida rendered a verdict against Reynolds Tobacco and awarded plaintiff $17 million in compensatory damages and $23.6 billion in punitive damages for the lung cancer death of plaintiff's spouse who smoked Kool brand cigarettes for more than 20 years from age 13 to his death at age 36. Reynolds Tobacco filed a motion on July 28, 2014 to set aside the jury's verdict on the grounds that it was unconstitutionally disproportionate to plaintiff's actual damages.

A number of *Engle* Progeny Cases have been placed on courts' 2014-2015 trial calendars; according to Reynolds American in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, there are 67 *Engle* Progeny Cases against Reynolds Tobacco and/or B&W set for trial through June 30, 2015 (but it is not known how many of these cases will actually be tried). 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, according to Lorillard, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

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 cases challenged the constitutionality of the amended statute. These motions were denied, withdrawn or declared moot. In January 2012, the Florida Supreme Court agreed to review one of the orders denying a challenge to the amended statute. In August 2012, the Florida Supreme Court dismissed the appeal as moot because the defendant had satisfied the judgment.

On October 23, 2013, Vector Group Ltd. announced that it and its subsidiary Liggett reached a comprehensive settlement (which is now final) resolving substantially all of the individual *Engle* Progeny Cases pending against them. Under the settlement, which did not require court approval, approximately 4,900 (out of approximately 5,300) individual *Engle* plaintiffs would dismiss their claims against Vector Group Ltd. and Liggett. Vector Group Ltd. recorded a charge of approximately $86 million for the year ended December 31, 2013 related to the settlement agreement. Pursuant to the terms of the agreement, Liggett will pay a total of $110 million, with approximately $61.6 million paid collectively in December 2013 and February 2014, and the balance to be paid in equal annual installments over the following 14 years.

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

West Virginia Cases

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. In September 2000, there were approximately 1,250 West Virginia Cases, but approximately 645 West Virginia Cases have been dismissed in their entirety. The claims alleging injury from smoking cigarettes were consolidated for a multi-phase trial, the first phase of which began April 15, 2013 and concluded May 13, 2013. The order that consolidated the cases for trial, among other things, 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 found against plaintiffs on their claims against defendants for design defect, negligent design, failure to warn, intentional concealment and breach of express warranty, and the jury found for plaintiffs on their claim that all ventilated filter cigarettes manufactured and sold between 1964 and July 1, 1969 were defective because of a failure to instruct, but found that the defendants' conduct was not willful or wanton. On September 16, 2013, the court entered a judgment on the jury's Phase I verdict and entered a separate order denying the parties' post-trial motions. Plaintiffs filed a motion to alter or amend the judgment on September 24, 2013. On October 7, 2013, the court informed the parties that, on its own authority, it would vacate the September 16, 2013 judgment and order. On October 28, 2013 the court entered a new judgment and order, reciting that: (1) ventilated filter cigarettes the defendants manufactured and sold between 1964 and July 1, 1969, were found to be defective due to a failure to instruct consumers as to their use; (2) all other cigarettes manufactured and sold by defendants were not found to be defective; (3) defendants' conduct did not justify an award of punitive damages; (4) the claims of the individual plaintiffs remain to be decided consistent with the Phase I verdict; and (5) there is no just reason for delay in permitting any appellate rights of the parties to be perfected as to the verdict rendered and the court's order. The order also denied the parties' post-trial motions, entered final judgments against the plaintiffs in the approximately 645 West Virginia Cases that were dismissed before trial, and stated that those dismissal orders were final and available for the proper application of the appellate process. On November 26, 2013, plaintiffs filed a notice of appeal from the October 28, 2013 judgment and order in the Supreme Court of Appeals of West Virginia. The defendants did not file a separate notice of appeal.

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, according to Lorillard. 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 were included in 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 was included in the consolidated trial of the West Virginia Cases. According to Lorillard, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of July 25, 2014, the Severed West Virginia Claims and the consolidated West Virginia Cases were not subject to a trial plan, and none was scheduled for trial as of July 25, 2014.

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, according to Lorillard. 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 second 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, Inc.'s Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of July 25, 2014, 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 discussed below 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.

"Lights" Class Action Cases. According to Lorillard, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, there are approximately 17 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 18, 2014, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, 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 four cases (*Tang*), plaintiffs voluntarily dismissed the

case without prejudice in July 2012, and another of the cases (*Phillips*) settled in mid-2014 for $6,000. The two other cases (*Wyatt* and *Cabbat*) remain pending, according to Altria.

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 and had dismissed a lawsuit filed against Philip Morris in 2002 by two Marlboro Lights smokers. 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, and remanded the case to the trial court for further consideration of class certification. The plaintiffs allege, among other things, that Philip Morris 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, which was denied on August 23, 2013. On October 25, 2013 Phillip Morris filed its petition for review to the Oregon Supreme Court, which the court accepted on January 16, 2014. Oral argument occurred on June 23, 2014, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

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 2003. 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. On April 29, 2014, the Fifth District Appellate Court reinstated the $10.1 billion 2003 verdict. Philip Morris appealed this reinstatement decision to the Illinois Supreme Court on May 13, 2014. The verdict has been stayed pending appeal.

In another "Lights" Class Action 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. On January

27, 2014, the trial court reversed its prior ruling granting partial summary judgment against plaintiffs' "more dangerous" claim and allowed plaintiffs to pursue that claim. Altria reported in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014 that the trial court has set alternative dates for the re-trial, with one possible date being January 20, 2015 and the other being March 16, 2015.

In another "Lights" Class Action Case, *In Re Tobacco II Cases* (*Brown v. The American Tobacco Company, Inc., et al.*, 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. Trial began April 15, 2013. On June 3, 2013, Philip Morris filed a motion to decertify the class. On September 24, 2013, the court issued a final Statement of Decision, in which the court found that Philip Morris violated California law and misrepresented the health benefits of its "light" cigarette, but that plaintiffs had not established a basis for relief and were thus not entitled to restitution or injunctive relief. On this basis, the court granted judgment for Philip Morris. The court also denied Philip Morris's motion to decertify the class. On October 15, 2013, the court entered final judgment in favor of Philip Morris. On November 8, 2013, plaintiffs moved for a new trial, which the court denied on December 12, 2013. On December 13, 2013, plaintiffs filed a notice of appeal of the final judgment, and the appeal remains pending, according to Lorillard, Inc.'s Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

In November 2013, an Arkansas trial court approved class certification in a Marlboro Lights lawsuit, *Miner et al v. Philip Morris Cos. Inc*. Plaintiffs initially filed the lawsuit against Philip Morris in 2003, accusing the company of deceptive marketing practices in violation of the Arkansas Deceptive Business Practices Act. Plaintiffs alleged that Philip Morris violated the law by advertising Marlboro Lights as a safer alternative to regular cigarettes. Philip Morris filed a notice of appeal of the class certification ruling to the Arkansas Supreme Court in December 2013, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

<u>Other Class Action Cases; Medical Monitoring</u>. 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 $300 million; struck an award of prejudgment interest, which totaled approximately $440 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.

In addition to the *Scott* case, purported medical monitoring class actions have been brought by plaintiffs. In one such case, *Caronia, et al. v. Philip Morris USA,* the New York Court of Appeals on December 17, 2013, answering a question certified to it by the United States Court of Appeals for the Second Circuit, held that current or former smokers that have not been diagnosed with a smoking-related disease could not pursue an independent cause of action for medical monitoring in New York. On April 14, 2014, the Second Circuit affirmed the district court's dismissal of the entire case, including the independent claim for medical monitoring, and issued its mandate on May 5, 2014. In the other case, *Donovan v. Philip Morris*, the Supreme Judicial Court of Massachusetts, in answering questions certified to it by the district court, held in October 2009 that under certain circumstances state law recognizes a claim by individual smokers for medical monitoring despite the absence of an actual injury. The case was remanded to federal court for further proceedings. In June 2010, the district court granted in part the plaintiffs' motion for class certification, certifying the class as to plaintiffs' claims for breach of implied warranty and violation of the Massachusetts Consumer Protection Act, but denying certification as to plaintiffs' negligence claim. In July 2010, Philip Morris petitioned the U.S. Court of Appeals for the First Circuit for appellate review of the class certification decision. The petition was denied in September 2010. As a remedy, plaintiffs have proposed a 28-year medical monitoring program with an approximate cost of $190 million. In June 2011, plaintiffs filed various motions for summary judgment and to strike affirmative defenses, which the district court denied in March 2012 without prejudice. In October 2011, Philip Morris filed a motion for class decertification, which motion was denied in March 2012. In February 2013, the district court amended the class definition to extend to individuals who satisfy the class membership criteria through February 26, 2013, and to exclude any individual who was not a Massachusetts resident as of February 26, 2013. On January 6, 2014, plaintiffs renewed their previously filed motions for summary judgment and to strike affirmative defenses. A trial date has not been set, according to Altria's Form 10-Q filed with the SEC for the six-month period ended June 30, 2014.

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 "onserts" (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.

The final judgment and remedial order has not yet been fully implemented. 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 and through other media. 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, regarding implementation of the

corrective statements. 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, claiming a violation of free speech rights. 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. In February 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. On January 10, 2014, the U.S. government and the defendant tobacco companies issued a joint status report confirming that the parties reached an agreement following the negotiations regarding implementation of the corrective statements and filed a Joint Motion for Consent Order Implementing the Corrective Statements Remedy Under Order #1015 and Order #34-Remand. For specified time periods following the date when all appeals are exhausted, corrective statements would be disseminated in newspapers (print and online), on television, on the tobacco companies' websites, and on "onserts" affixed to cigarette packs. On January 22, 2014, the district court held a hearing on the proposed consent order and asked the parties to address certain issues. Since the hearing, the district court has permitted the filing of several amicus curiae briefs that raise additional issues concerning the implementation of the corrective statements remedy. According to Altria, on April 22, 2014, the parties filed an amended proposed consent order and accompanying submission in the district court seeking entry of a revised agreement on the implementation details of the corrective communications remedy. On June 2, 2014, U.S. District Court for the District of Columbia approved the Joint Motion for Consent Order Implementing the Corrective Statements Remedy Under Order #1015 and Order #34-Remand. The June 2, 2014 Consent Order did not resolve outstanding issues as to whether corrective statements must be posted in retail point-of-sale displays, and according to Lorillard, Inc. in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, as of July 25, 2014 the district court had not yet entered an amended final judgment regarding the point-of-sale displays. The Consent Order as revised by the parties and approved by the U.S. District Court modifies various provisions of Order #1015 and provides that the parties thereto do not waive or abandon any appeal or appellate rights or argument and that defendants reserve the right to challenge on appeal the content of the Court-ordered corrective statements and the requirement that the Court-ordered corrective statements appear in the multiple media referenced in the Court's Remedial Order and in the Consent Order. The Consent Order further provides that defendants will not challenge on appeal the specific implementation executions in the Consent Order, that plaintiffs will not invoke defendants' agreement to the specific implementation executions in response to defendants' appellate challenge to the Court-ordered corrective statements, and that should the language of the corrective statements be changed as a result of further litigation, the parties reserve the right to seek different requirements than those in the Consent Order. In addition, the Consent Order stays implementation until the exhaustion of the defendants' appeal challenging the constitutionality of the corrective statements. On June 25, 2014, the defendants filed a notice of appeal of the Consent Order solely for the purpose of perfecting the U.S. Court of Appeals' jurisdiction over the pending appeal relating to the content of the corrective statements and, on July 2, 2014, moved to consolidate this appeal with the appeal filed in January 2013. The district court has not yet entered an amended final judgment addressing all of the directions from the Court of Appeals. Reynolds American has stated in its Form 10-K filed with the SEC for calendar year 2013 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, and in its Form 10-Q filed with the SEC for the six-month period ended June 30, 2014, in light of the implementation mediation and subsequent order Reynolds American has accrued $10 million for the estimated costs of the corrective communications.

Tobacco-Related Antitrust Cases

Indirect Purchaser Suits. According to Lorillard, approximately 30 antitrust suits were filed in 2000 and 2001 on behalf of putative classes of consumers in various state and federal 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. On July 18, 2014, the Kansas Court of Appeals issued a ruling in which it affirmed the district court's order granting defendants' motions for summary judgment and dismissing plaintiffs' claims. The plaintiff filed a certiorari petition seeking review of the decision by the Kansas Supreme Court on August 18, 2014.

For a discussion of other litigation involving claims of antitrust violations, such as *VIBO*, *Grand River* and *Freedom Holdings*, 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. 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 Corporation 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 2014 Senior 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 2014 Senior 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 September 9, 2014 on the consumption of cigarettes in the United States from 2014 through 2040 entitled, "A Forecast of U.S. Cigarette Consumption (2014-2040) for the Niagara Tobacco Asset Securitization Corporation" (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 2013. 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 2014 through 2040. The forecast indicates that total consumption in 2040 will be approximately 121.5 billion cigarettes (or 122 billion including roll-your-own tobacco equivalents), a 56% decline from the 2013 level. From 2013 through 2040 the average annual rate of decline is projected to be 3.0%.

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, which correlates with large price increases in 1998 and 1999 following the execution of the MSA and the Previously Settled State Settlements. 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), coincident with a large number of state excise tax increases. 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 and 9.1% in 2009, which correlated with the rapid spread of indoor smoking bans, the economic recession, the increase in federal excise tax effective April 1, 2009, and additional state excise tax increases. The decline in cigarette consumption was 6.4% in 2010, and decelerated to 2.8% in 2011 and 2.0% in 2012. In 2013, the decline sharpened to nearly 5%. This decline has been attributed by the industry in part to a weak economy and the rapid increase in usage of electronic cigarettes.

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 2013, 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 49.1% of the U.S. Based on its regression analysis using data from 1965 to 2013, 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. 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.

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 2040. 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 using U.S. data from 1965 through 2013, 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. The forecast assumptions have incorporated price increases in excess of general inflation to offset excise and other taxes. 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 2013 through 2040 to be 3.0%, with total consumption in 2040 projected to be approximately 121.5 billion cigarettes, a 56% decline from the 2013 level.

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2014 Senior 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 TSRs to be received by the Corporation (the **"Collection Methodology and Assumptions"**), as well as the methodology and assumptions used to structure the schedule of principal for the Series 2014 Senior 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 TSRs.

In projecting TSRs to be received by the Corporation, 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 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 85.02% for the OPMs (based on sales year 2013 OPM cigarette shipments of 234,841,000,000 divided by total net market cigarette shipments of 276,208,637,449 as reported by NAAG, each measuring roll-your-own shipments at 0.0325 ounces per cigarette conversion rate) and 8.43% for the SPMs based on the NAAG reported market share for SPMs in sales year 2013 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 2014 Senior 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

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

[†] 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 Annual Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Adjustments to Payments."

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Annual 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 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.

Volume Adjustment. Next, the Annual 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. The Previously-Settled States Reduction is as follows for each year of the following periods:

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 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 2013, 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 throughout the period forecasted in the IHS Global Report. 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 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 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 8.43% throughout the forecast period. Because the SPM Market Share exceeds the Base Share, the SPMs are assumed to make Annual Payments in each year in the same manner as the OPMs but assuming a Market Share equal to (y) the SPM Market Share (8.43%) 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 (85.20%).

Allocation Percentage for the County Under the MSA and Consent Decree. The amounts of Annual Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled State Reduction for each year were multiplied by the allocation percentage of such payments for the County under the MSA and Consent Decree (0.05959868477% for Annual Payments under the MSA, which is 0.467% of the State's 12.7620310% allocable share under the MSA) in order to determine the amount of Annual Payments to be made by the PMs in each year to be allocated to the County, and therefore, to the Corporation.

The following table shows the projection of Annual Payments to be received by the Indenture Trustee through the year 2040, calculated in accordance with the Collection Methodology and Assumptions.

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Projection of Annual Payments to be Received by the Indenture Trustee

Year	IHS Global Consumption Forecast	Estimated OPM Consumption	Base Annual Payment	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Total Adjusted Annual Payments by OPMs	TSR Allocation	OPM Annual Payments	SPM Annual Payments	Total Annual Payments to Indenture Trustee
2013	276,208,637,449	234,841,007,923									
2014	268,193,164,212	228,026,008,104									
2015	258,958,572,861	220,174,476,883	8,139,000,000	5,194,839,649	(6,802,860,538)	(799,220,444)	5,731,758,667	0.0595987%	3,416,053	223,570	3,639,623
2016	249,953,670,195	212,518,233,987	8,139,000,000	5,594,855,221	(7,229,113,740)	(796,009,647)	5,708,731,834	0.0595987%	3,402,329	222,672	3,625,001
2017	240,993,182,637	204,899,754,170	8,139,000,000	6,006,870,935	(7,669,127,728)	(792,583,393)	5,684,159,814	0.0595987%	3,387,684	221,713	3,609,398
2018	232,398,932,278	197,592,660,390	9,000,000,000	7,111,589,400	(8,987,728,928)	(788,373,895)	6,335,486,577	0.0595987%	3,775,867	243,866	4,019,732
2019	224,276,967,012	190,687,117,801	9,000,000,000	7,594,937,100	(9,507,195,868)	(784,376,699)	6,303,364,533	0.0595987%	3,756,722	242,629	3,999,352
2020	216,740,200,763	184,279,129,265	9,000,000,000	8,092,785,600	(10,035,600,867)	(780,995,113)	6,276,189,620	0.0595987%	3,740,526	241,583	3,982,110
2021	209,627,544,198	178,231,731,717	9,000,000,000	8,605,569,600	(10,569,105,955)	(778,701,979)	6,257,761,666	0.0595987%	3,729,544	240,874	3,970,418
2022	203,042,415,385	172,632,854,354	9,000,000,000	9,133,736,400	(11,112,116,770)	(777,059,241)	6,244,560,389	0.0595987%	3,721,676	240,366	3,962,042
2023	196,918,433,166	167,426,057,890	9,000,000,000	9,677,748,600	(11,660,936,331)	(776,527,227)	6,240,285,042	0.0595987%	3,719,128	240,201	3,959,329
2024	191,244,933,518	162,602,275,447	9,000,000,000	10,238,081,400	(12,217,143,612)	(776,983,784)	6,243,954,004	0.0595987%	3,721,314	240,342	3,961,657
2025	185,935,930,721	158,088,399,345	9,000,000,000	10,815,223,500	(12,780,591,287)	(778,499,301)	6,256,132,913	0.0595987%	3,728,573	240,811	3,969,384
2026	180,904,562,984	153,810,577,038	9,000,000,000	11,409,679,800	(13,353,818,691)	(780,848,632)	6,275,012,477	0.0595987%	3,739,825	241,538	3,981,363
2027	176,082,324,379	149,710,562,698	9,000,000,000	12,021,970,500	(13,939,713,758)	(783,769,748)	6,298,486,993	0.0595987%	3,753,815	242,442	3,996,257
2028	171,393,232,750	145,723,753,978	9,000,000,000	12,652,629,300	(14,540,811,451)	(787,041,178)	6,324,776,672	0.0595987%	3,769,484	243,453	4,012,937
2029	166,804,627,059	141,822,381,467	9,000,000,000	13,302,207,900	(15,160,227,544)	(790,379,162)	6,351,601,194	0.0595987%	3,785,471	244,486	4,029,957
2030	162,328,389,510	138,016,547,777	9,000,000,000	13,971,274,200	(15,799,678,584)	(793,656,584)	6,377,939,032	0.0595987%	3,801,168	245,500	4,046,668
2031	157,975,968,457	134,315,986,649	9,000,000,000	14,660,412,300	(16,459,195,039)	(796,934,713)	6,404,282,549	0.0595987%	3,816,868	246,514	4,063,382
2032	153,742,751,058	130,716,776,103	9,000,000,000	15,370,224,300	(17,138,776,835)	(800,280,189)	6,431,167,277	0.0595987%	3,832,891	247,549	4,080,440
2033	149,516,244,004	127,123,270,898	9,000,000,000	16,101,331,200	(17,839,079,143)	(803,689,230)	6,458,562,827	0.0595987%	3,849,218	248,603	4,097,822
2034	145,376,218,067	123,603,294,576	9,000,000,000	16,854,371,100	(18,565,670,628)	(806,616,188)	6,482,084,284	0.0595987%	3,863,237	249,509	4,112,746
2035	141,340,246,009	120,171,788,034	9,000,000,000	17,630,001,900	(19,315,767,971)	(809,441,891)	6,504,792,038	0.0595987%	3,876,771	250,383	4,127,153
2036	137,380,160,311	116,804,802,392	9,000,000,000	18,428,902,200	(20,089,162,861)	(812,264,489)	6,527,474,849	0.0595987%	3,890,289	251,256	4,141,545
2037	133,507,583,683	113,512,219,629	9,000,000,000	19,251,769,500	(20,887,821,647)	(814,943,565)	6,549,004,288	0.0595987%	3,903,120	252,084	4,155,205
2038	129,722,172,284	110,293,747,402	9,000,000,000	20,099,322,900	(21,711,859,044)	(817,546,003)	6,569,917,854	0.0595987%	3,915,585	252,889	4,168,474
2039	125,970,514,237	107,103,973,305	9,000,000,000	20,972,302,200	(22,561,962,617)	(820,077,583)	6,590,262,000	0.0595987%	3,927,709	253,673	4,181,382
2040	122,297,505,088	103,981,068,900	9,000,000,000	21,871,471,500	(23,441,706,865)	(822,227,289)	6,607,537,346	0.0595987%	3,938,005	254,337	4,192,343

Bond Structuring Assumptions

Issue Size. The objective in issuing the Series 2014 Senior Bonds is to receive proceeds, after application of certain amounts available in the Debt Service Account and the Liquidity Reserve Account, in an amount sufficient to: (i) currently refund all of the Series 2000 Bonds, currently outstanding in the aggregate principal amount of $38,690,000, (ii) acquire by negotiated purchase all of the $6,572,480 initial principal amount of outstanding NYCTT V/NTASC S4B Bonds for the purpose of cancellation, (iii) cancel the related bond RS4B-1 of the Series 2005 Subordinate Bonds, (iv) fund a payment to the owner of the Residual Certificate in an amount not to exceed $2,000,000 in order to provide the County with funds for capital purposes, and (v) pay the costs of issuance of the Series 2014 Senior Bonds. The debt service requirements of the Series 2014 Senior Bonds have been structured such that the rated debt service on the Series 2014 Senior Bonds in each year will not exceed the rated debt service on the Series 2000 Bonds.

Liquidity Reserve Account. The Liquidity Reserve Account will be funded on the Closing Date in an amount equal to $3,371,437.50, and will be maintained at the Liquidity Reserve Requirement as calculated from time to time, to the extent of available Collections. Amounts in the Liquidity Reserve Account will fund purchases of securities pursuant to the Forward Delivery Agreement.

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 2015 and each year thereafter. Interest earnings are assumed at 0% per annum on the Annual 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 prior to the time they are received by the Indenture Trustee.

Moneys deposited in the Liquidity Reserve Account are assumed to be invested at the blended arbitrage yield of 3.8%.

Operating Expense Assumptions. Operating Expenses of the Corporation have been assumed at the Operating Cap of $140,403.79 with respect to the period ending December 31, 2014, inflated at 3.00% per year thereafter. No arbitrage rebate expense was assumed.

Issuance Date. The Series 2014 Senior Bonds are assumed to be issued on September 24, 2014.

Interest Rates. The Series 2014 Senior 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 2014 Senior 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 TSRs available to the Corporation to pay the principal of and interest on the Series 2014 Senior Bonds could be adversely affected. See "BONDHOLDERS' RISKS" herein.

CONTINUING DISCLOSURE UNDERTAKING

In order to assist the Underwriter 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 2014 Senior Bonds, the Corporation will execute on the Closing Date a Continuing Disclosure Undertaking, acknowledged by the Indenture Trustee (the "**Continuing Disclosure Undertaking**").

Pursuant to the Continuing Disclosure Undertaking, the Corporation will provide, or cause to be provided, to the Electronic Municipal Market Access ("**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 Corporation's Fiscal Year (currently December 31), commencing with the fiscal year ended December 31, 2014, a copy of the Corporation's "**Annual Report**" containing (i) audited financial statements of the Corporation 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 for the most recent MSA payment year of the type set forth herein under the heading "SUMMARY OF COLLECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" under the last column in the table captioned "Projection of Annual Payments to be Received by the Indenture Trustee," and (iii) the debt service coverage for the Corporation's most recent Fiscal Year for Outstanding Series 2014 Senior Bonds, after giving credit for any redemptions that have been paid; and

(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 2014 Senior Bonds (each, a "**Listed Event**"):

(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 2014 Senior Bonds, or other material events affecting the tax status of the Series 2014 Senior Bonds;

(g) modifications to rights of Series 2014 Senior 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 2014 Senior Bonds, if material;

(k) rating changes;

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

(m) the consummation of a merger, consolidation, or acquisition involving the Corporation or the sale of all or substantially all of the assets of the Corporation, 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.

If the Corporation'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 must contain unaudited financial statements in a format similar to the Corporation's most recent audited financial statements, and the audited financial statements must be filed in the same manner as the Annual Report when they become available. The Corporation is required to file notice in a timely manner with the MSRB of a failure to provide the Annual Report to the MSRB by the date required in subparagraph (1) above. If the Corporation's fiscal year changes, it will give notice of such change in the same manner as for a Listed Event.

From time to time, the Corporation may appoint or engage a dissemination agent to assist the Corporation in carrying out its obligations under the Continuing Disclosure Undertaking, and may discharge any such agent, with or without appointing a successor dissemination agent.

Notwithstanding any other provision of the Continuing Disclosure Undertaking, the Corporation may amend the Continuing Disclosure Undertaking, and any provision of the Continuing Disclosure Undertaking 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 the Corporation, or the type of business conducted; (b) the undertaking, as amended or taking into account such waiver, 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 2014 Senior 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

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* As noted in the Rule, this event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for the Corporation 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 Corporation, 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 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 Corporation.

either (i) is approved by the holders of the Series 2014 Senior Bonds 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 2014 Senior Bonds.

In the event of any amendment or waiver of a provision of the Continuing Disclosure Undertaking, the Corporation 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 Corporation. 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 the same manner as for 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.

In the event of a failure of the Corporation to comply with any provision of the Continuing Disclosure Undertaking, the Indenture Trustee may (and, at the request of the Underwriter or the Holders of at least 51% aggregate principal amount of Outstanding Series 2014 Senior Bonds, will), or any Holder or Beneficial Owner of the Series 2014 Senior Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Corporation to comply with its obligations under the Continuing Disclosure Undertaking. A default under the Continuing Disclosure Undertaking will not be deemed an Event of Default under the Indenture, and the sole remedy under the Continuing Disclosure Undertaking in the event of any failure of the Corporation to comply with the Continuing Disclosure Undertaking will be an action to compel performance.

The Corporation's obligations under the Continuing Disclosure Undertaking will terminate upon the legal defeasance, prior redemption or payment in full of all of the Series 2014 Senior Bonds. If such termination occurs prior to the final maturity of the Series 2014 Senior Bonds, the Corporation will give notice of such termination in the same manner as for a Listed Event.

During the past five years, the Corporation 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 1934 Act.

TAX MATTERS

Federal Income Taxes

In the opinion of Harris Beach PLLC, Bond Counsel to the Corporation, and subject to the limitations set forth below, under existing statutes, regulations, administrative rulings and court decisions as of the date of such opinion, interest on the Series 2014 Senior Bonds is excluded from gross income for federal income tax purposes, pursuant to Section 103 of the Code. Furthermore, Bond Counsel is of the opinion that interest on the Series 2014 Senior Bonds is not an "item of tax preference" for purposes of computing the federal alternative minimum tax imposed on individuals and corporations. However, interest on the Series 2014 Senior Bonds is included in "adjusted current earnings" for purposes of calculating the federal alternative minimum tax imposed on certain corporations. Corporate purchasers of the Series 2014 Senior Bonds should consult with their tax advisors regarding the computation of any alternative minimum tax liability.

The Series 2014 Senior Bonds maturing on May 15 in the years 2015 through 2024, inclusive, on May 15, 2034 and on May 15, 2040 (collectively, the "**Premium Bonds**") are being offered at prices in excess of their principal amounts. An initial purchaser with an initial adjusted basis in a Premium Bond in excess of its principal amount will have amortizable bond premium which is not deductible from gross income for federal income tax purposes. The amount of amortizable bond premium for a taxable year is determined actuarially on a constant interest rate basis over the term of each Premium Bond based on the purchaser's yield to maturity (or, in the case of Premium Bonds callable prior to their maturity, over the period to the call date, based on the purchaser's yield to the call date and giving effect to any call premium). For purposes of determining gain or loss on the sale or other disposition of a Premium Bond, an initial purchaser who acquires such obligation with an amortizable bond premium is required to decrease such purchaser's adjusted basis in such Premium Bond annually by the amount of amortizable bond premium for the taxable year. As a result of the tax cost reduction requirements of the Code relating to amortization of bond premium, under certain circumstances, an initial owner of Premium Bonds may realize a taxable gain upon disposition of such Premium Bonds even though they are sold or redeemed for an amount equal to such owner's original cost of acquiring such Premium Bonds. Owners of the Premium Bonds are advised that they should consult with their own advisors with respect to the tax consequences of owning such Premium Bonds.

The Code establishes certain requirements that must be met at and subsequent to the issuance and delivery of the Series 2014 Senior Bonds in order that interest on the Series 2014 Senior Bonds be and remain excluded from gross income for federal income tax purposes, pursuant to Section 103 of the Code. These continuing requirements include certain restrictions and prohibitions on the use of the proceeds of the Series 2014 Senior Bonds and the projects financed and refinanced with such proceeds, restrictions on the investment of proceeds and other amounts and the rebate to the United States of certain earnings in respect of such investments. Failure to comply with such continuing requirements may cause the interest on the Series 2014 Senior Bonds to be included in gross income for federal income tax purposes retroactive to the date of issue of the Series 2014 Senior Bonds, irrespective of the date on which such noncompliance occurs. In the Indenture, the Tax Certificate and Agreement (including the exhibits thereto), and accompanying documents, the Corporation and the County have covenanted to comply with certain procedures, and have made certain representations and certifications, designed to assure compliance with the requirements of the Code. The opinion of Bond Counsel described above is made in reliance upon, and assumes continuing compliance with, such covenants and procedures and the continuing accuracy, in all material respects, of such representations and certifications.

Bond Counsel expresses no opinion regarding any other federal income tax consequences related to the ownership or disposition of, or the receipt or accrual of interest on, the Series 2014 Senior Bonds. The proposed form of opinion of Bond Counsel is attached hereto as Appendix F.

In addition to the matters referred to in the preceding paragraphs, prospective purchasers of the Series 2014 Senior Bonds should be aware that the accrual or receipt of interest on the Series 2014 Senior Bonds may otherwise affect the federal income tax liability of the recipient. The extent of these other tax consequences may depend upon the recipient's particular tax status or other items of income or deduction. Bond Counsel expresses no opinion regarding any such consequences. Examples of such other federal income tax consequences of acquiring or holding the Series 2014 Senior Bonds include, without limitation, that (i) with respect to certain insurance companies, the Code reduces the deduction for loss reserves by a portion of the sum of certain items, including interest on the Series 2014 Senior Bonds, (ii) interest on the Series 2014 Senior Bonds earned by certain foreign corporations doing business in the United States may be subject to a branch profits tax imposed by the Code, (iii) passive investment income, including interest on the Series 2014 Senior Bonds, may be subject to federal income taxation under the Code for certain S corporations that have certain earnings and profits, and (iv) the Code requires recipients of certain Social Security and certain other federal retirement benefits to take into account, in

determining gross income, receipts or accruals of interest on the Series 2014 Senior Bonds. In addition, the Code denies the interest deduction for indebtedness incurred or continued by a taxpayer, including, without limitation, banks, thrift companies, and certain other financial companies to purchase or carry tax exempt obligations, such as the Series 2014 Senior Bonds. The foregoing is not intended as an exhaustive list of potential tax consequences. Prospective purchasers should consult their tax advisors regarding any possible collateral consequences with respect to the Series 2014 Senior Bonds.

Certain requirements and procedures contained in or referred to in the Indenture, the Tax Certificate and Agreement (including the exhibits thereto), and other relevant documents may be changed, and certain actions may be taken or omitted subsequent to the date of issue, under the circumstances and subject to the terms and conditions set forth in such documents or certificates, upon the advice of, or with the approving opinion of, a nationally recognized bond counsel. Bond Counsel expresses no opinion as to any tax consequences with respect to the Series 2014 Senior Bonds, or the interest thereon, if such change occurs or action is taken or omitted upon the advice or approval of bond counsel other than Harris Beach PLLC.

Tax Reissuance of Remaining Series 2005 Subordinate Bonds. In accordance with the Purchase Agreement, Consent and Release, between the Corporation and the holders of all of the NYCTT V Bonds (the "**NYCTT V Holders**"), and acknowledged and agreed to by Manufacturers and Traders Trust Company, in its capacities as the Indenture Trustee and as the trustee for the NYCTT V Bonds, and the related Consent and Waiver from the NYCTT V Holders, each dated as of July 31, 2014 (collectively, the "**Consent and Waiver**"), which were executed in contemplation of the issuance of the Series 2014 Senior Bonds and the Corporation's purchase of all of the outstanding NYCTT V/NTASC S4B Bonds out of a portion of the proceeds of the Series 2014 Bonds, the Corporation, the NYCTT V Holders and the Indenture Trustee agreed to a waiver of certain provisions of the Series 2005 Supplemental Indenture, including the application of the Additional Bonds test set forth therein, that would otherwise have to be satisfied as a condition precedent to the issuance of the Series 2014 Senior Bonds. Bond Counsel has advised the Corporation that the waiver of such provisions of the Series 2005 Supplemental Indenture effected by the Consent and Waiver constitutes a "significant modification" of the Series 2005 Subordinate Bonds (other than the Series 2005 Subordinate Bonds represented by bond RS4B-1, which are being cancelled on the Closing Date), within the meaning of United States Treasury Regulations Section 1.1001-3. The "significant modification" of the Series 2005 Subordinate Bonds (other than the Series 2005 Subordinate Bonds represented by bond RS4B-1, which are being cancelled on the Closing Date) results in such bonds being treated for federal income tax purposes as having been reissued as of the Closing Date (such bonds being hereinafter referred to as the "**Reissued Series 2005 Subordinate Bonds**"). Further, the Reissued Series 2005 Subordinate Bonds will be treated for federal tax purposes as refunding bonds that currently refund the Series 2005 Subordinate Bonds (other than the Series 2005 Subordinate Bonds represented by bond RS4B-1, which are being cancelled on the Closing Date). Bond Counsel has also advised that, on the Closing Date, it will render its opinion to the effect that interest on the Reissued Series 2005 Subordinate Bonds is excluded from gross income for federal income tax purposes.

Bond Counsel has further advised the Corporation that the Series 2014 Senior Bonds and the Reissued Series 2005 Subordinate Bonds will be treated as a single issue of bonds for federal income tax purposes, with the purposes of such combined issue being the current refunding of the Series 2000 Bonds, the current refunding of the Series 2005 Subordinate Bonds, and the funding of a payment to the owner of the Residual Certificate to be applied to provide the County with funds for capital purposes.

State Income Taxes

In the opinion of Bond Counsel, under existing law as of the date of the issuance of the Series 2014 Senior Bonds, interest on the Series 2014 Senior Bonds is exempt from personal income taxes imposed by the State of New York and any political subdivision thereof.

However, noncompliance with any of the federal income tax requirements set forth above resulting in the interest on the Series 2014 Senior Bonds being included in gross income for federal tax purposes would also cause such interest to be subject to personal income taxes imposed by the State of New York or any political subdivision thereof.

Bond Counsel expresses no opinion regarding any other state or local tax consequences related to the ownership or disposition of, or the receipt or accrual of interest on, the Series 2014 Senior Bonds.

Interest on the Series 2014 Senior Bonds may or may not be subject to state or local income taxes in jurisdictions other than the State of New York under applicable state or local tax laws. Bond Counsel expresses no opinion as to the tax treatment of the Series 2014 Senior Bonds under the laws of such other state or local jurisdictions. Each purchaser of the Series 2014 Senior Bonds should consult his or her own tax advisor regarding the taxable status of the Series 2014 Senior Bonds in a particular jurisdiction other than the State of New York.

Other Considerations

Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or omitted) or any events occurring (or not occurring) after the date of issuance of the Series 2014 Senior Bonds may adversely affect the value of, or the tax status of interest on, the Series 2014 Senior Bonds.

No assurance can be given that any future legislation or governmental actions, including amendments to the Code or State income tax laws, regulations, administrative rulings, or court decisions, will not, directly or indirectly, cause interest on the Series 2014 Senior Bonds to be subject to federal, State or local income taxation, or otherwise prevent Bondholders from realizing the full current benefit of the tax status of such interest. Further, no assurance can be given that the introduction or enactment of any such future legislation, or any judicial decision or action of the Internal Revenue Service or any State taxing authority, including, but not limited to, the promulgation of a regulation or ruling, or the selection of the Series 2014 Senior Bonds for audit examination or the course or result of an audit examination of the Series 2014 Senior Bonds or of obligations which present similar tax issues, will not affect the market price, value or marketability of the Series 2014 Senior Bonds. For example, President Obama has released various legislative proposals that would limit the extent of the exclusion from gross income of interest on obligations of states and political subdivisions under Section 103 of the Code (including the Series 2014 Senior Bonds) for taxpayers whose income exceeds certain threshold levels. No prediction is made as to whether any such proposals will be enacted. Prospective purchasers of the Series 2014 Senior Bonds should consult their own tax advisors regarding the foregoing matters.

All quotations from and summaries and explanations of provisions of law do not purport to be complete, and reference is made to such laws for full and complete statements of their provisions.

ALL PROSPECTIVE PURCHASERS OF THE SERIES 2014 SENIOR BONDS SHOULD CONSULT WITH THEIR TAX ADVISORS IN ORDER TO UNDERSTAND THE IMPLICATIONS OF THE CODE AS TO THESE AND OTHER FEDERAL AND STATE TAX CONSEQUENCES, AS

WELL AS ANY LOCAL TAX CONSEQUENCES, OF PURCHASING OR HOLDING THE SERIES 2014 SENIOR BONDS.

RATINGS

It is expected that the Series 2014 Senior Bonds maturing on May 15 in the years 2015 through 2034 will be assigned a rating of "BBB+" by Fitch Ratings ("**Fitch**"), and the Series 2014 Senior Bonds maturing on May 15, 2040 will be assigned a rating of "BBB" by Fitch.

The ratings by Fitch of the Series 2014 Senior 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 Fitch with respect thereto should be obtained from Fitch, at the following address: One State Street Plaza, New York, New York 10004, telephone (212) 908-0500.

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 2014 Senior Bonds will continue for any given period of time or that the ratings will not be revised downward, suspended or withdrawn entirely by Fitch. 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 2014 Senior Bonds.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Upon delivery of the Series 2014 Senior Bonds, the arithmetical accuracy of certain computations included in the schedules provided by the Underwriter on behalf of the Corporation relating to the: (i) adequacy of forecasted receipts of principal of and interest on the Defeasance Collateral (as defined in the Indenture) and cash to be held pursuant to the Escrow Deposit Agreement for the refunding of the Series 2000 Bonds; and (ii) yields with respect to the Series 2014 Senior Bonds and on the obligations and other securities to be deposited pursuant to the Escrow Deposit Agreement upon delivery of the Series 2014 Senior Bonds, will be verified by Causey Demgen & Moore P.C., independent certified public accountants (the "**Verification Agent**").

In addition, the Verification Agent will verify the arithmetical accuracy of certain computations included in the schedules provided by the Underwriter on behalf of the Corporation relating to the projections of debt service coverage of the Series 2014 Senior Bonds, break-even consumption decline and optional redemptions of the Series 2014 Senior Bonds under various consumption decline scenarios.

The verifications will be based solely upon information and assumptions supplied to the Verification Agent by the Underwriter. The Verification Agent has not made a study or evaluation of the information and assumptions on which such computations are based and, accordingly, has not expressed an opinion on the data used, the reasonableness of the assumptions or the achievability of the forecasted outcome.

UNDERWRITING

Raymond James & Associates, Inc. (the "**Underwriter**") has agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2014 Senior Bonds from the Corporation at a purchase price equal to the aggregate principal amount of the Series 2014 Senior Bonds, plus original issue premium of $3,780,877.65, less an underwriter's discount of $604,044.58. The Underwriter will be obligated to purchase all of the Series 2014 Senior Bonds if any are purchased. The initial public offering prices of the Series 2014 Senior Bonds may be changed from time to time by the Underwriter.

The Series 2014 Senior Bonds may be offered and sold to certain dealers (including the Underwriter and other dealers depositing Series 2014 Senior Bonds into investment trusts) at prices lower than such public offering prices.

The Underwriter has provided the statements below in this section of the Official Statement:

The Underwriter and its 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. The Underwriter and its affiliates have, from time to time, performed, and may in the future perform, various investment banking services for the Corporation, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the Underwriter and its 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 2014 Senior Bonds.

LITIGATION

The Corporation 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 2014 Senior Bonds, or questioning the creation, organization or existence of the Corporation, the validity or enforceability of the Indenture, the sale of the TSRs by the County to the Corporation, the proceedings for the authorization, execution, authentication and delivery of the Series 2014 Senior Bonds or the validity of the Series 2014 Senior 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 TSRS."

LEGAL MATTERS

Harris Beach PLLC, as Bond Counsel to the Corporation, will render an opinion with respect to the validity of the Series 2014 Senior Bonds in substantially the form set forth in Appendix F. Certain legal matters will be passed upon for the Corporation by its counsel, Rupp, Baase, Pfalzgraf, Cunningham & Coppola LLC; for the County by Claude A. Joerg, County Attorney; and for the Underwriter by Hawkins Delafield & Wood LLP, counsel to the Underwriter.

OTHER PARTIES

IHS Global

IHS Global has been retained on behalf of the Corporation 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 2014 Senior Bonds. The IHS Global Report should be read in its entirety before purchasing any Series 2014 Senior Bonds.

Financial Advisor

Capital Markets Advisors, LLC (the "**Financial Advisor**") has been retained to act as financial advisor to the Corporation in connection with certain aspects of the issuance of the Series 2014 Senior 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.

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION

By /s/ Clyde L. Burmaster
President

September 9, 2014

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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) Allocation among Settling States of NPM Adjustment for Original Participating Manufacturers.

(A) The NPM Adjustment set forth in subsection (d)(1) shall apply to the Allocated Payments of all Settling States, except as set forth below.

(B) A Settling State's Allocated Payment shall not be subject to an NPM Adjustment: (i) if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year; or (ii) if such Settling State enacted the Model Statute (as defined in subsection (2)(E) below) for the first time during the calendar year immediately preceding the year in which the payment in question is due, continuously had the Model Statute in full force and effect during the last six months of such calendar year, and diligently enforced the provisions of such statute during the period in which it was in full force and effect.

(C) The aggregate amount of the NPM Adjustments that would have applied to the Allocated Payments of those Settling States that are not subject to an NPM Adjustment pursuant to subsection (2)(B) shall be reallocated among all other Settling States pro rata in proportion to their respective Allocable Shares (the applicable Allocable Shares being those listed in Exhibit A), and such other Settling States' Allocated Payments shall be further reduced accordingly.

(D) This subsection (2)(D) shall apply if the amount of the NPM Adjustment applied pursuant to subsection (2)(A) to any Settling State plus the amount of the NPM Adjustments reallocated to such Settling State pursuant to subsection (2)(C) in any individual year would either (i) exceed such Settling State's Allocated Payment in that year, or (ii) if subsection (2)(F) applies to the Settling State in question, exceed 65% of such Settling State's Allocated Payment in that year. For each Settling State that has an excess as described in the preceding sentence, the excess amount of NPM Adjustment shall be further reallocated among all other Settling States whose Allocated Payments are subject to an NPM Adjustment and that do not have such an excess, pro rata in proportion to their respective Allocable Shares, and such other Settling States' Allocated Payments shall be further reduced accordingly. The provisions of this subsection (2)(D) shall be repeatedly applied in any individual year until either (i) the aggregate amount of NPM Adjustments has been fully reallocated or (ii) the full amount of the NPM Adjustments subject to reallocation under subsection (2)(C) or (2)(D) cannot be fully reallocated in any individual year as described in those subsections because (x) the Allocated Payment in that year of each Settling State that is subject to an NPM Adjustment and to which subsection (2)(F) does not apply has been reduced to zero, and (y) the Allocated Payment in that year of each Settling State to which subsection (2)(F) applies has been reduced to 35% of such Allocated Payment.

(E) A "Qualifying Statute" means a Settling State's statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement. Each Participating Manufacturer and each Settling State agree that the model statute in the form set forth in Exhibit T (the "Model Statute"), if enacted without modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, shall constitute a Qualifying Statute. Each Participating Manufacturer agrees to support the enactment of such Model Statute if such Model

Statute is introduced or proposed (i) without modification or addition (except for particularized procedural or technical requirements), and (ii) not in conjunction with any other legislative proposal.

(F) If a Settling State (i) enacts the Model Statute without any modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, (ii) uses its best efforts to keep the Model Statute in full force and effect by, among other things, defending the Model Statute fully in any litigation brought in state or federal court within such Settling State (including litigating all available appeals that may affect the effectiveness of the Model Statute), and (iii) otherwise complies with subsection (2)(B), but a court of competent jurisdiction nevertheless invalidates or renders unenforceable the Model Statute with respect to such Settling State, and but for such ruling the Settling State would have been exempt from an NPM Adjustment under subsection (2)(B), then the NPM Adjustment (including reallocations pursuant to subsections (2)(C) and (2)(D)) shall still apply to such Settling State's Allocated Payments but in any individual year shall not exceed 65% of the amount of such Allocated Payments.

(G) In the event a Settling State proposes and/or enacts a statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that is not the Model Statute and asserts that such statute, regulation, law and/or rule is a Qualifying Statute, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of determining whether or not such statute, regulation, law and/or rule constitutes a Qualifying Statute. The Firm shall make the foregoing determination within 90 days of a written request to it from the relevant Settling State (copies of which request the Settling State shall also provide to all Participating Manufacturers and the Independent Auditor), and the Firm shall promptly thereafter provide written notice of such determination to the relevant Settling State, NAAG, all Participating Manufacturers and the Independent Auditor. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable; provided, however, (i) that such determination shall be of no force and effect with respect to a proposed statute, regulation, law and/or rule that is thereafter enacted with any modification or addition; and (ii) that the Settling State in which the Qualifying Statute was enacted and any Participating Manufacturer may at any time request that the Firm reconsider its determination as to this issue in light of subsequent events (including, without limitation, subsequent judicial review, interpretation, modification and/or disapproval of a Settling State's Qualifying Statute, and the manner and/or the effect of enforcement of such Qualifying Statute). The Original Participating Manufacturers shall severally pay their Relative Market Shares of the reasonable fees and expenses of the Firm. Only the Participating Manufacturers and Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (2)(G).

(H) Except as provided in subsection (2)(F), in the event a Qualifying Statute is enacted within a Settling State and is thereafter invalidated or declared unenforceable by a court of competent jurisdiction, otherwise rendered not in full force and effect, or, upon reconsideration by the Firm pursuant to subsection (2)(G) determined not to constitute a Qualifying Statute, then such Settling State's Allocated Payments shall be fully subject to an NPM Adjustment unless and until the requirements of subsection (2)(B) have been once again satisfied.

(3) Allocation of NPM Adjustment among Original Participating Manufacturers. The portion of the total amount of the NPM Adjustment to which the Original Participating Manufacturers are entitled in any year that can be applied in such year consistent with subsection IX(d)(2) (the "Available NPM Adjustment") shall be allocated among them as provided in this subsection IX(d)(3).

(A) The "Base NPM Adjustment" shall be determined for each Original Participating Manufacturer in such year as follows:

(i) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied exceed or are equal to their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal 0 (zero).

(ii) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied are less than their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal the result of (x) the difference between such Original Participating Manufacturer's Relative Market Share in such preceding year and its 1997 Relative Market Share multiplied by both (y) the number of individual Cigarettes (expressed in thousands of units) shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such preceding year (determined in accordance with subsection II(mm)) and (z) $20 per each thousand units of Cigarettes (as this number is adjusted pursuant to subsection IX(d)(3)(C) below).

(iii) For those Original Participating Manufacturers whose Base NPM Adjustment, if calculated pursuant to subsection (ii) above, would exceed $300 million (as this number is adjusted pursuant to subsection IX(d)(3)(C) below), the Base NPM Adjustment shall equal $300 million (or such adjusted number, as provided in subsection IX(d)(3)(C) below).

(B) The share of the Available NPM Adjustment each Original Participating Manufacturer is entitled to shall be calculated as follows:

(i) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year is less than or equal to the sum of the Base NPM Adjustments of all Original Participating

Manufacturers in such year, then such Available NPM Adjustment shall be allocated among those Original Participating Manufacturers whose Base NPM Adjustment is not equal to 0 (zero) pro rata in proportion to their respective Base NPM Adjustments.

(ii) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year exceeds the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then (x) the difference between such Available NPM Adjustment and such sum of the Base NPM Adjustments shall be allocated among the Original Participating Manufacturers pro rata in proportion to their Relative Market Shares (the applicable Relative Market Shares to be those in the year immediately preceding such year), and (y) each Original Participating Manufacturer's share of such Available NPM Adjustment shall equal the sum of *(1)* its Base NPM Adjustment for such year, and *(2)* the amount allocated to such Original Participating Manufacturer pursuant to clause (x).

(iii) If an Original Participating Manufacturer's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(3)(B)(i) or IX(d)(3)(B)(ii) exceeds such Original Participating Manufacturer's payment amount to which such NPM Adjustment applies (as such payment amount has been determined pursuant to step B of clause "Seventh" of subsection IX(j)), then *(1)* such Original Participating Manufacturer's share of the Available NPM Adjustment shall equal such payment amount, and *(2)* such excess shall be reallocated among the other Original Participating Manufacturers pro rata in proportion to their Relative Market Shares.

(C) Adjustments:

(i) For calculations made pursuant to this subsection IX(d)(3) (if any) with respect to payments due in the year 2000, the number used in subsection IX(d)(3)(A)(ii)(z) shall be $20 and the number used in subsection IX(d)(3)(A)(iii) shall be $300 million. Each year thereafter, both these numbers shall be adjusted upward or downward by multiplying each of them by the quotient produced by dividing (x) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such year, by (y) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such immediately preceding year.

(ii) For purposes of this subsection, the average revenue per Cigarette of all the Original Participating Manufacturers in any year shall equal (x) the aggregate revenues of all the Original Participating Manufacturers from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico after Federal excise taxes and after payments pursuant to this Agreement and the tobacco litigation Settlement Agreements with the States of Florida, Mississippi, Minnesota and Texas (as such revenues are reported to the United States Securities and Exchange Commission ("SEC") for such year (either independently by the Original Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of the Original Participating Manufacturers) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with United States generally accepted accounting principles and audited by a nationally recognized accounting firm), divided by (y) the aggregate number of the individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such year (determined in accordance with subsection II(mm)).

(D) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied both (x) the Relative Market Share of Lorillard Tobacco Company (or of its successor) ("Lorillard") was less than or equal to 20.0000000%, and (y) the number of individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by Lorillard (determined in accordance with subsection II(mm)) (for purposes of this subsection (D), "Volume") was less than or equal to 70 billion, Lorillard's and Philip Morris Incorporated's (or its successor's) ("Philip Morris") shares of the Available NPM Adjustment calculated pursuant to subsections (3)(A)-(C) above shall be further reallocated between Lorillard and Philip Morris as follows (this subsection (3)(D) shall not apply in the year in which either of the two conditions specified in this sentence is not satisfied):

(i) Notwithstanding subsections (A)-(C) of this subsection (d)(3), but subject to further adjustment pursuant to subsections (D)(ii) and (D)(iii) below, Lorillard's share of the Available NPM Adjustment shall equal its Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding the year in which such NPM Adjustment is applied). The dollar amount of the difference between the share of the Available NPM Adjustment Lorillard is entitled to pursuant to the preceding sentence and the share of the Available NPM Adjustment it would be entitled to in the same year pursuant to subsections (d)(3)(A)-(C) shall be reallocated to Philip Morris and used to decrease or increase, as the case may be, Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C).

(ii) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied either (x) Lorillard's Relative Market Share was greater than 15.0000000% (but did not exceed 20.0000000%), or (y) Lorillard's Volume was greater than 50 billion (but did not exceed 70 billion), or both, Lorillard's share of the Available NPM Adjustment calculated pursuant to subsection (d)(3)(D)(i) shall be reduced by a percentage equal to the greater of *(1)* 10.0000000% for each percentage point (or fraction thereof) of excess of such Relative Market Share over 15.0000000% (if any), or *(2)* 2.5000000% for each billion (or fraction thereof) of excess of such Volume over 50 billion (if any). The dollar amount by which Lorillard's share of the Available NPM Adjustment is reduced in any year pursuant to this subsection (D)(ii) shall be reallocated to Philip Morris and used to increase Philip Morris's share of the Available NPM Adjustment in such year.

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.

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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
FORM OF ESCROW AGREEMENT

This Escrow Agreement is entered into as of _______________, 1998 by the undersigned State officials (on behalf of their respective Settling States), the undersigned Participating Manufacturers and ____________________ as escrow agent (the "Escrow Agent").

WITNESSETH:

WHEREAS, the Settling States and the Participating Manufacturers have entered into a settlement agreement entitled the "Master Settlement Agreement" (the "Agreement"); and

WHEREAS, the Agreement requires the Settling States and the Participating Manufacturers to enter into this Escrow Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1. *Appointment of Escrow Agent.*

The Settling States and the Participating Manufacturers hereby appoint ______________________ to serve as Escrow Agent under this Agreement on the terms and conditions set forth herein, and the Escrow Agent, by its execution hereof, hereby accepts such appointment and agrees to perform the duties and obligations of the Escrow Agent set forth herein. The Settling States and the Participating Manufacturers agree that the Escrow Agent appointed under the terms of this Escrow Agreement shall be the Escrow Agent as defined in, and for all purposes of, the Agreement.

SECTION 2. *Definitions.*

(a) Capitalized terms used in this Escrow Agreement and not otherwise defined herein shall have the meaning given to such terms in the Agreement.

(b) "Escrow Court" means the court of the State of New York to which the Agreement is presented for approval, or such other court as agreed to by the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question.

SECTION 3. *Escrow and Accounts.*

(a) All funds received by the Escrow Agent pursuant to the terms of the Agreement shall be held and disbursed in accordance with the terms of this Escrow Agreement. Such funds and any earnings thereon shall constitute the "Escrow" and shall be held by the Escrow Agent separate and apart from all other funds and accounts of the Escrow Agent, the Settling States and the Participating Manufacturers.

(b) The Escrow Agent shall allocate the Escrow among the following separate accounts (each an "Account" and collectively the "Accounts"):

SUBSECTION VI(B) ACCOUNT
SUBSECTION VI(C) ACCOUNT (FIRST)
SUBSECTION VI(C) ACCOUNT (SUBSEQUENT)
SUBSECTION VIII(B) ACCOUNT
SUBSECTION VIII(C) ACCOUNT
SUBSECTION IX(B) ACCOUNT (FIRST)
SUBSECTION IX(B) ACCOUNT (SUBSEQUENT)
SUBSECTION IX(C)(1) ACCOUNT
SUBSECTION IX(C)(2) ACCOUNT
SUBSECTION IX(E) ACCOUNT
DISPUTED PAYMENTS ACCOUNT
STATE-SPECIFIC ACCOUNTS WITH RESPECT TO EACH SETTLING STATE IN WHICH STATE-SPECIFIC FINALITY OCCURS.

(c) All amounts credited to an Account shall be retained in such Account until disbursed therefrom in accordance with the provisions of this Escrow Agreement pursuant to (i) written instructions from the Independent Auditor; or (ii) written instructions from all of the following: all of the Original Participating Manufacturers; all of the Subsequent Participating Manufacturers that contributed to such amounts in such Account; and all of the Settling States (collectively, the "Escrow Parties"). In the event of a conflict, instructions pursuant to clause (ii) shall govern over instructions pursuant to clause (i).

(d) On the first Business Day after the date any payment is due under the Agreement, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount of such payment (or indicating that no payment was made, if such is the case), the source of such payment, the Account or Accounts to which such payment has been

credited, and the payment instructions received by the Escrow Agent from the Independent Auditor with respect to such payment.

(e) The Escrow Agent shall comply with all payment instructions received from the Independent Auditor unless before 11:00 a.m. (New York City time) on the scheduled date of payment it receives written instructions to the contrary from all of the Escrow Parties, in which event it shall comply with such instructions.

(f) On the first Business Day after disbursing any funds from an Account, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount disbursed, the date of such disbursement and the payee of the disbursed funds.

SECTION 4. *Failure of Escrow Agent to Receive Instructions.*

In the event that the Escrow Agent fails to receive any written instructions contemplated by this Escrow Agreement, the Escrow Agent shall be fully protected in refraining from taking any action required under any section of this Escrow Agreement other than Section 5 until such written instructions are received by the Escrow Agent.

SECTION 5. *Investment of Funds by Escrow Agent.*

The Escrow Agent shall invest and reinvest all amounts from time to time credited to the Accounts in either (i) direct obligations of, or obligations the principal and interest on which are unconditionally guaranteed by, the United States of America; (ii) repurchase agreements fully collateralized by securities described in clause (i) above; (iii) money market accounts maturing within 30 days of the acquisition thereof and issued by a bank or trust company organized under the laws of the United States of America or of any of the 50 States thereof (a "United States Bank") and having combined capital, surplus and undistributed profits in excess of $500,000,000; or (iv) demand deposits with any United States Bank having combined capital, surplus and undistributed profits in excess of $500,000,000. To the extent practicable, monies credited to any Account shall be invested in such a manner so as to be available for use at the times when monies are expected to be disbursed by the Escrow Agent and charged to such Account. Obligations purchased as an investment of monies credited to any Account shall be deemed at all times to be a part of such Account and the income or interest earned, profits realized or losses suffered with respect to such investments (including, without limitation, any penalty for any liquidation of an investment required to fund a disbursement to be charged to such Account), shall be credited or charged, as the case may be, to, such Account and shall be for the benefit of, or be borne by, the person or entity entitled to payment from such Account. In choosing among the investment options described in clauses (i) through (iv) above, the Escrow Agent shall comply with any instructions received from time to time from all of the Escrow Parties. In the absence of such instructions, the Escrow Agent shall invest such sums in accordance with clause (i) above. With respect to any amounts credited to a State-Specific Account, the Escrow Agent shall invest and reinvest all amounts credited to such Account in accordance with the law of the applicable Settling State to the extent such law is inconsistent with this Section 5.

SECTION 6. *Substitute Form W-9; Qualified Settlement Fund.*

Each signatory to this Escrow Agreement shall provide the Escrow Agent with a correct taxpayer identification number on a substitute Form W-9 or if it does not have such a number, a statement evidencing its status as an entity exempt from back-up withholding, within 30 days of the date hereof (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). The escrow established pursuant to this Escrow Agreement is intended to be treated as a Qualified Settlement Fund for federal tax purposes pursuant to Treas. Reg. § 1.468B-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

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Special Committee shall designate the times for such meetings, so that a response is made to the Grant Application as expeditiously as practicable.

Section 9

The Special Committee may issue a grant from the Fund only when an Attorney General certifies that the monies will be used in connection with a Qualifying Action, to wit: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute. The Attorney General submitting such application shall further certify that the entire grant of monies from the Fund will be used to pay for such investigation and/or litigation. The Grant Application shall describe the nature and scope of the intended action and use of the funds which may be granted.

Section 10

To the extent permitted by law, each Attorney General whose Grant Application is favorably acted upon shall promise to pay back to the Fund all of the amounts received from the Fund in the event the state is successful in litigation or settlement of a Qualifying Action. In the event that the monetary recovery, if any, obtained is not sufficient to pay back the entire amount of the grant, the Attorney General shall pay back as much as is permitted by the recovery. In all instances where monies are granted, the Attorney General(s) receiving monies shall provide an accounting to NAAG of all disbursements received from the Fund no later than the 30th of June next following such disbursement.

Section 11

In addition to the repayments to the Fund contemplated in the preceding section, the Special Committee may deposit in the Fund any other monies lawfully committed for the precise purpose of the Fund as set forth in section A(3) above. For example, the Special Committee may at its discretion accept for deposit in the Fund a foundation grant or court-ordered award for state antitrust and/or consumer protection enforcement as long as the monies so deposited become part of and subject to the same rules, purposes and limitations of the Fund.

Section 12

The Special Committee shall be the sole and final arbiter of all Grant Applications and of the amount awarded for each such application, if any.

Section 13

The Special Committee shall endeavor to maintain the Fund for as long a term as is consistent with the purpose of the Fund. The Special Committee will limit the total amount of grants made to a single state to no more than $500,000.00. The Special Committee will not award a single grant in excess of $200,000.00, unless the grant involves more than one state, in which case, a single grant so made may not total more than $300,000.00. The Special Committee may, in its discretion and by unanimous vote, decide to waive these limitations if it determines that special circumstances exist. Such decision, however, shall not be effective unless ratified by a two-thirds majority vote of the NAAG executive committee.

Section C
Grant Application Procedures

Section 1

This Protocol shall be transmitted to the Attorneys General within 90 days after the MSA Execution Date. It may not be amended unless by recommendation of the NAAG executive committee and majority vote of the Settling States. NAAG will notify the Settling States of any amendments promptly and will transmit yearly to the attorneys general a statement of the Fund balance and a summary of deposits to and withdrawals from the Fund in the previous calendar or fiscal year.

Section 2

Grant Applications must be in writing and must be signed by the Attorney General submitting the application.

Section 3

Grant Applications must include the following:

(A) A description of the contemplated/pending action, including the scope of the alleged violation and the area (state/regional/multi-state) likely to be affected by the suspected offending conduct.

(B) A statement whether the action is actively and currently pursued by any other Attorney General or other prosecuting authority.

(C) A description of the purposes for which the monies sought will be used.

(D) The amount requested.

(E) A directive as to how disbursements from the Fund should be made, e.g., either directly to a supplier of services (consultants, experts, witnesses, and the like), to the Attorney General's office directly, or in the case of multi-state action, to one or more Attorneys General's offices designated as a recipient of the monies.

(F) A statement that the applicant Attorney(s) General will, to the extent permitted by law, pay back to the Fund all, or as much as is possible, of the monies received, upon receipt of any monetary recovery obtained in the contemplated/pending litigation or settlement of the action.

(G) A certification that no part of the grant monies will be used to pay the salaries or ordinary expenses of any regular employee of the office of the applicant(s) and that the grant will be used solely to pay for the stated purpose.

(H) A certification that an accounting will be provided to NAAG of all monies received by the applicant(s) by no later than the 30th of June next following any receipt of such monies.

Section 4

All Grant Applications shall be submitted to the NAAG office at the following address: National Association of Attorneys General, 750 1st Street, NE, Suite 1100, Washington D.C. 20002.

Section 5

The Special Committee will endeavor to act upon all complete and properly submitted Grant Applications within 30 days of receipt of said applications.

Section D
Other Disbursements from the Fund

Section 1

To enforce and implement the terms of the Agreement, the Special Committee shall direct disbursements from the Fund to comply with the partial payment obligations set forth in section XI of the Agreement relative to costs of the Independent Auditor. A report of such disbursements shall be included in the accounting given pursuant to section C(1) above.

Section E
Administrative Costs

Section 1

NAAG shall receive from the Fund on July 1, 1999 and on July 1 of each year thereafter an administrative fee of $100,000 for its administrative costs in performing its duties under the Protocol and this Agreement. The NAAG executive committee may adjust the amount of the administrative fee in extraordinary circumstances.

EXHIBIT K
MARKET CAPITALIZATION PERCENTAGES

Philip Morris Incorporated	68.0000000%
Brown & Williamson Tobacco Corporation	17.9000000%
Lorillard Tobacco Company	7.3000000%
R.J. Reynolds Tobacco Company	6.8000000%
Total	100.0000000%

EXHIBIT L
MODEL CONSENT DECREE

IN THE [XXXXXX] COURT OF THE STATE OF [XXXXXX]
IN AND FOR THE COUNTY OF [XXXXX]

- x CAUSE NO. XXXXXX

STATE OF [XXXXXXXXXXX],
Plaintiff,
v.
[XXXXXX XXXXX XXXX], et al.,
Defendants.

CONSENT DECREE AND FINAL JUDGMENT

- x

WHEREAS, Plaintiff, the State of [name of Settling State], commenced this action on [date], [by and through its Attorney General [name]], pursuant to [her/his/its] common law powers and the provisions of [state and/or federal law];

WHEREAS, the State of [name of Settling State] asserted various claims for monetary, equitable and injunctive relief on behalf of the State of [name of Settling State] against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's complaint [and amended complaints, if any] and denied the State's allegations [and asserted affirmative defenses];

WHEREAS, the parties desire to resolve this action in a manner which appropriately addresses the State's public health concerns, while conserving the parties' resources, as well as those of the Court, which would otherwise be expended in litigating a matter of this magnitude; and

WHEREAS, the Court has made no determination of any violation of law, this Consent Decree and Final Judgment being entered prior to the taking of any testimony and without trial or final adjudication of any issue of fact or law;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED, AS FOLLOWS:

I. JURISDICTION AND VENUE

This Court has jurisdiction over the subject matter of this action and over each of the Participating Manufacturers. Venue is proper in this [county/district].

II. DEFINITIONS

The definitions set forth in the Agreement (a copy of which is attached hereto) are incorporated herein by reference.

III. APPLICABILITY

A. This Consent Decree and Final Judgment applies only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a violation of this Consent Decree and Final Judgment (or any order issued in connection herewith) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such violation, and there shall be no jurisdiction under this Consent Decree and Final Judgment to do so.

B. This Consent Decree and Final Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof. No portion of this Consent Decree and Final Judgment shall provide any rights to, or be enforceable by, any person or entity other than the State of [name of Settling State] or a Released Party. The State of [name of Settling State] may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment.

IV. VOLUNTARY ACT OF THE PARTIES

The parties hereto expressly acknowledge and agree that this Consent Decree and Final Judgment is voluntarily entered into as the result of arm's-length negotiation, and all parties hereto were represented by counsel in deciding to enter into this Consent Decree and Final Judgment.

V. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

A. Taking any action, directly or indirectly, to target Youth within the State of [name of Settling State] in the advertising, promotion or marketing of Tobacco Products, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within the State of [name of Settling State].

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of [name of Settling State] any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

C. After 30 days after the MSA Execution Date, making or causing to be made any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop within the State of [name of Settling State] any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any Media; provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults; and (4) actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) and III(c)(2)(B)(i) of the Agreement, and use of a Brand Name to identify a Brand Name Sponsorship permitted by subsection III(c)(2)(B)(ii).

D. Beginning July 1, 1999, marketing, distributing, offering, selling, licensing or causing to be marketed, distributed, offered, sold, or licensed (including, without limitation, by catalogue or direct mail), within the State of [name of Settling State], any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this section shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public; or (6) apply to apparel or other merchandise (a) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsection III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise, or (b) used at the site of a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement (during such event) that are not distributed (by sale or otherwise) to any member of the general public.

E. After the MSA Execution Date, distributing or causing to be distributed within the State of [name of Settling State] any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Consent Decree and Final Judgment, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

F. Using or causing to be used as a brand name of any Tobacco Product pursuant to any agreement requiring the payment of money or other valuable consideration, any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this provision, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

G. After 60 days after the MSA Execution Date and through and including December 31, 2001, manufacturing or causing to be manufactured for sale within the State of [name of Settling State] any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco); and, after 150 days after the MSA Execution Date and through and including December 31, 2001, selling or distributing within the State of [name of Settling State] any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

H. Entering into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in the preceding

sentence shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

I. Making any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Provided, however, that nothing in the preceding sentence shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

VI. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained by the Court for the purposes of implementing and enforcing the Agreement and this Consent Decree and Final Judgment and enabling the continuing proceedings contemplated herein. Whenever possible, the State of [name of Settling State] and the Participating Manufacturers shall seek to resolve any issue that may exist as to compliance with this Consent Decree and Final Judgment by discussion among the appropriate designees named pursuant to subsection XVIII(m) of the Agreement. The State of [name of Settling State] and/or any Participating Manufacturer may apply to the Court at any time for further orders and directions as may be necessary or appropriate for the implementation and enforcement of this Consent Decree and Final Judgment. Provided, however, that with regard to subsections V(A) and V(I) of this Consent Decree and Final Judgment, the Attorney General shall issue a cease and desist demand to the Participating Manufacturer that the Attorney General believes is in violation of either of such sections at least ten Business Days before the Attorney General applies to the Court for an order to enforce such subsections, unless the Attorney General reasonably determines that either a compelling time-sensitive public health and safety concern requires more immediate action or the Court has previously issued an Enforcement Order to the Participating Manufacturer in question for the same or a substantially similar action or activity. For any claimed violation of this Consent Decree and Final Judgment, in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation, the Attorney General shall give good-faith consideration to whether: (1) the Participating Manufacturer that is claimed to have committed the violation has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless that party has been guilty of a pattern of violations of like nature; and (2) a legitimate, good-faith dispute exists as to the meaning of the terms in question of this Consent Decree and Final Judgment. The Court in any case in its discretion may determine not to enter an order for monetary, civil contempt or criminal sanctions.

B. This Consent Decree and Final Judgment is not intended to be, and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Consent Decree and Final Judgment; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it in this action, and has stipulated to the entry of this Consent Decree and Final Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as expressly provided otherwise in the Agreement, this Consent Decree and Final Judgment shall not be modified (by this Court, by any other court or by any other means) unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions. Provided, however, that the provisions of sections III, V, VI and VII of this Consent Decree and Final Judgment shall in no event be subject to modification without the consent of the State of [name of Settling State] and all affected Participating Manufacturers. In the event that any of the sections of this Consent Decree and Final Judgment enumerated in the preceding sentence are modified by this Court, by any other court or by any other means without the consent of the State of [name of Settling State] and all affected Participating Manufacturers, then this Consent Decree and Final Judgment shall be void and of no further effect. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that the Participating Manufacturers will comply with this Consent Decree and Final Judgment as originally entered, even if the Participating Manufacturers' obligations hereunder are greater than those imposed under current or future law (unless compliance with this Consent Decree and Final Judgment would violate such law). A change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Participating Manufacturers shall not support modification of this Consent Decree and Final Judgment.

D. In any proceeding which results in a finding that a Participating Manufacturer violated this Consent Decree and Final Judgment, the Participating Manufacturer or Participating Manufacturers found to be in violation shall pay the State's costs and attorneys' fees incurred by the State of [name of Settling State] in such proceeding.

E. The remedies in this Consent Decree and Final Judgment are cumulative and in addition to any other remedies the State of [name of Settling State] may have at law or equity, including but not limited to its rights under the Agreement. Nothing herein shall be construed to prevent the State from bringing an action with respect to conduct not released pursuant to the Agreement, even though that conduct may also violate this Consent Decree and Final Judgment. Nothing in this Consent Decree and Final Judgment is intended to create any right for [name of Settling State] to obtain any Cigarette product formula that it would not otherwise have under applicable law.

F. No party shall be considered the drafter of this Consent Decree and Final Judgment for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter. Nothing in this Consent Decree and Final Judgment shall be construed as approval by the State of [name of Settling State] of the Participating Manufacturers' business organizations, operations, acts or practices, and the Participating Manufacturers shall make no representation to the contrary.

G. The settlement negotiations resulting in this Consent Decree and Final Judgment have been undertaken in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Consent Decree and Final Judgment shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Consent Decree and Final Judgment nor any public discussions, public statements or public comments with respect to this Consent Decree and Final Judgment by the State of [name of Settling State] or any Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Consent Decree and Final Judgment.

H. All obligations of the Participating Manufacturers pursuant to this Consent Decree and Final Judgment (including, but not limited to, all payment obligations) are, and shall remain, several and not joint.

I. The provisions of this Consent Decree and Final Judgment are applicable only to actions taken (or omitted to be taken) within the States. Provided, however, that the preceding sentence shall not be construed as extending the territorial scope of any provision of this Consent Decree and Final Judgment whose scope is otherwise limited by the terms thereof.

J. Nothing in subsection V(A) or V(I) of this Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

K. If the Agreement terminates in this State for any reason, then this Consent Decree and Final Judgment shall be void and of no further effect.

VII. FINAL DISPOSITION

A. The Agreement, the settlement set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein.

B. The Court finds that the person[s] signing the Agreement have full and complete authority to enter into the binding and fully effective settlement of this action as set forth in the Agreement. The Court further finds that entering into this settlement is in the best interests of the State of [name of Settling State].

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this _____ day of ______________, 1998.

EXHIBIT M
LIST OF PARTICIPATING MANUFACTURERS' LAWSUITS AGAINST THE SETTLING STATES

1. Philip Morris, Inc., et al. v. Margery Bronster, Attorney General of the State of Hawaii, In Her Official Capacity, Civ. No. 96-00722HG, United States District Court for the District of Hawaii

2. Philip Morris, Inc., et al. v. Bruce Botelho, Attorney General of the State of Alaska, In His Official Capacity, Civ. No. A97-0003CV, United States District Court for the District of Alaska

3. Philip Morris, Inc., et al. v. Scott Harshbarger, Attorney General of the Commonwealth of Massachusetts, In His Official Capacity, Civ. No. 95-12574-GAO, United States District Court for the District of Massachusetts

4. Philip Morris, Inc., et al. v. Richard Blumenthal, Attorney General of the State of Connecticut, In His Official Capacity, Civ. No. 396CV01221 (PCD), United States District Court for the District of Connecticut

5. Philip Morris, et al. v. William H. Sorrell, et al., No. 1:98-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.

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[1] [A State may elect to delete the "findings and purposes" section in its entirety. Other changes or substitutions with respect to the "findings and purposes" section (except for particularized state procedural or technical requirements) will mean that the statute will no longer conform to this model.]

(i) "Tobacco Product Manufacturer" means an entity that after the date of enactment of this Act directly (and not exclusively through any affiliate):

(1) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsections II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

(2) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(3) becomes a successor of an entity described in paragraph (1) or (2).

The term "Tobacco Product Manufacturer" shall not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within any of (1) - (3) above.

(j) "Units sold" means the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State. The [fill in name of responsible state agency] shall promulgate such regulations as are necessary to ascertain the amount of State excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

Section __. Requirements.

Any tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary or intermediaries) after the date of enactment of this Act shall do one of the following:

(a) become a participating manufacturer (as that term is defined in section II(jj) of the Master Settlement Agreement) and generally perform its financial obligations under the Master Settlement Agreement; or

(b) (1) place into a qualified escrow fund by April 15 of the year following the year in question the following amounts (as such amounts are adjusted for inflation) --

1999: $.0094241 per unit sold after the date of enactment of this Act;[2]

2000: $.0104712 per unit sold after the date of enactment of this Act;[3]

for each of 2001 and 2002: $.0136125 per unit sold after the date of enactment of this Act;

for each of 2003 through 2006: $.0167539 per unit sold after the date of enactment of this Act;

for each of 2007 and each year thereafter: $.0188482 per unit sold after the date of enactment of this Act.

(2) A tobacco product manufacturer that places funds into escrow pursuant to paragraph (1) shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances --

(A) to pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the State or any releasing party located or residing in the State. Funds shall be released from escrow under this subparagraph (i) in the order in which they were placed into escrow and (ii) only to the extent and at the time necessary to make payments required under such judgment or settlement;

(B) to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the State's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement (as determined pursuant to section IX(i)(2) of the Master Settlement Agreement, and before any of the adjustments or offsets described in section IX(i)(3) of that Agreement other than the Inflation Adjustment) had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or

(C) to the extent not released from escrow under subparagraphs (A) or (B), funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

(3) Each tobacco product manufacturer that elects to place funds into escrow pursuant to this subsection shall annually certify to the Attorney General [or other State official] that it is in compliance with this subsection. The Attorney General [or other State official] may bring a civil action on behalf of the State against any tobacco product 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.

APPENDIX B

CONSENT DECREE

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CONSENT DECREE

At IAS Part 56 of the Supreme Court of the State of New York, held in and for the County of New York, at the Courthouse located at 60 Centre Street, New York, New York, on the 23rd day of December, 1998

PRESENT:

HON. STEPHEN G. CRANE, Justice

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

THE STATE OF NEW YORK and DENNIS C. VACCO, Attorney General of the State of New York, for and on behalf of the PEOPLE OF THE STATE OF NEW YORK, Plaintiffs, -against- PHILIP MORRIS INCORPORATED; PHILIP MORRIS COMPANIES, INC.; RJR NABISCO, INC.; RJR NABISCO HOLDINGS CORP.; R.J. REYNOLDS TOBACCO CO.; THE AMERICAN TOBACCO CO., INC.; AMERICAN BRANDS, INC.; BROWN & WILLIAMSON TOBACCO CORP.; LORILLARD TOBACCO COMPANY; LORILLARD INCORPORATED; LOEWS CORPORATION; UNITED STATES TOBACCO COMPANY; UST, INC.; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY, LTD.; BATUS HOLDINGS, INC.; THE COUNCIL FOR TOBACCO RESEARCH - U.S.A., INC.; and TOBACCO INSTITUTE, INC., Defendants.	CONSENT DECREE AND FINAL JUDGMENT Index No.: 400361/97 Hon. Stephen G. Crane, Justice.

WHEREAS, Plaintiffs, the State of New York and Attorney General Dennis C. Vacco, commenced this action on January 27, 1997, pursuant to their common law powers and the provisions of N.Y. Executive Law, Public Health Law, General Business Law, Business Corporations Law, Penal Law, Social Services Law, Not-for-Profit Corporations Law, Unconsolidated Law, the Civil Practice Law and Rules, and the State Constitution;

WHEREAS, Plaintiffs asserted various claims for monetary, equitable and injunctive relief, on behalf of the State of New York, including its Counties under GBL §342-b, against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's complaint and amended complaint and denied the State's allegations;

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.

II. DEFINITIONS

The definitions set forth in the Master Settlement Agreement (''MSA'' or ''Agreement'') (a copy of which is attached hereto as Exhibit 1) are incorporated herein by reference. ''County'' means a county of the State of New York, including New York City, with New York City to be treated as a single county and none of its constituent counties to be treated separately; ''Counties'' means the counties of the State of New York, including New York City, with New York City to be treated as a single county and none of its constituent counties to be treated separately; provided, however, that any county that properly excludes itself from the class provisionally certified for settlement purposes only by this Court's Order of November 24, 1998 (the ''Class'') is not included in the definitions of ''County'' or ''Counties.''

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 New York or a Released Party. The State of New York may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment. Provided, however, that a County or Counties may enforce the payment rights provided in Article V of this Consent Decree and Final Judgment, but only against other Counties or the State. Only the State may enforce the provisions of Article V against the Participating Manufacturers.

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. MONETARY RELIEF

A. Under subsections II(r), (s), IX, and XI of the MSA, payments from the Participating Manufacturers will be made to the Escrow Agent for further disbursement, pursuant to an Escrow Agreement executed by the parties and approved by a Court of competent jurisdiction. The State shall instruct the Independent Auditor and the Escrow Agent to disburse funds from the New York State-Specific Account directly to the State of New York and directly to the Counties individually according to the payment schedule annexed hereto as Exhibit 2.

B. The payment schedule set forth in Exhibit 2 shall remain in effect for as long as payments are made from the Participating Manufacturers under the MSA. The portion of those payments credited to the New York State-Specific Account, if any, shall be allocable to the State of New York and the individual Counties as set forth in Exhibit 2.

C. Effective upon the occurrence of State-Specific Finality in the State of New York, and to the extent that such claims may not otherwise be released by operation of the MSA, the Counties (as defined in this Consent Decree and Final Judgment) hereby absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Counties directly, indirectly, derivatively or in any other capacity ever had, now have, or hereafter can, shall, or may have, to the same extent that the Settling States are releasing Released Claims against Released Parties under the MSA.

D. Each County (as defined in this Consent Decree and Final Judgment) further covenants and agrees that it shall not after the occurrence of State-Specific Finality in the State of New York 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.

E. Upon the occurrence of State-Specific Finality in the State of New York, the City of New York (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of the action entitled *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, and the County of Erie (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of its action entitled *County of Erie v. The Tobacco Institute, Inc. et al.*, Supreme Court of the State of New York, County of Erie, Index No. 1997/359.

F. If a County or Counties properly excludes itself from the Class, such County or Counties shall not receive any funds under the MSA, and the State may, in its sole discretion, place the funds allocated to such County or Counties under Exhibit 2 to this Consent Decree And Final Judgment in escrow.

G. If any funds are recouped from the State of New York by the Federal Government, pursuant to an Act of Congress or otherwise, from monies received or to be received by the State (including its political subdivisions) from the New York State-Specific Account, then the State shall recoup from the Counties the Counties' share of such funds, through offsets or any other mechanisms selected by the State, according to the allocation percentages of the settlement funds in the year or years in question assigned to the respective Counties pursuant to the allocation schedule set forth in Exhibit 2. Nothing herein acknowledges a right of the Federal Government to recoup any such funds.

VI. 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 New York 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 New York.

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of New York 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 New York 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 New York, 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 New York 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 New York 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 New York 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.

VII. 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 New York 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 New York 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. A County may apply for further orders and directions as may be necessary or appropriate for the implementation or enforcement of the fourth sentence of Article III(B) of this Consent Decree and Final Judgment. Provided, however, that with regard to subsections VI(A) and VI(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, VII and VIII of this Consent Decree and Final Judgment shall in no event be subject to modification without the consent of the State of New York 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 New York 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 only by the State of New York 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 New York 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 New York 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 New York 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 New York 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 VI(A) or VI(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.

VIII. 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 persons 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 New York and the Counties.

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this 23rd day of December, 1998

FILED
DEC 23, 1998

COUNTY CLERK'S OFFICE
NEW YORK

/s/ SGC
J.S.C.

STEPHEN G. CRANE
/s/ Norman Goodman
Clerk

EXHIBIT 2

At all times and under all circumstances specified in Section XI of the Master Settlement Agreement that require the Independent Auditor to instruct the Escrow Agent to disburse amounts to the State of New York pursuant to the terms of the Master Settlement Agreement ("New York Disbursal Share"), the Independent Auditor shall allocate all such New York Disbursal Share among the State of New York, the City of New York[1], and the individual counties of New York according to the schedule set forth below and instruct the Escrow Agent to disburse such allocated amounts directly to the State of New York, the City of New York and the specified counties.

(1) With respect to the New York Disbursal Share of all amounts paid by the Participating Manufacturers pursuant to Section IX(b) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse such amounts as follows:

Entity	Percentage of Payment
New York State	51.176%
New York City	26.670%
Albany	0.593%
Allegheny	0.107%
Broome	0.446%
Cattaraugus	0.179%
Cayuga	0.166%
Chautauqua	0.308%
Chemung	0.212%
Chenango	0.104%
Clinton	0.170%
Columbia	0.126%
Cortland	0.100%
Delaware	0.101%
Dutchess	0.500%
Erie	2.194%
Essex	0.075%
Franklin	0.098%
Fulton	0.121%
Genessee	0.118%
Greene	0.085%
Hamilton	0.013%
Herkimer	0.142%
Jefferson	0.190%
Lewis	0.054%
Livingston	0.112%
Madison	0.131%
Monroe	1.536%
Montgomery	0.114%
Nassau	2.739%
Niagara	0.467%

[1]The City of New York includes the five individual boroughs of Manhattan, Bronx, Brooklyn, Queens and Staten Island, and the New York City Health and Hospitals Corporation.

Entity	Percentage of Payment
Oneida	0.544%
Onondaga	0.972%
Ontario	0.181%
Orange	0.564%
Orleans	0.078%
Oswego	0.239%
Otsego	0.122%
Putnam	0.152%
Rensselaer	0.317%
Rockland	0.560%
St. Lawrence	0.239%
Saratoga	0.304%
Schenectady	0.319%
Schoharie	0.063%
Schuyler	0.038%
Seneca	0.069%
Steuben	0.211%
Suffolk	2.673%
Sullivan	0.155%
Tioga	0.100%
Tompkins	0.170%
Ulster	0.334%
Warren	0.113%
Washington	0.113%
Wayne	0.172%
Westchester	1.926%
Wyoming	0.081%
Yates	0.044%

(2) With respect to amounts paid by the Participating Manufacturers pursuant to Section IX(c)(2) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse the entire proceeds to the State of New York.

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. STEPHEN G. CRANE Part 56
Justice

THE STATE OF NEW YORK, et al.,

Plaintiff,

- v -

PHILIP MORRIS, INC., et al.,

Defendants.

INDEX NO.: 400361/97
MOTION DATE: 4/13/99
MOTION SEQ. NO.: 019
MOTION CAL. NO.: 139

The following papers, numbered 1 to ____ were read on this motion to/for

PAPERS NUMBERED

Notice of Motion/Order to Show Cause — Affidavits — Exhibits ____

Answering Affidavits — Exhibits ____

Replying Affidavits ____

Cross-Motion: [ ] Yes [X] No

The State of New York and defendants Brown & Williamson Tobacco Corporation, Philip Morris Incorporated, R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company, jointly move for an order, pursuant to CPLR 5019(a), correcting Exhibit 2 to the "Consent Decree and Final Judgment" relating to the Master Settlement Agreement, entered on December 23, 1998, so that the "Consent Decree and Final Judgment" accurately reflects the original intention of the parties and the terms of the Master Settlement Agreement with respect to the intra-State allocation of annual payments by the Participating Manufacturers pursuant to Section IX(c)(1) of the Master Settlement Agreement. The motion is granted on default.

Accordingly, it is

ORDERED that the motion is granted on default; and it is further

ORDERED that Paragraph (1) of "Exhibit 2" to the "Consent Decree and Final Judgment" relating to the Master Settlement Agreement, entered on December 23, 1998, shall be amended to read as follows:

(1) With respect to the New York Disbursal Share of all amounts paid by the Participating Manufacturers pursuant to Sections IX(b) or IX(c)(1) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse such amounts as follows: . . . .

The foregoing constitutes the decision and order of the court.

Dated: April 14, 1999

/s/ SGC
STEPHEN G. CRANE J.S.C.

Check One: [ ] FINAL DISPOSITION [X] NON-FINAL DISPOSITION
/s/ MDAR

APPENDIX C

ARBITRATION FINAL AWARD RE: STATE OF NEW YORK IN THE 2003 NPM ADJUSTMENT PROCEEDINGS

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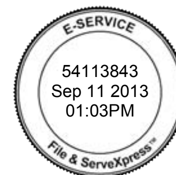

Hon. Fern M. Smith (Ret.)
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ARBITRATOR

ARBITRATION

In the 2003 NPM Adjustment Proceedings	**JAMS Ref No. 1100053390** **FINAL AWARD RE: STATE OF NEW YORK**

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

1 Tobaksfabrik A/S, P.T. Djarum, Santa Fe Natural Tobacco Company, Inc., Sherman 1400
2 Broadway N.Y.C., Inc., Top Tobacco LP, and Von Eicken Group. All Petitioners are
3 collectively referred to as PMs for purposes of this Award, and a finding as to one PM is a
4 finding as to all, unless specifically noted.

5 Respondents in the Petitioners' claim were initially listed as the 52 States and Territories
6 that are parties to the MSA. The MSA refers to these States and Territories as "Settling States."

7 The Settling States originally consisted of Alabama, Alaska, American Samoa, Arizona,
8 Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Georgia, Guam,
9 Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland,
10 Massachusetts, Michigan, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey,
11 New Mexico, New York, North Carolina, North Dakota, the Northern Marianas Islands, Ohio,
12 Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota,
13 Tennessee, U.S. Virgin Islands, Utah, Vermont, Virginia, Washington, West Virginia,
14 Wisconsin, and Wyoming. (Four States–Florida, Minnesota, Mississippi, and Texas–had entered
15 into separate settlements with certain PMs prior to the MSA and, therefore, are not parties to the
16 MSA.) Since this proceeding began, the PMs have dismissed their allegations against several
17 states (Alaska, Delaware, Hawaii, Idaho, Massachusetts, New Jersey, Rhode Island, South
18 Dakota, Utah, Vermont, Wisconsin, Wyoming, Guam, the Northern Mariana Islands, American
19 Samoa, and the U.S. Virgin Islands; *see* Participating Manufacturers' Notice of Contest as to
20 Certain States' Claims of Diligent Enforcement, filed November 3, 2011). Further, numerous
21 other states entered into a Settlement Agreement with the PMs, dated March 12, 2013, leaving 15
22 States who remain in this proceeding for whom Awards are now addressed by this Arbitration
23 Panel (the "Panel"). Numerous issues ("Global Issues") are decided and applicable to all
24 remaining Parties; however, because each remaining Settling State may have recourse to its own
25 MSA Court, the Panel will issue a separate Award for each specific state, including therein both
26 the Global Issues and also determinations that are specific to that state only.

27 Although numerous references may be made to the National Association of Attorneys
28 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

1 Manufacturers ("NPMs").

2 Pursuant to the MSA, each PM makes a single annual payment based on its nationwide
3 cigarette sales volume during each calendar year. The annual payment on a year's volume is due
4 on April 15 of the following year. It is alleged, and not disputed, that these annual payments
5 total in the billions of dollars each year. For example, the OPMs' aggregate base payment
6 obligation was approximately $8 billion for 2003 (the year in question here). *See* MSA §§
7 IX(c)(1)-(2). The SPMs make separate annual payments also based on their sales volume during
8 the year. *See* MSA § IX(i). The PMs' annual payments are calculated by an "Independent
9 Auditor" agreed to by the parties. *See* MSA § XI(a)(1).

10 The MSA's annual base payment amounts are subject to various adjustments, including
11 an Inflation Adjustment and a Volume Adjustment (under which the base payments are increased
12 or decreased in proportion to changes in the OPMs' nationwide volume of sales). *See* MSA §§
13 IX(c), XI(a). According to the PMs, and not disputed, the OPMs' aggregate annual payments
14 after these and other adjustments (other than the NPM Adjustment) since the MSA was entered
15 into have been as follows: 1999–$3.545 billion; 2000–$4.022 billion; 2001–$5.066 billion;
16 2002–$4.967 billion; 2003–$5.950 billion; 2004–$6.048 billion; 2005–$6.128 billion; 2006–
17 $6.221 billion; 2007–$7.076 billion; 2008–$7.011 billion; and 2009–$6.497 billion. These
18 payments are split among the OPMs in proportion to their relative market shares. *See* MSA §§
19 IX(c)(1)-(2).

20 Each SPM makes annual payments that, on a per-cigarette basis, approximate the OPMs'
21 annual payments and that are likewise based on the SPMs' sales volume during the year in
22 question. *See* MSA § IX(i). The SPMs' aggregate annual payments for each year have been
23 claimed as follows: 1999–$46.4 million; 2000–$98.5 million; 2001–$200.4 million; 2002–
24 $319.0 million; 2003–$484.5 million; 2004–$433.7 million; 2005–$441.5 million; 2006–$517.7
25 million; 2007–$475.0 million; 2008–$569.5 million; and 2009–$571.5 million.

26 These annual payments continue each year into perpetuity. The PMs' total MSA
27 payments to the Settling States to date exceed $70 billion, including the annual payments listed
28 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. <u>"Diligent Enforcement" Defined.</u>

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. Whether a State Used the "Fabricator" or "Control" Test.

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 New York.

1. The Attorneys and Witnesses for the New York Hearing.

a. The Attorneys for New York

i. New York State Office of the Attorney General

Louis Willenken

Sarah Evans

Dana Biberman

b. The Attorneys for the PMs

i. Jones Day

Peter Biersteker

Barbara Harding

Kelly Marino

William Laxton

ii. Winston & Strawn LLP

Alexander Shaknes

c. The Witnesses for New York

i. David Nocenti

Office of the Attorney General in 2002-2003 (served as counsel to the Attorney General)

ii. Pedro Perez

New York State Police

iii. Bernard Reddy

Expert Witness, Economic Consultant at NERA Economic Consulting

iv. William Comiskey

New York Office of Taxation and Finance

d. The Witnesses for the PMs

i. James Levinsohn

Expert Witness

ii. Colleen Waring

Expert Witness

iii. Richard Briffault

Expert Witness

iv. James Calvin

New York Association of Convenience Stores

2. 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.

New York is in a class by itself in these arbitrations, in that the only contested issue was whether New York failed to diligently enforce its escrow statute because it did not impose an excise tax on sales of units sold by Native American Tribes on their Reservations in New York State, or make any attempt to have escrow collected on those sales. The PMs contend that New York unilaterally excluded NPM sales from excise tax, something that they could not do, and so

failed to diligently enforce their escrow statute. In light of the narrow issue, the Panel foregoes its usual analysis of various factors in determining diligent enforcement.

While the issue presented to the Panel is narrow, its significance is not. Excluding 2002 NPM sales through New York's Native American Reservations, New York had a collection rate exceeding 100%, a statistic far exceeding any Settling State's collection rate, contested or not, and supporting the conclusion that New York had a robust enforcement environment. But if 2002 NPM sales through New York's Native American Reservations are included, the collection rate drops to a devastating 9–16%.

There is no question that NPMs had a considerable cost advantage over PMs, who had to make MSA payments on reservation sales because such sales generate federal tax payments and are so counted for MSA purposes. On the other hand, NPM sales on Native American Reservations did not result in state excise taxes.

The PMs' argument that New York did not diligently enforce its escrow statute depends on the definition of "Units Sold." New York's position was that, under the plain meaning of "units sold," it did not have to collect escrow on sales on Native American lands because no excise tax was imposed on such sales. The Panel has already agreed with New York's understanding of the meaning of "units sold." *See* pp. 14-15, *supra.* New York cannot be faulted for not collecting escrow on un-taxed cigarettes when the statute on its face did not require collection of escrow on cigarettes that were not taxed.

The PMs further argue that New York was somehow obliged to do what its escrow statute did not require—that, in fact, it should have changed the definition of "units sold," or changed its policy of not imposing state excise tax ("SET") on cigarettes sold on Native American lands. The PMs' position fundamentally comes down to an argument that New York was not acting in good faith and contrary to the spirit of the MSA.

There is no evidence that New York's policy of not collecting excise taxes on cigarettes sold on Native American Reservations was done in the face of a recognized obligation to do so. In fact, the testimony is just the contrary.

1 From January 1999 through December 2006, David Nocenti was the person with ultimate
2 responsibility for overseeing all tobacco enforcement matters. He persuasively testified at length
3 and without contradiction about New York's policy of forbearance of imposing excise taxes on
4 cigarettes sold through Native American Reservations. Although New York law did require the
5 taxation of such sales, there was a policy of forbearance that originated in the late 1930s. The
6 policy was declared unconstitutional in 1996, but when New York began to interdict illegal sales,
7 it led to significant destruction and violence on many of the Reservations. In May 1997, the
8 policy of interdiction was enjoined and the policy of forbearance continued. In October 1997,
9 the Appellate Division declared the policy unconstitutional, but in April 1998, Governor Pataki
10 issued regulations that explicitly said the State was not collecting SET on cigarette sales on
11 Native American Reservations. In July 1998, three or four months before the MSA was signed,
12 the New York State Court of Appeals held the forbearance policy was not unconstitutional and
13 remanded the case. In July 1999, the trial court declared the forbearance policy to be rational.
14 The decision was affirmed by the Appellate Division in August 2000.
15 In light of that tortious history, it cannot be said that the decision of the Attorney
16 General's office to continue the forbearance policy amounted to a bad-faith decision in
17 derogation of its MSA obligations to diligently enforce its escrow statute.
18 Mr. Nocenti's good-faith decision that he did not have a basis to collect a tax not
19 authorized by the statute and to adhere to New York's long-standing policy of forbearance does
20 not amount to an absence of diligent enforcement.
21 Nor was Mr. Nocenti's testimony in other respects contradicted. He testified that from
22 1999 through 2003 he had many one-on-one phone conversations with the PMs as well as
23 attending biannual meetings between Settling States and PMs where a variety of issues relating
24 to enforcement, marketing, and provisions of the MSA were discussed. He had no recollection
25 that during that time the PMs ever asserted that New York should be collecting escrow or excise
26 tax on any Native American cigarette sales.
27 It is inconceivable that the PMs were not aware of this situation since the escrow statute
28 itself requires that excise taxes were based on tax stamps and without such taxation there was no

possibility of ascertaining the amount owed on untaxed cigarettes. Moreover, some of the PMs themselves were selling cigarettes on Native American Reservations, so they had to know their sales were not tax stamped. As Mr. Nocenti testified: "Everybody knew we weren't collecting taxes" on Native American sales. At the very least, the PMs were put on inquiry notice.

The evidence of record discloses that it was the policy of New York before the MSA was signed, during the negotiations of the MSA, and immediately afterwards that New York was not seeking to collect excise taxes on those sales. There is no evidence to support the argument that New York arbitrarily decided not to impose excise taxes on and collect escrow from sales of cigarettes on Native American Reservations.

The argument of the PMs that Section XVIII (ff) MSA imposes such an obligation is without merit. That section reads:

> (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.

In other words, an obligation of a Settling State applies to Native American lands in a state. But for that provision to be operative, an obligation has to first exist. It does not impose an obligation that did not already exist. As discussed above, there was no obligation under the definition of "Units Sold" to collect escrow on cigarettes that were not subject to an excise tax. Nor does it require a Settling State to collect excise tax where it had a long-standing public policy not to impose excise taxes where it never before imposed them.

3. Conclusion.

For the reasons set forth above, the Panel unanimously finds that New York has satisfied its burden of proving that it diligently enforced the provisions of its Qualifying Statute during calendar year 2003.

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1
FINAL AWARD

2 The Panel unanimously finds that the State of New York diligently enforced its
3 Qualifying Statute during calendar year 2003 and therefore is not subject to an NPM Adjustment
4 pursuant to Section IX(d)(2)(B) of the Master Settlement Agreement.

5 All other claims, if any, not specifically addressed in the Final Award are Denied. This
6 Final Award therefore resolves all claims set forth in this proceeding.

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8 SO ORDERED.

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10 Dated: September 11, 2013

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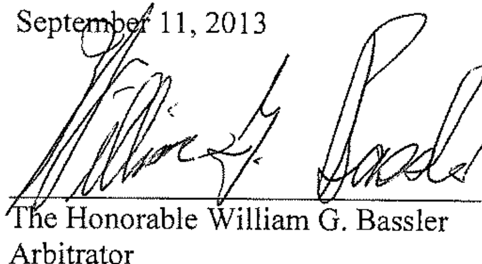

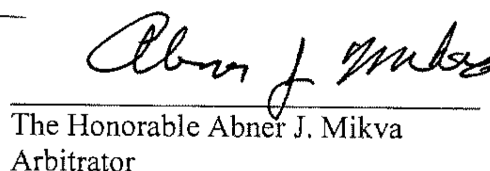

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13 The Honorable William G. Bassler
Arbitrator

The Honorable Abner J. Mikva
Arbitrator

14

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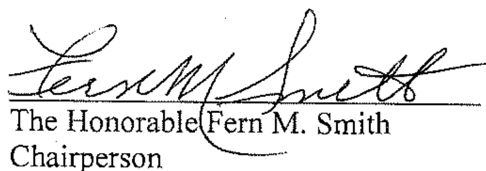

16 The Honorable Fern M. Smith
17 Chairperson

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APPENDIX D

IHS GLOBAL REPORT

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A Forecast of U.S. Cigarette Consumption (2014-2040) for The Niagara Tobacco Asset Securitization Corporation

Submitted to:

The Niagara Tobacco Asset Securitization Corporation

James Diffley
Senior Director

Prepared by:

IHS Global Inc.

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September 9, 2014

Executive Summary

IHS Global Insight has developed a cigarette consumption model based on historical U.S. data between 1965 and 2013. 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 2014 through 2040. Our forecast indicates that total consumption in 2040 will be 121 billion cigarettes (or 122 billion including roll-your-own tobacco equivalents), a 56% decline from the 2013 level. From 2013 through 2040 the average annual rate of decline is projected to be 3.0%.

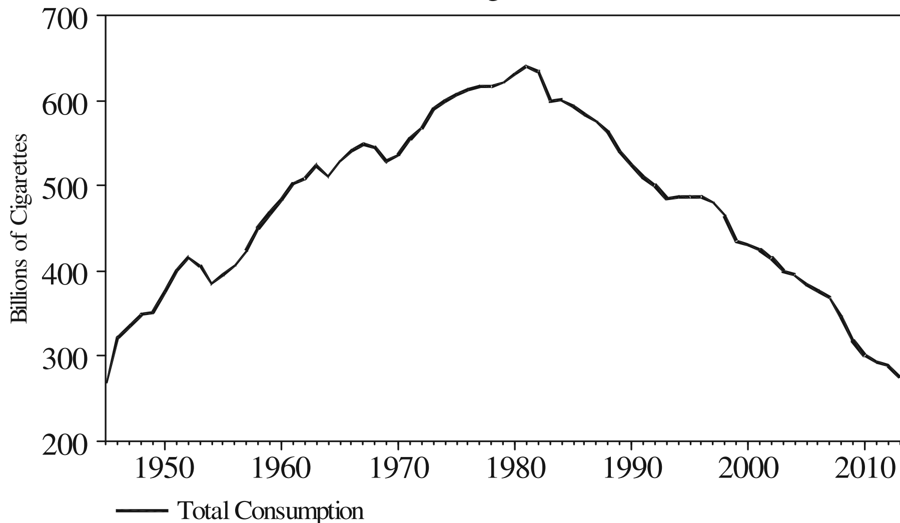
Our model was constructed based on widely accepted economic principles and IHS Global Insight's considerable experience in building econometric forecasting models. A review of the economic research literature indicates that our model is consistent with the prevalent consensus among economists concerning 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 274 billion in 2013[5]. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.



[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, MSAI

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 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 states 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 2.8% in 2011 and 2.0% in 2012. In 2013 the decline sharpened to nearly 5%. This decline has been attributed by the industry to a weak economy, the rapid increase in usage of electronic cigarettes, and to an unfavorable comparison with a surprisingly strong 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, 2013[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:* National Association of Attorneys General, 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
2013	274	-4.76	276	-4.86
2012	288	-1.85	290	-1.97
2011	293	-2.58	296	-2.77
2010	301	-5.52	304	-6.36
2009	319	-8.03	325	-9.09
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 to MSAI, the three leading manufacturers accounted for 85.4% of U.S. shipments in 2013. According to 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. (In July 2014 Reynolds American initiated a purchase of Lorillard.) These companies commanded 47.1%, 23.4%, and 14.9%, respectively of the domestic market in 2013[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, $17.1 billion in 2012 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 42.1 million American adults were current smokers in 2012, representing approximately 18.1% 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. The CDC has, in December 2013, released preliminary results that the smoking rate for adults fell to 17.4% for January to June 2013. 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 since 1998. The decline

[7] IHS Global Insight calculation based on industry shipments data.
[8] *Source*: CDC. Morbidity and Mortality Weekly Report. "Current Cigarette Smoking Among Adults – United States, 2005-2012".January, 2014.

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. The 2014 report also indicated that the percentage of smokers who smoked less than 30 cigarettes per day had declined from 12.6% to 7.0% since 2005.

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. In January 2014 the CDC released further results indicating the quit rates had increased to 52.9% for attempts made in the past year.

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 eighth, tenth, and twelfth graders were lower in 2013 than in 2012, 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.

[10] *Source*: CDC. Morbidity and Mortality Weekly Report. "Tobacco Use Among Adults – United States, 2010". September, 2011.

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

Grade	1991 (%)	2011 (%)	2012 (%)	2013 (%)	'91-'13 Change (%)
8th	14.3	6.1	4.9	4.5	-68.5%
10th	20.8	11.8	10.8	9.1	-56.3%
12th	28.3	18.7	17.1	16.3	-42.4%

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 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 CDC reported on November 15, 2013 that the National Youth Tobacco Survey found that in 2012 the prevalence of tobacco product use among middle and high school students was 6.7% and 23.3%, respectively. These rates decreased from 2011 when they were 7.5% and 24.3%, respectively.
.
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 increased that age to 21. A similar proposal to raise the smoking age has also been introduced in the Colorado, Missouri, New York State, New Jersey, and Vermont legislatures, in the Council of the District of Columbia, and in Suffolk County, New York. 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

[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.

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 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

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[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.
[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.

–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 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

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

[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.

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. Also, in October 2013 researchers at the University of Bristol reported in the British Medical Journal that cessation drugs do not increase suicide risk.

The Mayo Clinic is conducting a study combining Chantix with bupropion (the generic version of Zyban). The study has shown higher smoking abstinence rates compared to the use of Chantix alone (37% vs. 28% after 26 weeks).

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 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. 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. The Affordable Care Act now mandates that new private health insurance plans cover tobacco cessation, and effective January 2014, that tobacco cessation medications can no longer be excluded from state Medicaid coverage.

Electronic Cigarettes

Electronic cigarettes, which are not subject to the MSA, have also gained in popularity in recent years. NJOY, Vapor, Logic, and Blu, are marketing and advertising extensively across the US. Sales in 2013 have been estimated to be as much as $1.5 billion, 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, though it intends to sell the brand to Imperial Tobacco. Reynolds began a national roll-out of VUSE in June 2014 and has stated that it intends to remain focused on VUSE's growth and expansion nationwide. Altria had introduced its own brands as well in 2014.

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).

The American Legacy Foundation conducted a 2013 survey which found, as part of the 41% of smokers who intended to quit smoking in 2014, 12% planned to switch to e-cigs. A Centers for Disease Control and Prevention study published in the November 15th, 2013 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 middle school students increased from 0.6% in 2011 to 1.1% in 2012. Among high school students the prevalence increased from 1.5% in 2011 to 2.8% in 2012. In October 2013 a study at the University of Oklahoma Health Science Center concluded that e-cigarettes do not appear to entice teens to try smoking tobacco. In 2014 University College of London researchers indicated finding that e-cigarettes were 60% more effective than over-the-counter nicotine replacement therapies.

For the consumer, e-cigs are a less expensive alternative as they are not taxed as cigarettes. (Minnesota has imposed a 95% tax on the wholesale cost however, and New Jersey is considering a similar tax.) 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. The states of North Dakota, New Jersey, and Utah prohibit e-cigarette use in workplaces, restaurants, and bars. Arkansas, Colorado, Delaware, New Hampshire, Oklahoma, and Oregon restrict e-cig use at state workplaces and school grounds. And there are, based on data from the ANRF, e-cigarette restrictions at indoor smokefree venues in 172 localities in the US. In 2014, Chicago, New York, and San Francisco extended its public places smoking ban to include e-cigs. . In September 2013 forty state attorneys general sent a letter to the Food and Drug Administration (FDA) urging the agency to regulate electronic cigarettes in the same way it regulates tobacco products. In 2014 the state of Rhode Island banned e-cig sales to those under 18 years of age.

The FDA in April 2014 proposed rules on regulation of additional tobacco products, notably including e-cigarettes, and is taking public comments now. Under the proposed rule, makers of newly deemed tobacco products would register and report product ingredients, refrain from marketing until after FDA review, and make claims of reduced risk only after FDA confirmation that evidence supports such claims, and that the product will benefit public health. Minimum age restrictions and health warning requirements would also be applied to the deemed products. In August 2014, the American health Association backed the use of e-cigarettes as a last resort (after other cessation methods) to help smokers quit.

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

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[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.

points and reduce consumption by smokers nearly 10%. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day 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 2013, Cook County, Illinois increased its cigarette excise tax by $1.00 per pack, and in November Chicago increased its excise tax by $0.50 to push city, county, and state taxes in Chicago to $7.17 per pack. Also in 2013, cigarette excise tax increases were enacted in Minnesota, by $1.60 per pack, Massachusetts, by $1.00 per pack, Oregon, by $0.13 per pack effective January 1, 2014, and in New Hampshire, by $0.10 per pack. The average state tax rate is currently $1.53. Puerto Rico also enacted plans to increase its excise taxes

over the next two years. 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 recommended a bill to raise the state excise by $1.95 per pack. In November 2013 New York City passed an ordinance that set a minimum retail price of a pack of cigarettes at $10.50, and prohibited the use of coupons and promotions to discount that price. Tobacco companies and retail trade groups asked a Federal court in January to block the law. In March 2014, Ohio's Governor proposed a cigarette excise tax increase as part of a budget plan, and tax increase legislation has been introduced in the Maryland legislature. In August 2014, the City of Philadelphia is considering a proposal to establish a $2.00 per pack tax.

The federal excise tax had remained constant, at $0.39 per pack, from 2002 until 2009 when 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. President Obama's 2015 federal budget proposal includes an increase in the Federal Excise Tax to $1.95 per pack, and indexes the rate to inflation.

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 July 2014 was $7.43 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, and of 8 cents per pack by Lorillard. In June 2013 Philip Morris USA reduced promotional allowances on Marlboro and L&M cigarettes by 6 cents per pack. And on

November 25, Philip Morris USA announced that on December 1, 2013 it would reduce promotional allowances and raise prices by seven 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

[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.

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 major success, as the agency concluded that the ads helped to double the amount of calls to their telephone quit line. New CDC campaigns, with graphic adverse health images began in March 2013, and again in July 2014. 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 the graphic ads, which the CDC extrapolated to 100,000 sustained quitters, approximately 0.25% of US smokers. In November 2013 the journal Tobacco Control published research from the University of Illinois at Chicago which concluded that the FDA has underestimated the impact of graphic labels. Examining the experience in Canada the researchers concluded that graphic warning labels reduced smoking rates in Canada by 3% to 5%.

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 February 2014, CVS Caremark announced that it would stop selling cigarettes at its nationwide chain of more than 7,600 pharmacy stores.

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 49.1% 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.

The ANRF documents clean indoor air ordinances by local governments throughout the U.S. As of July 3, 2014, there were 4,037 municipalities with indoor smoking restrictions. Of these, 915 local governments required non-hospitality workplaces to be 100% smoke-free while 949 governments required 100% smoke-free conditions in restaurants, and 818 required the same for bars. The number of such ordinances has grown rapidly in the past two decades. The ordinances completely restricting smoking in

[25] *Source*: American Lung Association. "State Legislated Actions on Tobacco Issues". 2002.

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 2013, 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. estimates 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 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, Santa Monica, and Walnut Creek have also established extensive outdoor restrictions, as have Davis County and the City of Murray in Utah. 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. 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 April 2014, 967 municipalities prohibit smoking in city parks, and 209 municipalities mandate smoke-free city beaches. In January 2014 a smoking ban went into effect in Boston's parks, and 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

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[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

[28] Tauras, John A. "Smoke-Free Air Laws, Cigarette Prices, and Adult Cigarette Demand" Economic Inquiry, April 2006.

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 eight 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.

New Jersey has prohibited smoking in college dormitories since 2005. At least 1,343 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 Illinois, Maryland, New York, Ohio, Oregon, Utah, Vermont, 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.

[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.

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.

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 approximately 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. 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.

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 initiation 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. And in November 2013 twenty-five state attorneys general asked U.S. public health regulators to ban menthol cigarettes.

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[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.

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 2014. 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**.**

[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.

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 2040. It should also be noted that since our entire dataset incorporates the effect of the Surgeon General's health warning (1964), the impact of that variable too is accounted for in the forecast. Similarly the effect of nicotine dependence is incorporated into our entire dataset and influences the trend decline.

Using U.S. data from 1965 through 2013 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 of 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 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.

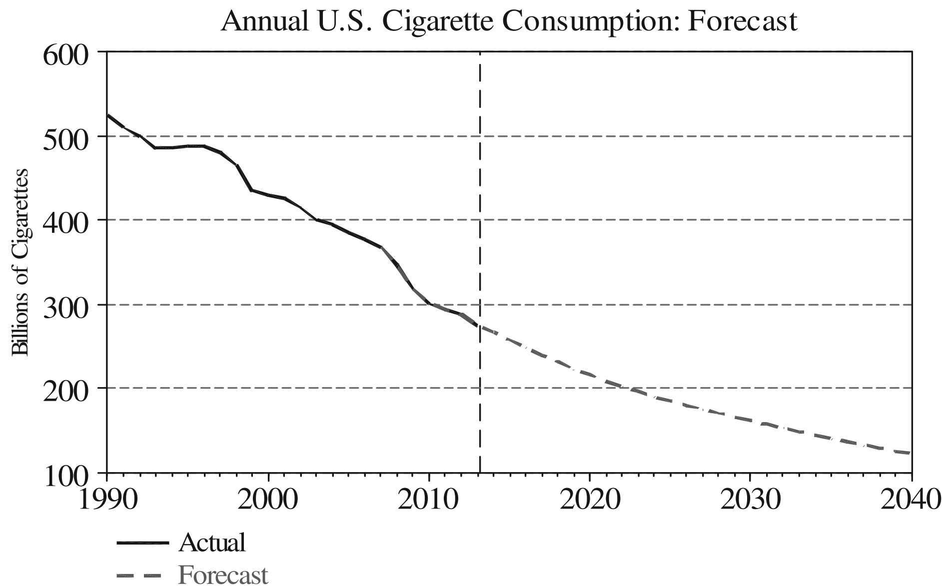
The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the MSA and other state settlement agreements and subsequent excise tax increases. Cigarette prices increased dramatically in November 1998, as manufacturers raised prices 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,$7.00 in 2012, and $7.19 in 2013 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 2015 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 nearly 4% in 2008 and by over 9% in 2009. Cigarette shipment declines moderated after 2010, and in 2012 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 were 4.6% lower than a year ago. For the full year TTB reports shipments 4.8% lower than in 2012. . Weak per capita disposable income

growth was responsible for part of the decline. In addition the manufacturers report that wholesale inventories declined by 1.4 billion sticks during the year. For 2014 we project a consumption decline of 3.4%, as economic growth accelerates. The decline in wholesale shipments of cigarettes will be somewhat less however, 2.9%, as inventories are expected to be rebuilt by 1.4 billion sticks to offset the 2013 decline. In the first quarter of 2014 MSAI reported shipments of 61.0 billion cigarettes, a 2.7% decline from the first quarter of 2013, though the manufacturers reported that after adjusting for inventory change and an extra shipping day the decline was approximately 4% from a year ago. TTB reported 2014 first quarter shipments of 61.3 billion, a decline of 2.5% from 2013, and through May reports a shipment decline of 7.5% compared with the first five months of 2013. On July 2, Altria announced second quarter 2014 earnings results, estimating that after adjusting for trade inventory fluctuation and other factors, its second quarter and first half cigarette shipment volume declined approximately 4% and that industry volume declined approximately 4.5%.

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 2013 through 2040 the average annual rate of decline is projected to be 3.0%.

Forecast U.S. Consumption of Cigarettes

	Total Consumption	Decline Rate	Consumption including Roll-Your-Own	Decline Rate
	(billions)	*(%)*	*(billions)*	*(%)*
2009	318.7	-8.1%	325.0	-9.1%
2010	300.8	-5.6%	304.1	-6.4%
2011	293.3	-2.5%	296.0	-2.7%
2012	287.9	-1.9%	290.1	-2.0%
2013	274.4	-4.8%	276.2	-4.9%
FORECAST				
2014	266.4	-2.9%	268.2	-2.9%
2015	257.2	-3.4%	259.0	-3.4%
2016	248.3	-3.5%	250.0	-3.5%
2017	239.4	-3.6%	241.0	-3.6%
2018	230.8	-3.6%	232.4	-3.6%
2019	222.8	-3.5%	224.3	-3.5%
2020	215.3	-3.4%	216.7	-3.4%
2021	208.2	-3.3%	209.6	-3.3%
2022	201.7	-3.1%	203.0	-3.1%
2023	195.6	-3.0%	196.9	-3.0%
2024	190.0	-2.9%	191.2	-2.9%
2025	184.7	-2.8%	185.9	-2.8%
2026	179.7	-2.7%	180.9	-2.7%
2027	174.9	-2.7%	176.1	-2.7%
2028	170.2	-2.7%	171.4	-2.7%
2029	165.7	-2.7%	166.8	-2.7%
2030	161.2	-2.7%	162.3	-2.7%
2031	156.9	-2.7%	158.0	-2.7%
2032	152.7	-2.7%	153.7	-2.7%
2033	148.5	-2.7%	149.5	-2.7%
2034	144.4	-2.8%	145.4	-2.8%
2035	140.4	-2.8%	141.3	-2.8%
2036	136.5	-2.8%	137.4	-2.8%
2037	132.6	-2.8%	133.5	-2.8%
2038	128.9	-2.8%	129.7	-2.8%
2039	125.1	-2.9%	126.0	-2.9%
2040	121.5	-2.9%	122.3	-2.9%

Comparison With Prior Forecasts

In October 2000 IHS Global, then WEFA presented a similar study, "A Forecast of U.S. Cigarette Consumption (2000-2043) for the Niagara Tobacco Asset Securitization Corporation." That report projected consumption in 2040 of 211.4 billion cigarettes, reflecting an average decline rate of 1.75%. Through 2006 the 2000 study accurately projected consumption declines, but the sharp acceleration in the decline rate thereafter resulted in a substantial forecast error. The current forecast projects an average decline rate of 2.97% through 2040, to an annual consumption level of 121.5 billion sticks. The new forecast was developed with consideration of the large federal tax increase in 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

CERTAIN DEFINITIONS

In addition to terms defined elsewhere in the Official Statement and in the Indenture, the following terms have the following meanings in this Official Statement, unless the context otherwise requires:

"Accounts" means the Collection Account, the Accounts in the Bond Fund and Accounts established by a Series Supplement, which if providing for Junior Payments will be outside the Bond Fund; all of which will be segregated trust accounts established and held by the Indenture Trustee.

"Accreted Value" means, in the case of a Bond that is issued in an amount that includes original issue discount and is specifically identified in the applicable Series Supplement as having Accreted Value, the amounts specified or which can be derived from a formula specified in the applicable Series Supplement.

"Act" means the Not-For-Profit Corporation Law of the State, as in effect from time to time.

"Ancillary Contracts" means contracts entered into by NTASC or for its benefit or the benefit of any of the Beneficiaries to facilitate the issuance, sale, resale, purchase, repurchase or payment of Bonds, including bond insurance, letters of credit and liquidity facilities, but excluding Swap Contracts.

"Authorized Officer" means: (i) in the case of NTASC, any of the President or a Vice President, the Treasurer, the Secretary, an Assistant Treasurer, an Assistant Secretary or their successors in office, and any other person authorized to act by appropriate Written Notice to the Indenture Trustee, and (ii) in the case of the Indenture Trustee, any officer assigned to the Corporate Trust Office, including any managing director, vice president, assistant vice president, assistant treasurer, assistant secretary or any other officer of the Indenture Trustee customarily performing functions similar to those performed by any of the above designated officers and having direct responsibility for the administration of the Indenture, and also, with respect to a particular matter, any other officer, to whom such matter is referred because of such officer's knowledge of and familiarity with the particular subject.

"Beneficiaries" means Bondholders and, to the extent specified in the Indenture, the owner of the Residual Certificate and the parties to Swaps and Ancillary Contracts.

"Bond Fund" means the fund held by the Indenture Trustee pursuant to the Indenture, which includes the Debt Service Account, the Liquidity Reserve Account, the Extraordinary Payment Account and the Trapping Account and such other Accounts as may be established therein by a Supplemental Indenture.

"Bondholders" or "Holders" means the registered owners of the Bonds from time to time as shown on the books of NTASC.

"Consumption Decline Trapping Requirement" means zero ($0.00) dollars.

"Corporation" means the Niagara Tobacco Asset Securitization Corporation.

"Counsel" means nationally recognized bond counsel or such other counsel as may be selected by NTASC for a specific purpose.

"County" means the County of Niagara, New York.

"Cumulative Planned Principal Payments Due" means, as of any date, an amount equal to the excess, if any, of (i) the principal amount of the Planned Principal Payment for such date, if any, plus the aggregate principal amount of the Planned Principal Payments for each prior Planned Principal Payment Date over (ii) Planned Principal Payments previously made on the applicable Senior Bonds.

"Debt Service" means interest (not exceeding the Maximum Rate), redemption premium (except when calculating the Liquidity Reserve Requirement) and Rated Maturities due on Outstanding Senior Bonds and Parity Payments. In the event that Debt Service has been funded from proceeds of Bonds, the amount of Debt Service so funded shall be excluded from the calculation of Debt Service when calculating the Liquidity Reserve Requirement.

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

"Defeasance Collateral" means money and (a) non-callable direct obligations of the United States of America, non-callable and non-prepayable direct federal agency obligations, the timely payment of principal of and interest on which are fully and unconditionally guaranteed by the United States of America, non-callable direct obligations of the United States of America which have been stripped by the United States Treasury itself or by any Federal Reserve Bank (not including "CATS," "TIGRS" and "TRS" unless NTASC obtains a Rating Confirmation with respect thereto) and the interest components of REFCORP bonds for which the underlying bond is non-callable (or non-callable before the due date of such interest component) for which separation of principal and interest is made by request to the Federal Reserve Bank of New York in book-entry form, and shall exclude investments in mutual funds and unit investment trusts; (b) non-callable obligations, the timely payment of principal and interest on which are fully and unconditionally guaranteed by the United States of America; and (c) bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state rated "Aaa" by Moody's (i) 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 (ii) timely payment of which is fully secured by a fund consisting only of cash or obligations of the character described in clauses (a), (b) or (c) which fund may be applied only to the payment when due of such bonds or other obligations.

"Defeased Bonds" means Bonds that are Defeased Obligations.

"Distribution Date" means May 15, 2001, and thereafter each November 15 and each May 15 (which shall be specified in each Series Supplement as the date of Planned Principal Payments and Rated Maturities), each additional Distribution Date selected by the Corporation or the Trustee following an Event of Default, and for purposes of Section 5.1(b)(6) of the Indenture, as amended, and the concurrent application of any applicable moneys for the purposes of Section 5.1(b)(7), the date of delivery of the Series 2014 Bonds unless a prior use of such moneys shall then exist on such date.

"Downgrade Trapping Requirement" means zero ($0.00) dollars.

"Eligible Investments" means: (a) Defeasance Collateral; (b)direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, FHLMC, FNMA or the Federal Farm Credit System; (c) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank or trust company, savings and loan association or savings bank, payable on demand or on a specified date no more than three months after the date of

issuance thereof, if such deposits or instruments are rated "P-1" by Moody's; (d) general obligations of, or obligations guaranteed by, any state of the United States or the District of Columbia receiving one of the two highest long-term unsecured debt ratings available for such securities by Moody's; (e) commercial or finance company paper (including both non-interest bearing discount obligations and interest bearing obligations payable on demand or on a specified date not more than three months after the date of issuance thereof) that is rated "P-1" by Moody's; (f) repurchase obligations with respect to any security described in clause (b) or (c) above entered into with a primary dealer, depository institution or trust company (acting as principal) rated "P-1" by Moody's or in one of the two highest long-term rating categories by Moody's; (g) securities bearing interest or sold at a discount that are issued by any corporation incorporated under the laws of the United States of America or any state thereof and rated "P-1" by Moody's, at the time of such investment or contractual commitment providing for such investment; provided, however, 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; (h) units of taxable money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated in one of the two highest categories by Moody's, 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 (i) 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, (ii) the Indenture Trustee charges and collects fees and expenses for services rendered pursuant to the Indenture, and (iii) services performed for such funds and pursuant to the Indenture may converge at any time (NTASC specifically authorizes the Indenture Trustee or an affiliate of the Indenture Trustee to charge and collect all fees and expenses from such funds for services rendered to such funds, in addition to any fees and expenses the Indenture Trustee may charge and collect for services rendered pursuant to the Indenture); (i) 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, in one of the two highest long-term rating categories by Moody's if NTASC has an option to terminate such agreement in the event that such rating is downgraded below the rating on the Senior Bonds or withdrawn; and (j) other obligations or securities that are non-callable and that are acceptable to each Rating Agency; provided, however, that no Eligible Investment may (i) except for Defeasance Collateral, evidence the right to receive only interest with respect to the obligations underlying such instrument or (ii) be purchased at a price greater than par if such instrument may be prepaid or called at a price less than its purchase price prior to its stated maturity.

"Extraordinary Payment" means Prepayments and payments of principal amounts due but unpaid on the Senior Bonds.

"FHLMC" means the Federal Home Loan Mortgage Corporation.

"Fiduciary" means the Indenture Trustee, any representative of the Holders of Bonds appointed by Series Supplement, and each Paying Agent.

"Final Lump Sum Payment" means a final payment from a PM which results in or is a release of such PM from all of its future obligations under the MSA that has been received and deposited in the Collection Account.

"Fitch" means Fitch Ratings or its successor; references herein to Fitch are effective so long as Fitch is a Rating Agency.

"FNMA" means the Federal National Mortgage Association.

"Junior Payments" means (i) termination payments on Swaps and any other payments thereon based upon a rate in excess of the applicable Maximum Rate, (ii) amounts payable to or for the benefit of the Holders of Subordinate Bonds, (iii) Bond principal payable under term-out provisions of Ancillary Contracts, (iv) other amounts due under Ancillary Contracts and not payable as Priority Payments or Debt Service, (v) purchase price of Bonds and (vi) Junior Payments so identified in or by reference to this Indenture.

"Local Law" means Local Law No. 5 of the County (Resolution FN-038-00), enacted August 1, 2000.

"Lump Sum Payment Event" means the occurrence of either a Partial Lump Sum Payment or a Final Lump Sum Payment.

"Lump Sum Payment Requirement" means the sum of (a) any Partial Lump Sum Payment not previously applied to make a payment in accordance with the Indenture and (b) the amount of any Final Lump Sum Payment not previously applied to make a payment in accordance with the Indenture.

"Majority in Interest" means the Holders of a majority of the Outstanding Bonds eligible to act on a matter, measured by face value at maturity or by Accreted Value as specified in a Series Supplement.

"Maturity Date" means, as stated in any Bond, the final date on which all remaining unpaid principal of such Bond is due and payable.

"Maximum Rate" means (i) the highest rate payable on a Bond to Holders, as specified in the related Series Supplement or, if not so specified, as allowed by law or (ii) the rate specified in the related Series Supplement as the Maximum Rate on a Swap.

"NPM Trapping Requirement" means zero ($0.00) dollars.

"NTASC" means the Corporation.

"Officer's Certificate" means a certificate signed by an Authorized Officer of NTASC or, if so specified, of the Indenture Trustee.

"Operating Cap" means $90,000 in the first Fiscal Year (i.e. the year ending 12/31/00), inflated in each following Fiscal Year by the Inflation Adjustment (as defined in the MSA) applicable pursuant to the MSA to the calendar year ending in or with such Fiscal Year, plus arbitrage rebate and penalties, as specified in an Officer's Certificate.

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

"Optional Redemption" means redemption of Bonds in the discretion and at the option of NTASC.

"Outstanding Bonds" means Bonds issued under the Indenture, excluding: (i) Bonds that have been exchanged or replaced, or delivered to the Indenture Trustee for credit against a principal payment; (ii) Bonds that have been paid in full; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Defeased Bonds and (v) for purposes of any consent or other action to be taken by the Holders of a Majority in Interest or specified percentage of Bonds hereunder, Bonds held by or for the account of NTASC, the County or any person controlling, controlled by or under common control with either of them. For the purposes of this definition, "control," when used with

respect to any specified person, means the power to direct the management and policies of such person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise, and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"Parity Payments" means Swap payments not to exceed the applicable Maximum Rate, and does not include (i) any Termination Payment or (ii) any payments under Ancillary Contracts.

"Partial Lump Sum Payment" means a payment from a PM which results in a release of such PM from a portion, but not all, of its future payment obligations under the MSA, and which has been received and deposited in the Collection Account.

"Prepayment(s)" means amounts paid to fund the prepayment of the principal amount of a Senior Bond before it is due.

"Priority Payments" means fees payable pursuant to Ancillary Contracts that are identified by Series Supplement as Priority Payments, which shall not include payments of or in lieu of interest, principal or purchase price of Bonds.

"Purchase and Sale Agreement" means the Purchase and Sale Agreement, dated as of November 1, 2000, between NTASC and the County, as amended, supplemented and in effect from time to time.

"Rating Agency" means each nationally recognized securities rating organization that has, at the request of NTASC, a rating in effect for Senior Bonds.

"Rating Confirmation" means, in respect of any particular action, written evidence from a Rating Agency that no Senior Bond rating in effect from such Rating Agency will be withdrawn or downgraded solely as a result of such action.

"Required Sinking Fund Payments" means required, without regard to availability of funds, and scheduled mandatory Sinking Fund Payments to be applied to redemptions of Senior Bonds as set forth in the applicable Series Supplement or the forms of the Senior Bonds.

"Revenues" means the TSRs and all aid, rents, fees, charges, payments, investment earnings and other income and receipts (including bond proceeds other than refunding bond proceeds but only to the extent deposited in an Account) paid to NTASC or the Indenture Trustee for the account of NTASC or the Beneficiaries.

"Series 2014 Bonds" means the Series 2014 Senior Bonds.

"Series Supplement" means a resolution or Supplemental Indenture described in the Indenture, or a supplement thereto.

"Sinking Fund Payments" means scheduled payments to be made by NTASC and applied to redemption of Senior Bonds before their stated Maturity Dates, in some cases without regard to the availability of funds, as with Required Sinking Fund Payments, and in some cases only if funds are available, as with Planned Principal Payments.

"Supplemental Indenture" means a Series Supplement or supplement to the Indenture adopted and becoming effective in accordance with the terms of the Indenture. Any provision that may be included in a Series Supplement or Supplemental Indenture is also eligible for inclusion in the other subject to the provisions of the Indenture.

"Surplus Account" means an Account within the Bond Fund designated as such, established by a Series Supplement executed in connection with the issuance of a Series of Additional Bonds as Senior Bonds.

"Swap" or "Swap Contract" means an interest rate exchange, currency exchange, cap, collar, hedge or similar agreement entered into by NTASC.

"Tax-Exempt" means, with respect to interest on any obligation of a state or local government or public instrumentality, including NTASC and the Series 2014 Bonds, that such interest is excluded from gross income for federal tax purposes (other than for an owner who is a "substantial user" of any project being financed by such obligations or a "related person" within the meaning of Section 147(a) of the Code), whether or not such interest is includable as an item of tax preference or otherwise includable directly or indirectly for purposes of calculating other tax liabilities, including, any alternative minimum tax or environmental tax under the Code. The Trustee may conclusively rely on an opinion of Counsel to the effect that a particular series of Bonds is Tax-Exempt.

"Tax-Exempt Bonds" means all Bonds so identified in any Series Supplement.

"Termination Payment" means a payment to be made to the counterparty to a Swap Contract upon termination of such contract based upon a rate up to, but not in excess of, the applicable Maximum Rate.

"Trapping Event" means a Consumption Decline Trapping Event, a Downgrade Trapping Event or an NPM Trapping Event.

"Trapping Requirement" means the greatest of the Consumption Decline Trapping Requirement, the Downgrade Trapping Requirement or the NPM Trapping Requirement.

SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE

The following summary describes certain provisions of the Indenture pursuant to which the Series 2014 Bonds will be issued. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Series 2014 Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee. See the information in the Official Statement under captions "SECURITY" and "THE SERIES 2014 SENIOR BONDS" for further descriptions of certain terms and provisions of the Series 2014 Bonds.

Security and Pledge

Pursuant to the Indenture, NTASC assigned and pledged to the Indenture Trustee in trust upon the terms thereof (a) the Revenues, (b) all rights to receive the Revenues and the proceeds of such rights, (c) all Accounts and assets thereof, including money, contract rights, general intangibles or other personal property, held by the Indenture Trustee under the Indenture, (d) subject to the following sentence, all rights and interest of NTASC under the Purchase and Sale Agreement, including the representations, warranties and covenants of the County in the Purchase and Sale Agreement, the Tobacco Assets and payments in respect of Tobacco Assets (as defined therein) and (e) any and all other property of every kind and nature from time to time, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture. All of the foregoing are collectively referred to as the "Trust Estate" in the Indenture and herein. Except as specifically provided in the Indenture, such assignment and pledge does not include: (i) the rights of NTASC pursuant to provisions for consent or other action by NTASC, notice to NTASC, indemnity or the filing of documents with NTASC, or otherwise for its benefit and not for that of the Beneficiaries, (ii) any right or power reserved to NTASC pursuant to the Act or other law or (iii) any limitation on the amount of the Series 2014 Bonds set forth in the Purchase and Sale Agreement; nor does such section of the Indenture preclude NTASC's enforcement of its rights under and pursuant to the Purchase and Sale Agreement for the benefit of the Beneficiaries as provided in the Indenture. NTASC will implement, protect and defend such assignment and pledge by all appropriate legal action, the cost thereof to be an Operating Expense. The foregoing collateral is pledged and a security interest therein is granted to secure the payment of Bonds and payments in respect of Swaps and Ancillary Contracts, all with the respective priorities specified in the Indenture. The lien of such pledge and the obligation to perform the contractual provisions made in the Indenture will have priority over any or all other obligations and liabilities of NTASC secured by the Revenues. (Section 2.1)

Bonds of the Corporation

By Series Supplement, NTASC may authorize, issue, sell, direct the application of proceeds of and deliver (i) the Series 2014 Bonds and (ii) subject to the provisions in the Indenture, Additional Bonds from time to time in such principal amounts as NTASC will determine; and may issue Bonds to renew or refund Bonds, by exchange, purchase, redemption or payment, and establish such escrows therefor as it may determine. (Section 3.1)

See the information in the Official Statement under caption "THE SERIES SENIOR 2014 BONDS -Additional Series of Bonds."

Bond Fund

A Bond Fund has been will be established with the Indenture Trustee and money will be deposited therein as provided in the Indenture. The money in the Bond Fund will be held in trust and, except as otherwise provided in the Indenture, will be applied solely to the payment of Debt Service. The Bond Fund includes the Debt Service Account, the Liquidity Reserve Account, the Trapping Account, the Extraordinary Payment Account and such other Accounts as may be established in the Bond Fund by a Supplemental Indenture. (Section 5.2)

Swaps and Ancillary Contracts

NTASC may enter into, amend or terminate, as it determines to be necessary or appropriate, Swaps or Ancillary Contracts, and may by Series Supplement provide for the payment of amounts due thereunder as Junior Payments or, to the extent permitted under the Indenture, as Parity Payments or Priority Payments. (Section 5.3)

Defeasance

When (a) there is held by or for the account of the Indenture Trustee Defeasance Collateral in such principal amounts (based upon Rated Maturities due), bearing fixed interest at such rates and with such maturities as will provide sufficient funds to pay or redeem all or a portion of the obligations to Beneficiaries (including parties to Swaps and Ancillary Contracts but excluding the holder of the Residual Certificate) (to be verified by a nationally recognized firm of independent certified public accountants), (b) any required notice of redemption shall have been duly given in accordance with the Indenture or irrevocable instructions to give notice will have been given to the Indenture Trustee, (c) there is delivered to the Indenture Trustee an opinion of Counsel to the effect that such defeasance will not adversely affect the Tax-Exempt status of any Tax-Exempt Bonds and (d) all the related rights under the Indenture of the Fiduciaries have been provided for (such obligations being referred to as the "Defeased Obligations"), then upon written notice from NTASC to the Indenture Trustee, the Defeased Obligations and the Beneficiaries thereof will cease to be entitled to any benefit or security under the Indenture except for 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 as to the Defeased Obligations, and NTASC 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 for the benefit of the Defeased Obligations and the Beneficiaries thereof. Upon such defeasance, the funds and investments required to pay or redeem the Defeased Obligations will be irrevocably set aside for that purpose, subject, however, to the provisions of the Indenture, and money held for defeasance will be invested only as provided in the Indenture and applied by the Indenture Trustee and other Paying Agents, if any, to the retirement of the Defeased Obligations. (Section 5.4)

Investments

Pending its use under the Indenture, money in the Accounts shall, pursuant to written direction of NTASC, be invested by the Indenture Trustee in Eligible Investments maturing or redeemable at the option of the holder at or before the time when such money is expected to be needed, provided, however, that if no such direction is timely received by the Indenture Trustee or, if to the actual knowledge of an Authorized Officer of the Indenture Trustee, an Event of Default has occurred, such money shall be invested in such Eligible Investments in accordance with the Indenture. 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 not be liable for any losses on investments made at the direction of NTASC.

The Indenture Trustee may hold undivided interests in Eligible Investments for more than one Account (for which they are eligible) and may make interfund transfers in kind. (Section 5.5)

Contract; Obligations to Beneficiaries

In consideration of the purchase and acceptance of any or all of the Bonds, Swaps and Ancillary Contracts by those who will hold the same from time to time, the provisions of the Indenture will be a part of the contract of NTASC with the Beneficiaries. The pledge made in the Indenture and the covenants set forth in the Indenture to be performed by NTASC will be for the equal benefit, protection and security of the Beneficiaries (other than the holder of the Residual Certificate) of the same priority. All of the Bonds or payments on Swaps or Ancillary Contracts of the same priority, regardless of the time

or times of their issuance or maturity, will be of equal rank without preference, priority or distinction of any thereof over any other except as expressly provided pursuant to the Indenture.

Under the Indenture, NTASC covenants to pay when due all sums payable on the Bonds, from the Revenues and money designated in the Indenture, subject only to (a) the Indenture and (b) to the extent permitted by the Indenture, (i) agreements with Holders of Bonds pledging particular collateral for the payment thereof and (ii) the rights of Beneficiaries under Swaps and Ancillary Contracts. The obligation of NTASC to pay principal, interest and redemption premium, if any, to the Holders of Bonds will be absolute and unconditional, will be binding and enforceable in all circumstances whatsoever, and will not be subject to setoff, recoupment or counterclaim.

NTASC has represented under the Indenture that it is duly authorized pursuant to law, including the Act, to create and issue the Bonds, to enter into the Indenture and to pledge the Revenues and other collateral purported to be pledged in the manner and to the extent provided in the Indenture. The Revenues and other collateral so pledged are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Indenture, and all corporate action on the part of NTASC 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 NTASC in accordance with their terms. (Section 6.1)

Operating Expenses; Priority Payments

NTASC will pay its Operating Expenses and make Priority Payments to the parties entitled thereto. NTASC may borrow money to pay, and repay such borrowings as, Operating Expenses. The aggregate amount of such outstanding borrowings will never exceed the Operating Cap and will be zero for at least 30 days of each Fiscal Year. (Section 6.2)

Tax Covenants

(a) NTASC will at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by NTASC on Tax-Exempt Bonds will be excludable from gross income for Federal income tax purposes pursuant to Section 103(a) of the Code; and no funds of NTASC will at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code and any applicable regulations thereunder. If and to the extent required by the Code, NTASC will periodically, at such times as may be required to comply with the Code, pay as an Operating Expense the amount, if any, required by the Code to be rebated or paid as a related penalty.

(b) The property of NTASC is irrevocably dedicated to charitable purposes. No part of the income or earnings of NTASC will inure to the benefit or profit of, nor will any distribution of its property or assets be made to, any member, director or officer of NTASC, or private person, corporate or individual, or to any other private interest, except that NTASC may repay loans made to it and may repay contributions (other than dues) made to it to the extent that any such contribution may not be allowable as a deduction in computing taxable income under the Code.

(c) NTASC will not attempt to influence legislation by propaganda or otherwise, or participate in or intervene, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

(d) NTASC will not engage in any activities not permitted to be carried on by an organization exempt from Federal income taxation pursuant to Section 501(c)(3) of the Code and the regulations thereunder. (Section 6.3)

Accounts and Reports

Pursuant to the Indenture, NTASC will:

(a) cause to be kept books of account in which complete and accurate entries will be made of its transactions relating to all funds and accounts under the Indenture, which books will at all reasonable times be subject to the inspection of the Indenture Trustee and the Holders of an aggregate of not less than 25% in principal amount of Bonds then Outstanding or their representatives duly authorized in writing;

(b) annually, within 180 days after the close of each fiscal year, deliver to the Indenture Trustee and the Rating Agency, a copy of its financial statements for such fiscal year, as audited by an independent certified public accountant or accountants;

(c) keep in effect at all times by an Officer's Certificate an accurate and current schedule of all Debt Service (separately stating Rated Maturities and Planned Principal Payments) to be payable during the life of then Outstanding Bonds, Swaps and Ancillary Contracts; certifying for this purpose such estimates as may be necessary; and

(d) on each May 1 and November 1 (or if either of such date is not a Business Day, on the next Business Day) and, if a change in circumstances requires an update or revision, at any time prior to the Distribution Date following such May 1 or November 1 date (except that with respect to the information required pursuant to clause (viii) below, the date will not apply), provide to the Indenture Trustee and the Rating Agency a statement indicating the following; provided, however, that the Indenture Trustee will cooperate with NTASC in developing such statement, particularly insofar as the Indenture Trustee possesses or has more ready access to any information that is to be included in the statement.

(i) the amount of principal to be paid to Bondholders of each Series on such Distribution Date;

(ii) the amount of interest to be paid to Bondholders of each Series on such Distribution Date;

(iii) the Cumulative Planned Principal Payments Due for each Series as of such Distribution Date;

(iv) the amount on deposit in each Account as of such Distribution Date;

(v) the Liquidity Reserve Requirement as of such Distribution Date;

(vi) to the extent permitted by applicable law and based upon information reasonably available to NTASC, whether or not a Trapping Event has occurred and is continuing;

(vii) the Trapping Requirement, if any, as of such Distribution Date;

(viii) to the extent permitted by applicable law and based upon information reasonably available to NTASC, provide to the Rating Agency a statement of cigarette shipments, lump sum receipts, NPM and OPM Market Share, and OPM ratings (each as defined in the MSA), all to the extent necessary to determine whether a Trapping Event has occurred and is continuing; and

(ix) the amounts to be distributed in accordance with the provisions of the Indenture. (Section 6.4)

Rating

Unless otherwise specified by Series Supplement, NTASC will pay, as an Operating Expense, such reasonable fees and provide such available information as may be necessary to obtain and keep in effect a rating on all the Senior Bonds from a nationally recognized securities rating organization. (Section 6.5)

Affirmative Covenants

(a) *Maintenance of Existence.* NTASC will keep in full effect its existence, rights and franchises as a not-for-profit corporation under the laws of the State.

(b) *Protection of Collateral.* NTASC will from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (a) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (b) perfect, publish notice of or protect the validity of any grant made or to be made by the Indenture; (c) preserve and defend title to the Revenues and other collateral pledged under the Indenture and the rights of the Indenture Trustee and the Bondholders in such collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of the Consent Decree, the Indenture or the Purchase and Sale Agreement or the performance by any party thereunder; (d) enforce the Purchase and Sale Agreement; (e) pay any and all taxes levied or assessed upon all or any part of the collateral; or (f) carry out more effectively the purposes of the Indenture.

(c) *Performance of Obligations.* NTASC (i) will diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the collateral and (ii) will not take any action and will use its best efforts not to permit any action to be taken by others that would release any person from any of such person's covenants or obligations under any such instrument or agreement or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, any such instrument or agreement, except, in each case, as expressly provided in the Indenture, the Purchase and Sale Agreement or the Consent Decree.

(d) *Notice of Events of Default.* NTASC will give the Indenture Trustee and the Rating Agency prompt written notice of each Event of Default under the Indenture. (Section 6.6)

Negative Covenants

(a) *Sale of Assets.* Except as expressly permitted by the Indenture, (a) NTASC will not sell, transfer, exchange or otherwise dispose of any of its properties or assets that are pledged under the Indenture, and (b) NTASC will not cause directly or indirectly the payment of the TSRs to be directed other than to the Collection Account.

(b) *Liquidation.* NTASC will not terminate its existence or dissolve or liquidate in whole or in part.

(c) *Limitation of Liens.* NTASC will not (a) 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 by the Indenture, (b) permit any lien, charge, excise, claim, security

interest, mortgage or other encumbrance (other than the lien of the Indenture) to be created on or extend to or otherwise arise upon or burden the collateral or any part thereof or any interest therein or the proceeds thereof or (c) permit the lien of the Indenture not to constitute a valid first priority security interest in the Trust Estate.

(d) *Limitations on Consolidation, Merger, Sale of Assets, etc.* Except as otherwise provided in the Indenture, NTASC 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:

(i) the person surviving such consolidation or merger (if other than NTASC or the transferee) is organized and existing under the laws of the United States or any state and expressly assumes the due and punctual payment of the principal of and premium, if any, and interest on all Bonds and the performance or observance of every agreement and covenant of NTASC in the Indenture;

(ii) immediately after giving effect to such transaction, no Default has occurred and is continuing under the Indenture;

(iii) NTASC has received a Rating Confirmation;

(iv) NTASC has received an opinion or opinions of Counsel to the effect that such transaction will not have material adverse tax consequence to NTASC or any Bondholder and no offering of Bonds will require registration under the Securities Act of 1933, as amended, or the Investment Company Act of 1940, as amended;

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

(vi) NTASC 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.

(e) *No Other Business.* NTASC will not engage in any business other than financing, purchasing, owning and managing the Trust Estate in the manner contemplated by the Indenture and activities incidental thereto.

(f) *No Borrowing.* NTASC will not issue, incur, assume, guarantee or otherwise become liable, directly or indirectly, for any indebtedness except Permitted Indebtedness. Swaps and Ancillary Contracts are not indebtedness within the meaning of this covenant.

(g) *Guarantees, Loan, Advances and Other Liabilities.* Except as otherwise contemplated by the Indenture and the Purchase and Sale Agreement, NTASC will not make any loan or advance of credit to, or guarantee (directly or indirectly or by an instrument having the effect or assuring another's payment or performance on any obligation or capability of so doing or otherwise), endorse or otherwise become contingently liable, directly or indirectly, in connection with the obligations, stock or dividends of, or own, purchase, repurchase or acquire (or agree contingently to do so) any stock, obligations, assets or securities of, or any other interest in, or make any capital contribution to, any other person.

(h) *Restricted Payments.* NTASC will not, directly or indirectly, make payments to or distributions from the Collection Account except in accordance with the Indenture.

(i) *Directors.* NTASC will not amend its certificate of incorporation or bylaws to eliminate the requirement of a director who is independent of the County. (Section 6.7)

Tobacco Settlement Revenues

Under the Indenture, NTASC acknowledges that the MSA, the Consent Decree and the Purchase and Sale Agreement constitute important security provisions of the Bonds and waives any right to assert any claim to the contrary and agrees that it will neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the County, the State or any other person of, any such claim to the contrary.

By acknowledging that the MSA, the Consent Decree and the Purchase and Sale Agreement constitute important security provisions of the Bonds, NTASC also acknowledges under the Indenture that, in the event of any failure or refusal by the County or the State to comply with its agreements included in the MSA, the Consent Decree and the Purchase and Sale Agreement, the Holders of the Bonds may have suffered monetary damages, the extent of the remedy for which may be, to the fullest extent permitted by applicable Federal and State law, determined, in addition to any other remedy available at law or in equity, in the course of any action taken pursuant to the Indenture; and, under the Indenture, NTASC has waived any right to assert any claim to the contrary and agrees that it will neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the County, the State or any other person of, any claim to the effect that no such monetary damages have been suffered.

Pursuant to the Indenture, NTASC has assigned to the Indenture Trustee for the benefit of the Holders of the Outstanding Bonds, the County's pledge and agreement that the County will not limit or alter the rights of NTASC to fulfill the terms of its agreements with such Holders, or in any way impair the rights and remedies of such Holders or the security for such Bonds until such Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Holders, are fully met and discharged. (Section 7.1)

No Indebtedness or Funds of County

The Indenture does not create indebtedness of the County for any purpose, including any constitutional or statutory limitations. NTASC's revenues are not funds of the County. (Section 7.2)

Rights and Duties of the Fiduciaries

(a) All money and investments received by the Fiduciaries under the Indenture will be held in trust, in a segregated account in the trust department of such Fiduciary, not commingled with any other funds, and applied solely pursuant to the provisions of the Indenture.

(b) 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 NTASC and its representatives duly authorized in writing.

(c) The Fiduciaries will not be required to monitor the financial condition of NTASC and, unless otherwise expressly provided, will not have any responsibility with respect to reports, notices, certificates or other documents filed with them hereunder, except to make them available for inspection by Beneficiaries.

(d) 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. A permissive right or power to act will not be construed as a requirement to act.

(e) 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, the Bonds, the Residual Certificate or any Swaps or Ancillary Contracts against any director, officer, agent or employee of any Fiduciary unless such claim is based upon the bad faith, fraud or deceit of such person.

(f) 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, the Residual Certificate, Swaps or Ancillary Contracts except from money received for such purposes under the provisions of the Indenture or from the exercise of the Indenture Trustee's rights thereunder.

(g) The Fiduciaries may be or become the owner of or trade in the Bonds or enter into Swaps or Ancillary Contracts with the same rights as if they were not the Fiduciaries.

(h) Unless otherwise specified by Series Supplement, the Fiduciaries will not be required to furnish any bond or surety.

(i) NTASC 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 incur in the exercise of its duties under the Indenture and that are not due to its negligence or bad faith.

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

(k) Any fees, expenses, reimbursements or other charges which any Fiduciary may be entitled to receive from NTASC under the Indenture, if not otherwise paid, will be a first lien upon (but only upon) any funds held under the Indenture by the Indenture Trustee for payment of Operating Expenses. (Section 8.2)

Resignation or Removal of the Indenture Trustee

Under the Indenture, the Indenture Trustee may resign on not less than 30 days' written notice to NTASC, the Holders and the Rating Agency. The Indenture Trustee will be removed if rated below investment grade by the Rating Agency and each successor Indenture Trustee will have an investment grade rating from the Rating Agency. The Indenture Trustee may be removed by written notice from NTASC (if not in Default) or a Majority in Interest of the Outstanding Senior Bonds to the Indenture Trustee and NTASC. Such resignation or removal will not take effect until a successor has been appointed and has accepted the duties of the Indenture Trustee. (Section 8.4)

Successor Fiduciaries

Any corporation or association which succeeds to the related corporate trust business of a Fiduciary as a whole or substantially as a whole, whether by sale, merger consolidation or otherwise, will

thereby become vested with all the property, rights, powers and duties thereof under the Indenture, without any further act or conveyance.

In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary will with due care terminate its activities under the Indenture and a successor may, or in the case of the Indenture Trustee will, be appointed by NTASC. NTASC will notify the Holders and the Rating Agency of the appointment of a successor Trustee in accordance with the Indenture. If no appointment of a successor Trustee is made within 45 days after the giving of written notice in accordance with the Indenture or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Trustee or any Holder may apply to any court of competent jurisdiction for the appointment of such a successor. (Section 8.5)

Reports by Trustee to Holders

In accordance with the Indenture, the Indenture Trustee will deliver to each Holder and the Rating Agency on or prior to each Distribution Date a statement of allocation of funds. (Section 8.7)

Action by Holders

Any request, authorization, direction, notice, consent, waiver or other action provided by the Indenture to be given or taken by Holders of Bonds may be contained in and evidenced by one or more writings of substantially the same tenor signed by the requisite number of Holders or their attorneys duly appointed in writing. Proof of the execution of any such instrument, or of an instrument appointing any such attorney, will be sufficient for any purpose of the Indenture (except as otherwise expressly provided in the Indenture) if made in the following manner, but NTASC 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 his attorney of such instrument may be proved by the certificate or signature guarantee, which need not be acknowledged or verified, of an officer of a bank, trust company or securities dealer satisfactory to NTASC or 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 he purports to act, that the person signing such request or other instrument acknowledged to him the execution thereof; or by an affidavit of a witness of such execution, duly sworn to before such notary public or other officer. The authority of the person or persons executing any such instrument on behalf of a corporate Holder may be established without further proof if such instrument is signed by a person purporting to be the president or a vice president of such corporation with a corporate seal affixed and attested by a person purporting to be its clerk or secretary or an assistant clerk or secretary. Any action of the Holder of any Bond will be irrevocable and bind all future record and beneficial owners thereof . For purposes of voting, consents, or similar actions by Bondholders, references to principal shall mean Accreted Value for Bonds for which there is Accreted Value. (Section 9.1)

Registered Owners

In accordance with the Indenture, any payment to the registered owner of a Bond will satisfy NTASC's obligations thereon to the extent of such payment. (Section 9.2)

Supplements and Amendments to the Indenture

The Indenture may be:

(a) supplemented by delivery to the Indenture Trustee of an instrument certified or executed by an Authorized Officer of NTASC to (i) provide for earlier or greater deposits into the Bond Fund, (ii) subject any property to the lien of the Indenture, (iii) add to the covenants and agreements of NTASC or surrender or limit any right or power of NTASC, (iv) identify particular Bonds for purposes not inconsistent herewith, including credit or liquidity support, remarketing, serialization and defeasance, (v) cure any ambiguity or

defect, (vi) protect the exclusion of interest on the Tax-Exempt Bonds from gross income for Federal, New York State or New York local income tax purposes, or the exemption from registration of the Series 2014 Bonds under the Securities Act of 1933, as amended, or of the Indenture under the Trust Indenture Act of 1939, as amended, or the exemption of NTASC or any arrangement evidenced by the Indenture from registration under the Investment Company Act of 1940, as amended, or (vii) authorize Bonds of a Series and in connection therewith determine the matters referred to in the Indenture as and to the extent deemed appropriate by the Authorized Officer of NTASC, and any other things relative to such Bonds that are not materially adverse to the Holders of Outstanding Bonds, or to modify or rescind any such authorization or determination at any time prior to the first authentication and delivery of such Series of Bonds; or

(b) amended by NTASC and the Indenture Trustee, with the consent of the holder of the Residual Certificate, (i) with a Rating Confirmation, to add provisions that in the judgment of Counsel are not materially adverse to the Holders, (ii) to adopt amendments that do not take effect unless and until (1) no Bonds Outstanding prior to the adoption of such amendment remain Outstanding or (2) such amendment is consented to by the Holders of such Bonds in accordance with the Indenture, or (iii) pursuant to the following paragraph.

Except as provided in the foregoing paragraph, the Indenture may be amended:

(a) only with (i) written notice to the Rating Agency and the written consent of a Majority in Interest of the Subordinate Bonds and Senior Bonds (acting as separate classes) to be Outstanding at the effective date thereof and affected thereby or (ii) a Rating Confirmation; but

(b) only with the unanimous written consent of the affected Holders for any of the following purposes: (i) to extend the maturity, Rated Maturity Date or Planned Principal Payment Date of any Bond, (ii) to reduce the principal amount, applicable premium or interest rate of any Bond, (iii) change, in the judgment of Counsel, in a material way any fundamental redemption feature of a Bond, (iv) to create a preference or priority of any Bond over any other Bond of the same class or (v) to reduce the percentage of Bonds required to be represented by the Holders giving their consent to any amendment.

Any amendment of the Indenture will be accompanied by an opinion of Counsel to the effect that the amendment is permitted by law and does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for Federal income tax purposes.

When NTASC determines that the requisite number of consents have been obtained for an amendment to the Indenture or the Purchase and Sale Agreement which requires consents, it will, file a certificate to that effect in its records and give notice to the Indenture Trustee and the Holders. (Section 11.1)

Supplements and Amendments to the Purchase and Sale Agreement

In the event that the Indenture Trustee receives a request for a consent or other action under the Purchase and Sale Agreement, the Indenture Trustee may, and if consent or other action by Holders is required will, transmit a notice of such request to each Holder and request directions with respect thereto; and the Indenture Trustee (and NTASC, if applicable) will proceed in accordance with such directions (if any), the Indenture and the Purchase and Sale Agreement. (Section 11.2)

Persons Not Liable on Bonds

Neither the members, directors or officers of NTASC nor any person executing the Series 2014 Bonds or other obligations of NTASC will be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance thereof. (Section 12.8)

No Liability of County or State

The Series 2014 Bonds and other obligations of NTASC will not be a debt of either the State or the County, and neither the State nor the County will be liable thereon, nor will they be payable out of any funds other than those of NTASC. (Section 12.9)

Covenants of NTASC under the Series 2014 Supplement

No Swaps. Under the Series 2014 Supplement, NTASC covenants and agrees for so long as the Series 2014 Bonds shall remain Outstanding, that it shall not enter into any Swaps with respect to any Bonds issues pursuant to the Indenture. (Section 3.1)

No Planned Principal Payments. Under the Series 2014 Supplement, NTASC covenants and agrees that for so long as the Series 2014 Bonds shall remain Outstanding, that it shall not issue any Senior Bonds with Planned Principal Payments. (Section 3.2)

Accreted Value under the Series 2014 Supplement

No Series 2014 Bond has Accreted Value for any purpose of the Indenture or under any provision of the Indenture in which such term is used. (Section 4.3)

SUMMARY OF CERTAIN PROVISIONS OF THE PURCHASE AND SALE AGREEMENT

The following summary describes certain provisions of the Purchase and Sale Agreement. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Purchase and Sale Agreement. Copies of the Purchase and Sale Agreement may be obtained upon written request to NTASC.

Conveyance of Tobacco Assets

Under the Purchase and Sale Agreement, the County sold, transferred, assigned, set over and otherwise conveyed to NTASC, without recourse (except as specifically set forth in the Purchase and Sale Agreement), all right, title and interest of the County in and to the Tobacco Assets. As consideration for such conveyance, NTASC (i) delivered to the County the net proceeds of the Series 2000 Bonds and (ii) sold, transferred, assigned, set over and otherwise conveyed to the County, without recourse, the 100% beneficial interest in the Residual Trust.

Representations of County

The County made certain representations upon which NTASC was deemed to have relied in acquiring the Tobacco Assets including representations that the County had the power and authority to enter into the Purchase and Sale Agreement, that the Purchase and Sale Agreement is a binding obligation of the County and that the County was the sole owner of the Tobacco Assets.

Protection of Title; Non-Impairment Covenant

The County agreed to take all action required by law fully to preserve, maintain, defend, protect and confirm the transfer of the County's right, title and interest in the TSRs. The County further agreed not to take any action that would adversely affect the NTASC's ability to receive payments made under the MSA and the Consent Decree.

Protection of Consent Decree and MSA

The County agreed not to take any action and agreed to use its best reasonable efforts to not permit any action to be taken by others that would release any person from, or result in a modification of, any of such person's covenants or obligations under the Consent Decree and the MSA or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the Consent Decree or the MSA, or otherwise materially adversely affect the interest of NTASC or the Bondholders therein, nor, without the prior written consent of NTASC and the Indenture Trustee on behalf of the Bondholders, amend, modify, terminate, waive or surrender, or agree to any amendment, modification, termination, waiver or surrender of, the terms of the Consent Decree, the MSA or the Purchase and Sale Agreement, or waive timely performance or observance under such documents, in each case if the effect thereof would be materially adverse to the Bondholders.

Further Actions

Upon request of NTASC or the Indenture Trustee, the County will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of the Purchase and Sale Agreement. The County will promptly pay over to the Indenture Trustee the proceeds of any Tobacco Assets received by the County in error and following receipt and until such payment will keep separate records with respect to any such proceeds and will not commingle any such proceeds with County funds.

Tax Covenant

The County will at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by NTASC on Tax-Exempt Bonds will be excludable from gross income for Federal income tax purposes pursuant to Section 103(a) of the Code; and no funds of the County will at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Tax Exempt-Bond to be an arbitrage bond as defined in the Code and any applicable regulations thereunder.

Assignment by NTASC

The County acknowledged and consented to any pledge, assignment and grant of a security interest by NTASC to the Indenture Trustee pursuant to the Indenture for the benefit of the Bondholders of any or all right, title and interest of NTASC in, to and under the Tobacco Assets or the assignment of any or all of NTASC's rights and obligations thereunder to the Indenture Trustee.

Non-Petition Covenants

Notwithstanding any prior termination of the Purchase and Sale Agreement, the County shall not, prior to the date which is one year and one day after (a) the termination of the Purchase and Sale Agreement, and (b) the date on which the Senior Bonds and no other bonds, notes or other obligations to NTASC remain outstanding, acquiesce to, petition for or otherwise invoke or cause NTASC or the Residual Trust or the holder of the Residual Certificate to invoke the process of any court or government authority for the purpose of commencing or sustaining a case against NTASC or the Residual Trust under any Federal or state bankruptcy, insolvency or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official of NTASC or the Residual Trust or any substantial part of its property, or ordering the winding up or liquidation of the affairs of NTASC or the Residual Trust.

Limitation of Liability of Officers of the County

Notwithstanding anything in the Purchase and Sale Agreement to the contrary, no officer or employee of the County will have any liability for the representations, warranties, covenants, agreements or other obligations of the County in the Purchase and Sale Agreement or in any of the certificates, notices or agreements delivered pursuant to the Purchase and Sale Agreement, as to all of which recourse will be had solely to the assets of the County.

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APPENDIX F

PROPOSED FORM OF OPINION OF BOND COUNSEL

Niagara Tobacco Asset Securitization Corporation
175 Hawley Street
Lockport, NY 14094

Ladies and Gentlemen:

We have examined a record of proceedings relating to the sale and issuance of $44,295,000 aggregate principal amount of Tobacco Settlement Asset Backed Bonds, Series 2014 (the "Series 2014 Bonds") issued by the Niagara Tobacco Asset Securitization Corporation (the "Issuer"), a not-for-profit local development corporation organized under the laws of the State of New York (the "State"). The Series 2014 Bonds are being issued as Senior Bonds under and pursuant to an Indenture, dated as of November 1, 2000 (the "Original Indenture"), as amended by the Series 2005 Supplemental Indenture (as hereinafter defined) and by a certain First Amendment to Indenture, dated August 14, 2014 (the "First Amendment to Indenture"), and as supplemented by the Series 2014 Supplement, dated as of August 14, 2014 (the "Series 2014 Supplement"; the Original Indenture, as so amended and supplemented, being hereinafter referred to as the "Indenture"), each by and between the Issuer and Manufacturers and Traders Trust Company, as Trustee (the "Trustee"). Capitalized terms used herein without other definition have the meanings set forth in the Indenture.

The Series 2014 Bonds are being issued under the Indenture as additional Senior Bonds to (i) currently refund all of the Issuer's outstanding Tobacco Settlement Asset-Backed Bonds, Series 2000 (the "Series 2000 Bonds"), (ii) acquire by negotiated purchase all of the $6,572,480 initial principal amount of outstanding New York Counties Tobacco Trust V Tobacco Settlement Pass-Through Bonds, Series 2005 S4B attributable to the Issuer for the purpose of cancellation; (iii) cancel the related bond RS4B-1 of the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2005 (the "Series 2005 Bonds"), (iv) fund a payment to the NTASC Residual Trust in an amount not to exceed $2,000,000 in order to provide the County with funds for capital purposes, and (v) pay the costs of issuance of the Series 2014 Bonds. The Series 2014 Bonds are also being issued in accordance with a certain Consent and Waiver and related Purchase Agreement, Consent and Release, each dated as of July 31, 2014 (the "Consent and Waiver" and the "Purchase Agreement", respectively), that evidence the agreement of all affected parties to the issuance of the Series 2014 Bonds and the use of the proceeds thereof in the manner described above notwithstanding any restrictions to the contrary contained in the Series 2005 Supplemental Bond Indenture, dated as of November 1, 2005, (the "2005 Supplemental Indenture"). All Senior Bonds are entitled to the equal benefit, protection and security of the provisions, covenants and agreements contained in the Indenture in accordance with the terms thereof.

In rendering this opinion, we have reviewed executed copies of the following documents (collectively the "Documents"):

(a) The Indenture;

(b) The Authorizing Resolution of the Issuer, adopted on August 14, 2014;

(c) The Consent and Waiver and the Purchase Agreement; and

(d) The Purchase and Sale Agreement, dated as of November 1, 2000 (the "Agreement"), by and between the Issuer and the County of Niagara, New York (the "County").

We have also examined such certificates, documents, records and matters of law as we have deemed necessary for the purpose of rendering the opinions hereinafter set forth.

The Series 2014 Bonds are dated their date of delivery and bear interest payable on May 15 and November 15 of each year until maturity, commencing November 15, 2014. The Series 2014 Bonds mature, are subject to redemption and prepayment and are secured as set forth in the Indenture. The Series 2014 Bonds are issuable in the form of fully registered bonds in the denominations of $5,000 or any integral multiple thereof. The Series 2014 Bonds shall be lettered "R-" and numbered consecutively from one upward in order of issuance.

The Issuer has executed a certain Tax Certificate and Agreement of the Issuer, dated the date hereof (the "Tax Certificate"), and the County has executed a certain Tax Certificate and Agreement of the County, dated the date hereof (the "County Certificate"), which is attached to the Tax Certificate as an exhibit. In the Tax Certificate and the County Certificate, the Issuer and the County, respectively, have made certain representations and covenants, established certain conditions and limitations and created certain expectations, relating to compliance with the requirements imposed by the Internal Revenue Code of 1986, as amended, and regulations of the United States Treasury Department promulgated thereunder (collectively, the "Code").

We have also examined one of the Series 2014 Bonds as executed and authenticated.

Based on the foregoing, and subject to the further qualifications and limitations noted below, we are of the opinion that:

1. The Issuer is a not-for-profit local development corporation organized under the laws of the State, with the right and lawful authority and power to enter into the Indenture and the Agreement and to issue the Series 2014 Bonds.

2. The Indenture has been duly and lawfully authorized, executed and delivered by the Issuer, is in full force and effect, and constitutes the legal, valid and binding obligation of the Issuer enforceable in accordance with its terms.

3. The Indenture creates a valid pledge of and a valid lien upon the revenues and other collateral (collectively, the "Trust Estate") that it purports to create, subject only to the provisions thereof permitting the withdrawal, payment or setting apart thereof for the purposes and on the terms and conditions set forth therein. All action has been taken as is necessary to perfect such security interest in the Trust Estate as it exists on the date hereof and such perfected pledge and security interest constitutes a first priority pledge and security interest.

4. Upon the execution and delivery thereof by the Issuer and the authentication thereof by the Trustee, the Series 2014 Bonds will have been duly and validly authorized executed and delivered by the Issuer in accordance under the Indenture and will constitute legal, valid and binding special limited obligations of the Issuer, payable from the sources and in the order of priority specified in, and enforceable against the Issuer in accordance with, the Indenture. The Series 2014 Bonds do not constitute a debt of the State or the County, and neither the State nor the County shall be liable thereon, nor shall the Series 2014 Bonds be payable out of any funds other than those of the Issuer.

5. The Agreement has been duly and lawfully authorized, executed and delivered by the Issuer and the County and is a valid and binding agreement of each of them, enforceable in accordance with its terms.

6. Under existing statutes, regulations, administrative interpretations and court decisions, as of the date hereof, interest on the Series 2014 Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Code and is not treated as an item of tax preference for purposes of calculating the federal alternative minimum tax imposed on individuals and corporations. Interest on the Series 2014 Bonds is, however, included in adjusted current earnings for purposes of calculating the federal alternative minimum tax imposed on certain corporations.

7. Under statutes existing as of the date hereof, interest on the Series 2014 Bonds is exempt from personal income taxes imposed by the State and any political subdivision thereof.

In rendering the opinions set forth in paragraph 6 and 7 above, we have relied upon, among other things, certain representations and covenants of (i) the Issuer in the Indenture, the Tax Certificate and the General Certificate of the Issuer, dated the date hereof and (ii) the County in the County Certificate. We call your attention to the fact that there are certain requirements contained in the Code with which the Issuer and the County must comply from and after the date of issuance of the Series 2014 Bonds in order for the interest thereon to be and remain excluded from gross income for federal income tax purposes, and consequently to remain exempt from personal income taxes imposed by the State or any political subdivision thereof. The Issuer, the County or any other person, by failing to comply with such requirements, may cause interest on the Series 2014 Bonds to become includable in gross income for federal income tax purposes, and therefore subject to personal income taxes imposed by the State and any political subdivision thereof, in each case, retroactive to the date of issuance of the Series 2014 Bonds. We render no opinion as to any federal, state or local tax consequences with respect to the Series 2014 Bonds, or the interest thereon, if any change occurs, or action is taken or omitted, under the Indenture, the Tax Certificate, or under any other relevant documents without the advice or approval of, or upon the advice or approval of any Bond Counsel other than, Harris Beach PLLC. In addition, we have not undertaken to determine, or to inform any person, whether any actions taken, or not taken, or events occurring, or not occurring, after the date of issuance of the Series 2014 Bonds may affect the tax status of interest on the Series 2014 Bonds. Except for the opinions set forth in paragraphs 6 and 7 above, we take no responsibility for, and express no opinion regarding, any other federal, state or local tax consequences in connection with the purchase, ownership or disposition of the Series 2014 Bonds.

The opinions contained in paragraphs 2, 3, 4 and 5 above are qualified only to the extent that the enforceability of the Indenture and the Series 2014 Bonds may be limited by bankruptcy, moratorium, insolvency, reorganization or other laws affecting creditors' rights or remedies heretofore or hereafter enacted and judicial decisions relating to or affecting the enforcement of creditors' rights or remedies or contractual obligations generally and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

We express no opinion as to the validity or enforceability under certain circumstances of provisions of the Documents with respect to severability or any right of setoff or the enforceability of provisions in the Documents to the effect that terms may not be waived or modified except in writing.

In rendering the foregoing opinions, we have made a review of such legal proceedings as we have deemed necessary to approve the legality and validity of the Series 2014 Bonds. In rendering the foregoing opinions, we have not been requested to examine any document or financial or other information concerning the Issuer other than the record of proceedings referred to above, and we express no opinion as to the accuracy, adequacy or sufficiency of any financial or other information which has

been or will be supplied to purchasers of the Series 2014 Bonds. In addition, we express no opinion as to the severability of any provisions of the Indenture.

This opinion is rendered solely with regard to the matters expressly opined on above and does not consider or extend to any documents, agreements, representations or other material of any kind not specifically opined on above. No other opinions are intended nor should they be inferred. This opinion is issued 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, or in interpretations thereof, that may hereafter occur, or for any other reason whatsoever.

Respectfully submitted,

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