

In the opinion of Orrick, Herrington & Sutcliffe LLP ("Bond Counsel"), based on an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 2017 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. In the further opinion of Bond Counsel, interest on the Series 2017 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes. Bond Counsel expresses no opinion as to whether some or all interest on the Series 2017 Bonds is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel is of the further opinion that under existing statutes, interest on the Series 2017 Bonds is not exempt from Illinois taxes. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 2017 Bonds. See "TAX MATTERS" herein.

\$670,965,000

RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY
Tobacco Settlement Revenue Bonds, Series 2017

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

The Railsplitter Tobacco Settlement Authority (the "Authority") is a special purpose corporation and a body corporate and politic of, but having a legal existence independent and separate from, the State of Illinois (the "State"), and was established under the Railsplitter Tobacco Settlement Authority Act (30 ILCS §171/3-1 et seq.) (as amended from time to time, the "Act").

\$670,965,000 Tobacco Settlement Revenue Bonds, Series 2017 (the "Series 2017 Bonds") of the Authority are to be issued pursuant to the Indenture, dated as of December 1, 2010, as amended and supplemented by the Series 2017 Supplement, dated as of December 1, 2017 (collectively, the "Indenture"), each by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as Trustee (the "Trustee"), for the purposes of refunding a portion equal to \$682,375,000 aggregate principal amount of the Authority's outstanding Tobacco Settlement Revenue Bonds, Series 2010 (the "Series 2010 Bonds"), and paying costs of issuance in connection with the issuance of the Series 2017 Bonds. Following the refunding of such portion of the Series 2010 Bonds, \$385,125,000 aggregate principal amount of Series 2010 Bonds will remain outstanding under the Indenture. The Series 2010 Bonds, and any Refunding Bonds (including the Series 2017 Bonds) issued under the Indenture from time to time, are collectively referred to herein as the "Bonds".

Pursuant to a purchase and sale agreement dated as of December 1, 2010 (the "Sale Agreement"), between the State and the Authority, the State sold to the Authority the "Pledged Settlement Payments", consisting of 100% of the Tobacco Assets less the State's Unsold Assets. The "Tobacco Assets" are all tobacco settlement payments payable to the State pursuant to the terms of the Master Settlement Agreement that was entered into by participating tobacco product manufacturers (the "PMs"), 46 states (including the State) and six other U.S. jurisdictions in November 1998 in settlement of certain smoking-related litigation (the "MSA"), as described further herein. The "State's Unsold Assets", which the State did not sell to the Authority, consist of (i) any payments made with respect to liability to make those payments under the MSA for calendar years completed prior to calendar year 2010, and (ii) those amounts otherwise to be received by the State which were deposited by PMs into the Disputed Payments Account (as herein defined) or withheld by PMs in accordance with Section XI(f)(2) of the MSA prior to December 8, 2010 (the date of issuance of the Series 2010 Bonds). In connection with the execution of the Sale Agreement, the State irrevocably instructed the Escrow Agent under the MSA to remit all Tobacco Assets directly to the Trustee. The Trustee will apply, no later than ten business days after receipt of such Tobacco Assets, amounts to fund the payment of fees, operating expenses and debt service on the Bonds and the replenishment of the Debt Service Reserve Account. The Trustee will not remit to the State the State's Unsold Assets and the Residual Revenues (as defined below) until after receipt of an Officer's Certificate of the Authority, which is dependent upon delivery of certain information by the State.

The Series 2017 Bonds are being issued as fixed interest rate serial bonds. Interest on the outstanding principal amount of the Series 2017 Bonds will be payable on each June 1 and December 1, commencing June 1, 2018. The Series 2017 Bonds are subject to redemption prior to maturity as described herein. Failure to pay interest when due or the principal of any Bonds when due will constitute an Event of Default under the Indenture.

The Bonds are special obligations of the Authority and are secured solely by a pledge under the Indenture of (i) the Pledged Revenues (including the Pledged Settlement Payments), (ii) all amounts and assets on deposit in the Pledged Accounts (which exclude the State's Unsold Assets) established under the Indenture, including the Debt Service Reserve Account maintained under the Indenture, and (iii) all other property pledged for the payment of the Bonds under the Indenture. The Authority has no assets available for the payment of the Bonds other than the Collateral (as defined herein) pledged under the Indenture. The Indenture provides for the release to the State of all "Residual Revenues", consisting of all Pledged Revenues deposited in the Residual Account maintained under the Indenture after prior funding of certain operating expenses, amounts attributable to debt service on Bonds and replenishment of the Debt Service Reserve Account, and any Junior Payments described in the Indenture, within five business days after the Trustee's deposit of such Residual Revenues in the Residual Account.

Payments with respect to the Bonds are dependent upon receipt of the Pledged Settlement Payments. The amount of Pledged Settlement Payments received depends on many factors, including future domestic cigarette consumption, the financial capability of the PMs and the domestic tobacco industry, litigation generally, including litigation challenging the MSA and related state statutes, and federal, state and local regulations affecting the domestic tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, including the NPM Adjustment (defined herein), which may be material. See "RISK FACTORS".

Prospective investors should carefully consider the discussion of certain risks and other considerations contained in "RISK FACTORS" and "LEGAL CONSIDERATIONS", as well as the other information contained in this Offering Circular, regarding an investment in the Series 2017 Bonds. One or a combination of the risk factors discussed herein, and other risks, may materially adversely affect the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full, and could have a material adverse effect on the liquidity and/or market value of the Series 2017 Bonds.

As described further herein, as a result of their purchase of the Series 2017 Bonds, owners thereof (but not the Underwriters) will be deemed as of the date of issuance of the Series 2017 Bonds to have irrevocably consented to an amendment to the Indenture, modifying the definition of Debt Service Reserve Requirement. See "SECURITY FOR THE BONDS—Consent to Amendment to Indenture."

See the Inside Front Cover for Maturities, Principal Amounts, Interest Rates, Yields, and CUSIPs.

Pursuant to the Act, the Series 2017 Bonds shall not constitute an indebtedness or an obligation of the State or any subdivision thereof, within the purview of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them but shall be payable solely from the Collateral. No owner of any Series 2017 Bond shall have the right to compel the exercise of the taxing power of the State to pay any principal installment of, redemption premium, if any, or interest on the Series 2017 Bonds.

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

The Series 2017 Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, Bond Counsel. Certain legal matters will be passed upon for the State by Lisa Madigan, as State Attorney General, and by Chapman and Cutler LLP, Chicago, Illinois. Certain legal matters will be passed upon for the Authority by Hawkins Delafield & Wood LLP, New York, New York, as Disclosure Counsel. Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, as Underwriters' Counsel. It is expected that the Series 2017 Bonds will be available for delivery in book-entry only form through The Depository Trust Company in New York, New York, on or about December 27, 2017.

Jefferies**Ramirez & Co., Inc.****Siebert Cisneros Shank & Co., L.L.C.****Stifel, Nicolaus & Company, Incorporated****Loop Capital Markets****Morgan Stanley****Academy Securities****Cabrera Capital Markets, LLC****Estrada Hinojosa & Company, Inc.****Mischler Financial Group, Inc.****Raymond James**

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES,
YIELDS, AND CUSIPS**

\$670,965,000 Tobacco Settlement Revenue Bonds, Series 2017

Serial Bonds

Maturity (June 1)	Principal Amount	Interest Rate	Yield	CUSIP[†] (Base CUSIP 75076P)
2022	\$109,655,000	5.00%	2.48%	AU9
2023	112,260,000	5.00	2.60	AV7
2024	109,745,000	5.00	2.71	AW5
2025	107,305,000	5.00	2.80	AX3
2026	105,370,000	5.00	2.89	AY1
2027	103,360,000	5.00	2.98 ^{††}	AZ8
2028	23,270,000	5.00	3.08 ^{††}	BA2

[†] Copyright, American Bankers Association (“ABA”). CUSIP data herein are provided by CUSIP Global Services, operated on behalf of the ABA by S&P Global Market Intelligence, a division of S&P Global Inc. The CUSIP numbers listed above are being provided solely for the convenience of holders of the Series 2017 Bonds only at the time of issuance of the Series 2017 Bonds and neither the Authority nor the Underwriters make any representation with respect to such numbers or undertake any responsibility for their accuracy now or at any time in the future. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2017 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 2017 Bonds.

^{††} Priced to first optional call on June 1, 2026.

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

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

THERE CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES 2017 BONDS WILL DEVELOP OR, IF ONE DEVELOPS, THAT IT WILL CONTINUE FOR THE LIFE OF THE SERIES 2017 BONDS.

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

The Offering Circular has been prepared by the Authority and contains information furnished by the State, the Authority and IHS Global and includes information obtained from other sources, all of which are believed to be reliable. Information concerning the domestic tobacco industry and industry participants has been obtained from certain publicly available information provided by certain industry participants and certain other sources. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY”. The industry participants have not provided any information to the Authority for use in connection with this offering. In certain cases, domestic tobacco industry information provided herein (such as market share data) may be derived from sources that are inconsistent or in conflict with each other. The Authority has not independently verified the information under the caption “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY”; the Authority cannot and does not warrant the accuracy or completeness of this information. The information contained under the caption “SUMMARY OF THE TOBACCO CONSUMPTION REPORT” and in APPENDIX A—“TOBACCO CONSUMPTION REPORT” has been included in reliance upon IHS Global as an expert in econometric forecasting.

The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Offering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority or the matters covered by the report of IHS Global included as APPENDIX A to this Offering Circular or the matters described relating to the domestic tobacco industry herein under the heading “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY” 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 made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other party. See “CONTINUING DISCLOSURE UNDERTAKING”.

This Offering Circular contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the factors that may materially affect the amount of Pledged Settlement Payments (see “RISK FACTORS”, “LEGAL CONSIDERATIONS” and “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT”), the inclusion in this Offering Circular of such forecasts, projections and estimates should not be regarded as a representation by the Authority, its financial advisor,

IHS Global, or the Underwriters that such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

If and when included in this Offering Circular, the words “expects”, “forecasts”, “projects”, “intends”, “anticipates”, “estimates”, “assumes” and analogous expressions are intended to identify forward-looking statements and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those that have been projected. Such risks and uncertainties include, among others, general economic and business conditions, changes in political, social and economic conditions, regulatory initiatives and compliance with governmental regulations, litigation and various other events, conditions and circumstances, including with respect to the domestic tobacco industry, many of which are beyond the control of the Authority. These forward-looking statements speak only as of the date of this Offering Circular. The Authority disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any changes in the Authority’s expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Offering Circular and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Series 2017 Bonds to potential investors is made only by means of the entire Offering Circular. Capitalized terms used in this Summary Statement and not otherwise defined shall have the meanings given such terms in the Indenture and the Sale Agreement. See “APPENDIX D — DEFINITIONS AND SUMMARY OF THE INDENTURE” attached hereto and “THE SALE AGREEMENT” herein. For definitions of certain terms used herein, see also the Index of Defined Terms at the end of this Offering Circular.

Overview The Railsplitter Tobacco Settlement Authority (the “**Authority**”) is a special purpose corporation and a body corporate and politic of, but having a legal existence independent and separate from, the State of Illinois (the “**State**”) and was established under the Railsplitter Tobacco Settlement Authority Act (30 ILCS §171/3-1 et seq.) (the “**Act**”). \$670,965,000 Tobacco Settlement Revenue Bonds, Series 2017 (the “**Series 2017 Bonds**”) of the Authority are to be issued pursuant to the Indenture, dated as of December 1, 2010, as amended and supplemented by the Series 2017 Supplement, dated as of December 1, 2017 (collectively, the “**Indenture**”), each by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as Trustee (the “**Trustee**”), for the purposes of refunding a portion equal to \$682,375,000 aggregate principal amount of the Authority’s outstanding Tobacco Settlement Revenue Bonds, Series 2010 (the “**Series 2010 Bonds**”), and paying costs of issuance in connection with the issuance of the Series 2017 Bonds. Following the refunding of such portion of the Series 2010 Bonds, \$385,125,000 aggregate principal amount of Series 2010 Bonds will remain outstanding under the Indenture. The Series 2010 Bonds, and any Refunding Bonds (including the Series 2017 Bonds) issued under the Indenture from time to time, are collectively referred to herein as the “**Bonds**”.

The Bonds are special obligations of the Authority and are secured solely by a pledge under the Indenture of (i) the Pledged Revenues (including the Pledged Settlement Payments), as described herein, (ii) all amounts and assets on deposit in the Pledged Accounts (which exclude the State’s Unsold Assets) established under the Indenture, including the Debt Service Reserve Account maintained under the Indenture, and (iii) all other property pledged for the payment of the Bonds under the Indenture. The Authority has no assets available for the payment of the Bonds other than the Collateral (as defined herein) pledged under the Indenture.

Pursuant to the Act, the Series 2017 Bonds shall not constitute an indebtedness or an obligation of the State or any subdivision thereof, within the purview of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them but shall be payable solely from the Collateral. No

owner of any Series 2017 Bond shall have the right to compel the exercise of the taxing power of the State to pay any principal installment of, redemption premium, if any, or interest on the Series 2017 Bonds.

Consent to Amendment to Indenture

As a result of their purchase of the Series 2017 Bonds, owners thereof (but not the Underwriters) will be deemed as of the date of issuance of the Series 2017 Bonds to have irrevocably consented to (and to have waived notice, if any, required to be given under the Indenture, regarding) an amendment to the Indenture. The amendment will modify the definition of Debt Service Reserve Requirement so that upon and following such amendment, the Debt Service Reserve Requirement will be changed from \$146,768,256.26 to \$140,461,875.00. Upon such modification of the definition of Debt Service Reserve Requirement, amounts then on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement will be released to the State as holder of the Residual Certificate (as defined below).

The Series 2017 Bonds will represent a Majority in Interest of the Bonds to be Outstanding upon the issuance of the Series 2017 Bonds and the defeasance of the Series 2010 Bonds to be refunded, and accordingly, such amendment will be effective on the date of issuance of the Series 2017 Bonds. The Underwriters have not consented to, and shall not be deemed to have consented to, such amendment to the Indenture. See “SECURITY FOR THE BONDS—Consent to Amendment to Indenture” and “SECURITY FOR THE BONDS—Debt Service Reserve Account.”

Sale of Pledged Settlement Payments.....

Pursuant to a purchase and sale agreement dated as of December 1, 2010 (the “**Sale Agreement**”), between the State and the Authority, the State sold to the Authority the “**Pledged Settlement Payments**”, consisting of 100% of the Tobacco Assets less the State’s Unsold Assets. The “**Tobacco Assets**” are all tobacco settlement payments payable to the State pursuant to the terms of the Master Settlement Agreement that was entered into by participating tobacco product manufacturers (the “**PMs**”), 46 states (including the State) and six other U.S. jurisdictions in November 1998 in settlement of certain smoking-related litigation (the “**MSA**”), as described further herein. The “**State’s Unsold Assets**”, which the State did not sell to the Authority, consist of (i) any payments made with respect to liability to make those payments under the MSA for calendar years completed prior to calendar year 2010, and (ii) those amounts otherwise to be received by the State which were deposited by PMs into the Disputed Payments Account (as herein defined) or withheld by PMs in accordance with Section XI(f)(2) of the MSA prior to December 8, 2010 (the date of issuance of the Series 2010 Bonds).

The purchase price paid by the Authority to the State under the Sale Agreement consisted of: (i) the net proceeds of the Series 2010 Bonds and (ii) a security (the “**Residual Certificate**”), issued by the Authority

under the Indenture, which entitles the State as holder of the Residual Certificate to the Residual Revenues, as defined herein.

The sale of the Pledged Settlement Payments and the lien created under the Indenture will stay in effect so long as any Bonds remain Outstanding. The Act provides that the Authority and its corporate existence will continue until six months after all the Authority's liabilities (which include the Bonds) have been met or otherwise discharged, and upon the termination of the existence of the Authority, all of the Authority's rights and property will pass to and be vested in the State.

Master Settlement

Agreement.....

On November 23, 1998, the MSA was entered into by 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 what were then the four largest United States tobacco manufacturers: Philip Morris USA Inc. (“**Philip Morris**”), R.J. Reynolds Tobacco Company (“**Reynolds Tobacco**”), Brown & Williamson Tobacco Corporation (“**B&W**”) and Lorillard Tobacco Company (“**Lorillard**”). In January 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. On June 12, 2015, Reynolds American acquired Lorillard, Inc., of which Lorillard was a wholly-owned subsidiary, and Lorillard was merged into Reynolds Tobacco, with Reynolds Tobacco as the surviving entity. Contemporaneous with Reynolds American's acquisition of Lorillard, Inc., Imperial Tobacco Group PLC (“**Imperial Tobacco**”) purchased certain of Reynolds Tobacco's and certain of Lorillard's cigarette brands, among other assets. The payment obligations under the MSA follow tobacco product brands if they are transferred; thus, Imperial Tobacco is required to make payments under the MSA as a result of its acquisition of those cigarette brands. On July 25, 2017, Reynolds American became a wholly-owned subsidiary of British American Tobacco p.l.c. (“**BAT**”) following BAT's acquisition of the approximately 58% of Reynolds American stock not then owned by BAT. As a result of such acquisition, BAT is responsible for Reynolds Tobacco's payment obligations under the MSA.

References herein to the “**Original Participating Manufacturers**” or “**OPMs**” means (i) prior to July 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard, (ii) after July 30, 2004 and prior to June 12, 2015, collectively Philip Morris, Reynolds Tobacco and Lorillard, and (iii) on and after June 12, 2015, Philip Morris and Reynolds Tobacco, along with Imperial Tobacco with respect to those cigarette brands that Imperial Tobacco acquired from Reynolds Tobacco and Lorillard. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Industry Overview.” The MSA

provides for tobacco companies, other than the OPMs, to become parties to the MSA (“**Subsequent Participating Manufacturers**” or “**SPMs**”).

The MSA is an industry-wide settlement of litigation between the OPMs and SPMs (collectively, the “**Participating Manufacturers**” or “**PMs**”) and the Settling States, and resolved cigarette smoking-related litigation among the Settling States and the OPMs, released the PMs 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. The Authority is not a party to the MSA.

MSA Payments

Under the MSA, the OPMs are required to pay to the Settling States: (i) five initial payments (the “**Initial Payments**”) (all of which have been previously made by the OPMs), (ii) annual payments (the “**Annual Payments**”), which are required to be made annually on each April 15, having commenced April 15, 2000, and continuing in perpetuity (subject to adjustment as described herein), and (iii) ten annual payments of \$861 million (subject to adjustment as described herein) that were required to be made on each April 15 in the years 2008 through 2017, all of which have been paid (the “**Strategic Contribution Payments**”). SPMs are also required to make Annual Payments in certain circumstances. See “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Subsequent Participating Manufacturers.” Under the MSA, the State is entitled to 4.6542472% of the Annual Payments made by PMs under the MSA.

The Annual Payments that are due under the MSA (and the Strategic Contribution Payments that were due under the MSA) are subject to numerous adjustments, some of which are material. Such adjustments include reductions when the PMs experience a loss of market share to tobacco companies that do not become part of the MSA (“**Non-Participating Manufacturers**” or “**NPMs**”), as a result of the PMs’ participation in the MSA (the “**NPM Adjustment**”). The State and certain other Settling States are currently in arbitration regarding the 2004 NPM Adjustment. See “RISK FACTORS—Payment Decreases Under the Terms of the MSA,” “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments” and “—NPM Adjustment Claims”.

Other adjustments to payments due under the MSA include reductions for decreased domestic cigarette shipments, reductions for amounts paid by OPMs to four states which had previously settled their claims against the PMs independently of the MSA, increases related to inflation of not less than 3% each year, and offsets for disputed and/or miscalculated payments, as described herein.

Industry Overview..... Philip Morris and Reynolds Tobacco (both OPMs) are the largest manufacturers of cigarettes in the United States (based on 2016 market share). The market for cigarettes is highly competitive and is characterized by brand recognition. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY.”

As reported by the National Association of Attorneys General (“NAAG”), based upon OPM shipments reported to Management Science Associates, Inc., an independent third-party database management organization that collects wholesale shipment data (“MSAI”), the OPMs accounted for approximately 84.41%^(*) of the U.S. domestic cigarette market in payment year 2017 (sales year 2016), based upon shipments and 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 8.72%^(*) of the U.S. domestic cigarette market in payment year 2017 (sales year 2016), based upon shipments and measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate.

Cigarette Consumption As described in the Tobacco Consumption 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 264 billion cigarettes in 2014, before increasing slightly to 269 billion cigarettes in 2015 and then decreasing to 259 billion cigarettes in 2016. The Tobacco Consumption Report projects that consumption declines will continue in subsequent years. See “SUMMARY OF THE TOBACCO CONSUMPTION REPORT” and APPENDIX A—“TOBACCO CONSUMPTION REPORT”.

Tobacco Consumption Report IHS Global Inc. (“IHS Global”) has prepared a report dated December 20, 2017 on the consumption of cigarettes in the United States from 2017 through 2028 entitled, “*A Forecast of U.S. Cigarette Consumption (2017-2028) for the Railsplitter Tobacco Settlement Authority*” (the “**Tobacco Consumption Report**”).

IHS Global’s cigarette consumption model is based on historical United States data between 1965 and 2016. In the Tobacco Consumption Report, IHS Global has projected the average annual rate of decline in U.S. cigarette consumption from 2017 through 2028 to be 3.1%, resulting in a forecast of total U.S. cigarette consumption in 2028 to be

^(*) OPMs make payments under the MSA based upon the 0.0325 ounce per cigarette conversion rate, and SPMs make payments under the MSA based upon the 0.09 ounce per cigarette conversion rate. 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 “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY.” The aggregate market share information for sales year 2016 from NAAG used in the Pledged Settlement Payments Projection Methodology and Assumptions may differ materially in the future from the market share information used by the MSA Auditor in calculating the adjustments to MSA payments in future years. See “PLEGGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS” and “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments.”

177.3 billion cigarettes (a 31% decline from the 2016 level). The projections and forecasts regarding future cigarette consumption included in the Tobacco Consumption Report are estimates which have been prepared on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of, and no representation or warranty should be inferred from, these projections and forecasts. See “SUMMARY OF THE TOBACCO CONSUMPTION REPORT” and APPENDIX A—“TOBACCO CONSUMPTION REPORT”. See also “PLEGGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS.”

**Pledged Settlement Payments
Projection Methodology and
Bond Structuring
Assumptions.....**

Certain assumptions, forecasts and methodology were used to calculate a forecast of Pledged Settlement Payments to be received by the Authority (including forecasts of United States cigarette consumption based on the Tobacco Consumption Report, which report is also based on assumptions) and the anticipated application of certain adjustments and offsets to Annual Payments to be made by the PMs pursuant to the MSA. Once Pledged Settlement Payments were forecast, certain structuring assumptions for the Series 2017 Bonds were applied. No assurance can be given, however, that events will occur in accordance with such assumptions and forecasts. Any deviation from such assumptions and forecasts could materially and adversely affect the payment of the Series 2017 Bonds. See “TABLE OF BOND DEBT SERVICE AND COVERAGE” and “PLEGGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS.”

Securities Offered

The Series 2017 Bonds are being issued as fixed interest rate serial bonds. Interest on the outstanding principal amount of the Series 2017 Bonds will be payable on each June 1 and December 1, commencing June 1, 2018 (each, a “**Distribution Date**”). Interest on the Series 2017 Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. The Series 2017 Bonds mature on June 1 in the years as set forth on the inside front cover. The Debt Service Reserve Account is available to pay interest on and principal of the Series 2017 Bonds when due to the extent Pledged Revenues are insufficient for such purpose. Failure to pay interest when due or the principal of any Bonds when due will constitute an Event of Default under the Indenture.

It is expected that the Series 2017 Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York (“**DTC**”), on or about December 27, 2017 (the “**Closing Date**”). See “APPENDIX F — BOOK-ENTRY ONLY SYSTEM”.

Individual purchases of beneficial ownership interests may be made in the principal amount of \$5,000 or any integral multiple thereof (an

“**Authorized Denomination**”). Beneficial owners of the Series 2017 Bonds will not receive physical delivery of bond certificates.

Collateral.....

The Bonds are special revenue obligations of the Authority payable solely from and secured solely by a pledge under the Indenture of (a) the Pledged Revenues (including all Pledged Settlement Payments), as defined below, (b) all rights to receive the Pledged Revenues and the proceeds of such rights, (c) the Pledged Accounts (which exclude any State’s Unsold Assets deposited in the Tobacco Assets Account) and assets thereof (including Related Contracts), including money, contract rights, general intangibles or other personal property, held by the Trustee under the Indenture, (d) subject to the following sentence, all rights and interest of the Authority under the Sale Agreement including the representations, warranties and covenants of the State 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 (collectively, the “**Collateral**”). The Collateral does not include the State’s Unsold Assets, the Residual Revenues once deposited in the Residual Account, and certain other reserved rights of the Authority set forth in the Indenture, as described herein. In addition, the proceeds of the Series 2017 Bonds are not pledged to the payment of, and are therefore not available to, the holders of the Series 2017 Bonds.

“**Pledged Revenues**” are (i) the Pledged Settlement Payments, (ii) to the extent set forth in the applicable series supplement or series indenture, payments made to the Authority or Trustee under Related Contracts (as defined herein), and (iii) all fees, charges, payments, investment earnings and other income and receipts paid or payable to the Authority or the Trustee for the account of the Authority or Beneficiaries (as defined herein). Pledged Revenues do not include Residual Revenues (as defined herein) once deposited in the Residual Account.

Debt Service Reserve Account...

Upon the Closing Date of the Series 2017 Bonds, a debt service reserve account held under the Indenture (the “**Debt Service Reserve Account**”) will be funded at its amended required level of \$140,461,875.00 (the “**Debt Service Reserve Requirement**”), which level is required to be maintained through required deposits of Pledged Revenues for so long as any Bonds remain Outstanding. See “— Consent to Amendment to Indenture” above. The Indenture does not require a ratable increase in the Debt Service Reserve Requirement, or any further funding of the Debt Service Reserve Requirement, in connection with the issuance of Refunding Bonds.

Prior to an Event of Default, amounts on deposit in the Debt Service Reserve Account will be available to pay the principal of and interest on the Bonds when due, to the extent Pledged Revenues are insufficient for such purpose. After an Event of Default, money in the Debt Service Reserve Account will be available to pay the principal of and interest on the Bonds pursuant to Extraordinary Prepayments, as described herein.

Unless an Event of Default has occurred, amounts withdrawn from the Debt Service Reserve Account will be replenished from Pledged Revenues as described herein.

If an Event of Default has not occurred, money in the Debt Service Reserve Account may be applied to the redemption of outstanding Bonds, under the circumstances described under the caption “THE SERIES 2017 BONDS — Optional Redemption” or “THE SERIES 2017 BONDS — Optional Clean-Up Call”.

Optional Redemption The Series 2017 Bonds maturing on and after June 1, 2027 are subject to redemption, in whole or in part, on any date on and after June 1, 2026, at the option of the Authority, from any source including the proceeds of Refunding Bonds or other refunding obligations, at a redemption price equal to 100% of the principal amount of Series 2017 Bonds to be redeemed, plus interest accrued thereon to the redemption date.

Partial Lump Sum Payments and Lump Sum Payments..... The Indenture provides that Partial Lump Sum Payments (as defined herein) are to be deposited in the Lump Sum Account and shall be transferred to the Debt Service Account at the times and in the amounts necessary to pay the principal or Sinking Fund Installments (if any) of the Bonds on the respective Distribution Dates covered by such Partial Lump Sum Payments. The Indenture provides that any Lump Sum Payments (as defined herein) shall be placed into a defeasance escrow to pay or redeem the Bonds, pro rata by principal amount among maturities and within a maturity, in an aggregate principal amount equal to the amount of such Lump Sum Payments.

Extraordinary Prepayments Following the occurrence of a Payment Default, the Bonds are subject to redemption, on each Distribution Date thereafter, pro rata among maturities and within a maturity, at a redemption price equal to 100% of the principal amount of Bonds to be redeemed, plus interest accrued thereon to the redemption date, from Extraordinary Prepayments derived from amounts on deposit in the Pledged Revenues Account (after application to payment of Operating Expenses (subject to the Operating Cap and the limitation on State Attorney General Operating Expenses), and after funding amounts attributable to interest on the Bonds), from amounts on deposit in the Debt Service Reserve Account, and from Partial Lump Sum Payments in the Lump Sum Account.

Optional Clean-up Call The Bonds are subject to redemption at the option of the Authority on any Distribution Date at a redemption price equal to 100% of the principal amount of Bonds to be redeemed, plus interest accrued thereon to the redemption date, in the event liquidation of the aggregate amount on deposit in the Pledged Accounts (which excludes the State’s Unsold Assets in the Tobacco Assets Account), other than amounts set aside for the payment of Bonds, is greater than the principal amount of and accrued interest (if any) on the Bonds after the application of Pledged Revenues in accordance with the Indenture on such Distribution Date.

Distributions..... The Trustee will deposit all Pledged Revenues in the Pledged Revenues Account and distribute them as described under “—Application of Pledged Revenues” set forth under the caption “SECURITY FOR THE BONDS”.

Event of Default and Extraordinary Payment If an Event of Default (as defined herein) occurs, the Trustee may, and upon written request of the holders of 25% in principal amount of the Bonds outstanding shall, in its own name by action or proceeding in accordance with the law: (a) enforce all rights of the holders and require the Authority or, to the extent permitted by law, the State to carry out its agreements with the holders and to perform its duties under the Sale Agreement, (b) sue upon such Bonds, (c) require the Authority 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. Failure to pay interest when due or the principal of any Bonds (including by Sinking Fund Installment, if any) when due will constitute an Event of Default under the Indenture (a “**Payment Default**”). Upon a Payment Default, the Bonds shall not be subject to acceleration of the maturity of principal, but shall be subject to pro rata redemption among maturities from Extraordinary Prepayments on each Distribution Date thereafter. For a description of Events of Default under the Indenture, see “APPENDIX D — DEFINITIONS AND SUMMARY OF THE INDENTURE – *Events of Default*”.

Refunding Bonds..... One or more additional Series of Bonds (the “**Refunding Bonds**”) may be issued by the Authority solely for refunding purposes (each, a “**Series**”). In accordance with the Indenture, no such Refunding Bonds may be issued that mature on or after the final maturity date of the Bonds to be refunded. See “THE SERIES 2017 BONDS — Refunding Bonds”. No other additional bonds may be issued under the Indenture with a parity claim against the Pledged Revenues.

Covenants of the State and the Authority The State has covenanted in the Sale Agreement that, among other things, it will (i) irrevocably direct, through the Attorney General, the Independent Auditor and the Escrow Agent (as such terms are defined in the MSA) to transfer all Tobacco Assets directly to the Trustee as the assignee of the Authority, (ii) enforce its right to collect all moneys due from the PMs under the MSA, (iii) diligently enforce the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA against all NPMs selling tobacco products in the State that are not in compliance with the Qualifying Statute, in each case in the manner and to the extent deemed necessary in the judgment of, and consistent with the discretion of, the Attorney General (provided, that remedies available to the Authority and the owners of the Bonds for any breach of these agreements of the State shall be limited to injunctive relief), (iv) neither amend the MSA nor the Consent Decree or take any other action in any way that would materially adversely (a) impair the Authority’s right to receive Pledged Settlement Payments, or (b) limit or alter the rights

vested in the Authority to fulfill the terms of its agreements with the Beneficiaries, or (c) impair the rights and remedies of the Beneficiaries 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 proceedings by or on behalf of the Beneficiaries, are fully paid and discharged and (v) not amend, supersede or repeal the MSA or the Qualifying Statute, in any way that would materially adversely affect the amount of any payment to, or the rights to such payments of, the Authority or the Beneficiaries. Notwithstanding these pledges and agreements by the State, nothing in the Sale Agreement, the Indenture, the Bonds or the Act shall be construed or interpreted to limit or impair the authority or discretion of the Attorney General to administer and enforce provisions of the MSA or to direct, control and settle any litigation or arbitration proceeding arising from or relating to the MSA.

The Authority has covenanted in the Indenture that, among other things, it will (a) duly and punctually pay the principal or Sinking Fund Installments (if any) of and premium, if any, and interest on the Bonds in accordance with the terms of the Bonds and the Indenture, (b) (i) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (ii) perfect, publish notice of or protect the validity of any grant made or to be made by the Indenture; (iii) preserve and defend title to the Pledged Revenues and other collateral pledged under the Indenture and the rights of the Trustee and the registered owners of the Bonds (“**Bondholders**”) and Beneficiaries in such collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of the Consent Decree, the Indenture, the Act or the Sale Agreement or the performance by any party thereunder; and (iv) cause the Trustee to enforce the Sale Agreement and (c) diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the Collateral. In accordance with the Act, the Indenture provides that the Authority has no authority to file a voluntary petition under, or become a debtor or bankrupt under, the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency, or moratorium law or statute as may from time to time be in effect and neither any public officer nor any organization, entity, or other person shall authorize the Authority to become a debtor or bankrupt under the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency or moratorium law or statute as may from time to time be in effect.

The Authority and the State have each covenanted not to impair the exclusion of interest on the Bonds from gross income for federal income tax purposes. See “APPENDIX D — DEFINITIONS AND SUMMARY OF THE INDENTURE” attached hereto for a summary of the covenants made by the Authority and “THE SALE AGREEMENT” herein for a summary of the covenants made by the State.

Ratings A security rating is not a recommendation to buy, sell or hold securities. There is no assurance that the initial ratings assigned to the Series 2017

Bonds will continue for any given period of time or that any of such ratings will not be revised downward, suspended or withdrawn entirely. 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 2017 Bonds. See “RATINGS”.

Risk Factors and Legal

Considerations Reference is made to “RISK FACTORS” and “LEGAL CONSIDERATIONS” for a description of certain risks and legal issues relevant to an investment in the Series 2017 Bonds.

Continuing Disclosure

Undertaking The Authority has agreed to provide, or cause to be provided, to the Municipal Securities Rulemaking Board (the “MSRB”), through its Electronic Municipal Market Access (“EMMA”) system, pursuant to Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission (the “SEC”), certain annual financial information and operating data and, in a timely manner, notices of certain specified events (but in no event in excess of ten business days after the occurrence of the event). See “APPENDIX E—FORM OF CONTINUING DISCLOSURE UNDERTAKING.”

Tax Matters

In the opinion of Orrick, Herrington & Sutcliffe LLP (“Bond Counsel”), based on an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 2017 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”). In the further opinion of Bond Counsel, interest on the Series 2017 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes. Bond Counsel expresses no opinion as to whether some or all interest on the Series 2017 Bonds is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel is of the further opinion that under existing statutes, interest on the Series 2017 Bonds is not exempt from Illinois taxes. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 2017 Bonds. See “TAX MATTERS” herein.

Availability of Documents

Included herein are brief summaries of certain documents, which summaries do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statements of the contents thereof. Copies of the Indenture and the Sale Agreement may be obtained by written request from the Trustee at Two North LaSalle Street, Suite 1020, Chicago, Illinois 60602. Any statements in this Offering Circular involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Offering Circular is not to be construed as a contract or agreement among the Authority, the State and the Bondholders.

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\$670,965,000

**Railsplitter Tobacco Settlement Authority
Tobacco Settlement Revenue Bonds, Series 2017**

This Offering Circular sets forth information concerning the issuance by the Railsplitter Tobacco Settlement Authority of its Tobacco Settlement Revenue Bonds, Series 2017, pursuant to the Indenture. Defined terms used herein not otherwise defined below shall have the meanings set forth in the Summary Statement and in “APPENDIX D—DEFINITIONS AND SUMMARY OF THE INDENTURE”.

SECURITY FOR THE BONDS

Consent to Amendment to Indenture

As a result of their purchase of the Series 2017 Bonds, owners thereof (but not the Underwriters) will be deemed as of the date of issuance of the Series 2017 Bonds to have irrevocably consented to (and to have waived notice, if any, required to be given under the Indenture, regarding) an amendment to the Indenture. The amendment will modify the definition of Debt Service Reserve Requirement so that upon and following such amendment, the Debt Service Reserve Requirement will be changed from \$146,768,256.26 to \$140,461,875.00. See “APPENDIX D — DEFINITIONS AND SUMMARY OF THE INDENTURE”. Upon such modification of the definition of Debt Service Reserve Requirement, amounts then on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement will be released to the State as holder of the Residual Certificate.

The Series 2017 Bonds will represent a Majority in Interest of the Bonds to be Outstanding upon the issuance of the Series 2017 Bonds and the defeasance of the Series 2010 Bonds to be refunded, and accordingly, such amendment will be effective on the date of issuance of the Series 2017 Bonds. The Underwriters have not consented to, and shall not be deemed to have consented to, such amendment to the Indenture.

Pledge of Collateral

Under the Indenture, the Bonds are secured by a pledge and assignment of the Authority’s right, title and interest in:

(a) the “**Pledged Revenues**”, consisting of (i) the “**Pledged Settlement Payments**” (which are the “pledged tobacco revenues” as defined in the Act, which for purposes of the Sale Agreement and the Indenture consist of the Tobacco Assets less the State’s Unsold Assets), (ii) to the extent set forth in the applicable series supplement or other supplemental indenture, payments made to the Authority or Trustee under Related Contracts, and (iii) all fees, charges, payments, investment earnings and other income and receipts paid or payable to the Authority or the Trustee for the account of the Authority or the Beneficiaries,

(b) all rights to receive the Pledged Revenues and the proceeds of such rights,

(c) the Pledged Accounts (which exclude any State’s Unsold Assets deposited in the Tobacco Assets Account) and assets thereof (including Related Contracts), including money, contract rights, general intangibles or other personal property, held by the Trustee under the Indenture,

(d) subject to the paragraph below, all rights and interest of the Authority under the Sale Agreement including the representations, warranties and covenants of the State 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 (collectively, the “**Collateral**”).

Except as specifically provided in the Indenture, such assignment and pledge does not include: (i) the State’s Unsold Assets and the Residual Revenues (upon deposit in the Residual Account), (ii) the rights of the Authority pursuant to provisions for consent or other action by the Authority, notice to the Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Beneficiaries, (iii) any right or power reserved to the Authority pursuant to the Act or other law, (iv) any Defeasance Collateral held by the Trustee for the benefit of Defeased Beneficiaries in accordance with the Indenture, and (v) as to any Series of Bonds, any other property or interest explicitly excluded from Collateral pursuant to the terms of the related Series Supplement. Further, such assignment and pledge does not preclude the Authority’s enforcement of its rights under and pursuant to the Sale Agreement for the benefit of the Beneficiaries as provided in the Indenture. The Residual Revenues, the State’s Unsold Assets and the proceeds of the Series 2017 Bonds do not constitute any portion of the Pledged Revenues, are not pledged to the holders of the Bonds and are not subject to the lien of the Indenture.

The “**Tobacco Assets**” are all tobacco settlement payments paid or payable to the State on and after December 8, 2010 (the date of issuance of the Series 2010 Bonds) and required to be made, pursuant to the terms of the MSA, by PMs to the State, and the State’s rights to receive such tobacco settlement payments, consisting of (i) the Annual Payments and Strategic Contribution Payments payable to the State under the MSA (and all adjustments thereto) and (ii) any Partial Lump Sum Payments and Lump Sum Payments.

For the purposes of the Indenture, the following portions of Tobacco Assets are the “**State’s Unsold Assets**” (which were not sold to the Authority under the Sale Agreement and are not pledged under the Indenture): (i) any payments made with respect to liability to make those payments under the MSA for calendar years completed prior to calendar year 2010; and (ii) those amounts otherwise to be received by the State which were deposited by PMs into the Disputed Payments Account or withheld by PMs in accordance with Section XI(f)(2) of the MSA prior to December 8, 2010 (the date of issuance of the Series 2010 Bonds).

For the purposes of the Indenture, the “**Residual Revenues**” consist of the Pledged Revenues deposited in the Residual Account that are in excess of the amounts required to pay, as allocated under the Indenture to each Distribution Date, (1) (a) the Trustee fees and expenses and (b) Operating Expenses of the Authority (subject to the Operating Cap) and the State Attorney General (in an amount not to exceed \$2,500,000 per Fiscal Year); (2) interest due on Bonds on such Distribution Date and the next succeeding Distribution Date; (3) principal and Sinking Fund Installments (if any) due on Bonds; (4) amounts required to replenish the Debt Service Reserve Account until the amount on deposit therein equals the Debt Service Reserve Requirement; and (5) Junior Payments. See “—Application of Pledged Revenues” below.

The pledge of the Collateral made by the Indenture shall be for the equal and ratable benefit, protection and security of the Holders of any and all of the Outstanding Bonds and all other Beneficiaries, all of which, regardless of the time or times of their issue or maturity, shall be of equal rank without preference, priority or distinction of such Bonds and all other Beneficiaries over any other Bonds or Beneficiaries except as expressly provided by the Indenture or permitted thereby.

The pledge of the Collateral will stay in effect so long as the Bonds remain outstanding. The Act provides that the Authority and its corporate existence will continue until six months after all the

Authority's liabilities (which include the Bonds) have been met or otherwise discharged, and upon the termination of the existence of the Authority, all of the Authority's rights and property will pass to and be vested in the State.

Accounts

The following accounts are established under the Indenture and held by the Trustee for the benefit of the holders of the Bonds (except to the extent that State's Unsold Assets are deposited in the Tobacco Assets Account) (the "**Pledged Accounts**"). All money on deposit in the following accounts will be invested in Eligible Investments.

Tobacco Assets Account. All Tobacco Assets received by the Trustee shall immediately be deposited in the Tobacco Assets Account. Within five business days after receipt of an Officer's Certificate of the Authority (identifying the total amount of Tobacco Assets received, the amount representing State's Unsold Assets, the amount representing Pledged Settlement Payments and the amount representing Residual Revenues, which information will be based upon documentation received by the Authority from the State Attorney General), the Trustee will make the following transfers: (i) Pledged Settlement Payments (other than Partial Lump Sum Payments and Lump Sum Payments) to the Pledged Revenues Account; (2) Partial Lump Sum Payments and Lump Sum Payments to the Lump Sum Account; and (3) State's Unsold Assets to, or upon the order of, the State; provided, however, that if by the earlier of the business day prior to a Distribution Date and the tenth business day after receipt of any Tobacco Assets the Authority has not received documentation required from the State Attorney General or has not delivered the required Officer's Certificate described above, the Trustee will apply amounts to fund the payment of fees, Operating Expenses and debt service on the Bonds and the replenishment of the Debt Service Reserve Account (as described in subclauses (i) through (v) of clause (A) under the subheading "Application of Pledged Revenues" below).

Pledged Revenues Account. Funds in the segregated trust account designated the "**Pledged Revenues Account**" will be transferred to various other accounts under the Indenture, in accordance with the priorities described below under "—Application of Pledged Revenues".

Debt Service Account. The Trustee will deposit into the "**Debt Service Account**" amounts transferred from the Pledged Revenues Account in respect of interest on and principal of the Bonds. The Trustee will make payments on the Bonds from the Debt Service Account in accordance with the priority of payments as described below under "Application of Pledged Revenues".

Debt Service Reserve Account. On the Closing Date of the Series 2017 Bonds, the "**Debt Service Reserve Account**" will be funded at its amended required level of \$140,461,875.00 (the "**Debt Service Reserve Requirement**"), which level is required to be maintained for so long as any Bonds remain Outstanding. See "—Consent to Amendment to Indenture" above. The Indenture does not require a ratable increase in the Debt Service Reserve Requirement, or any further funding of the Debt Service Reserve Requirement, in connection with the issuance of Refunding Bonds. Unless a Payment Default has occurred, amounts withdrawn from the Debt Service Reserve Account will be replenished from Pledged Revenues as described herein. Whenever the amount on deposit in the Debt Service Reserve Account exceeds the Debt Service Reserve Requirement, at the direction of the Authority, the excess may be transferred by the Trustee to the Debt Service Account or, if approved by an opinion of Bond Counsel, transferred to any Fund or Account specified by the Authority.

Lump Sum Account. The Trustee will transfer all Pledged Revenues that constitute "**Partial Lump Sum Payments**" (a lump sum payment received by the Trustee as a payment from a PM which results in, or is due to, a release of that PM from a portion of its obligations due under the MSA) and

“Lump Sum Payments” (a lump sum payment received by the Trustee as a payment from a PM which results in, or is due to, a release of that PM from all of its obligations under the MSA) to the Lump Sum Account. To the extent that amounts represent a Lump Sum Payment, the Trustee will invest such amount in Defeasance Collateral to pay or redeem a Pro Rata portion of each maturity of Outstanding Bonds in accordance with their terms. To the extent that the amounts represent a Partial Lump Sum Payment, such amounts will be held by the Trustee in the Lump Sum Account and transferred to the Debt Service Account at the times and in the amounts necessary to pay the principal or Sinking Fund Installments (if any) of the Bonds on the respective Distribution Dates covered by such Partial Lump Sum Payment. Upon the occurrence of a Payment Default, any Partial Lump Sum Payment will be applied to make Extraordinary Prepayments.

Each of the following accounts has been established under the Indenture and is held by the Trustee, but none of these accounts is a Pledged Account, and amounts on deposit therein are not available to pay principal of and interest on the Bonds.

Costs of Issuance Account. Upon issuance of the Series 2017 Bonds, the amount of proceeds thereof specified for payment of costs of issuance will be deposited in the **“Costs of Issuance Account”** for payment of such costs of issuance. Any money or investments held in the Costs of Issuance Account for more than 180 days shall be transferred to the State for deposit in the Tobacco Settlement Bond Proceeds Account within the Tobacco Settlement Recovery Fund established in the State Treasury.

Operating Account. The Trustee holds the **“Operating Account”** into which the Trustee deposits amounts transferred from the Pledged Revenues Account to pay Operating Expenses in accordance with the priority of payments as described below under “Application of Pledged Revenues”.

Rebate Account. The Trustee holds the **“Rebate Account”** into which the Trustee deposits amounts to the extent required to satisfy the Rebate Requirement (as defined, computed and provided to the Trustee in accordance with the Tax Certificate), for payment to the United States Treasury. Neither the Authority nor any Bondholder will have any rights in or claim to such money in the Rebate Account.

Residual Account. The Trustee holds the **“Residual Account”** into which the Trustee deposits the Residual Revenues, which are those Pledged Revenues in excess of those required to make the deposits required by clauses (i) through (vi) of paragraph (A) set forth below under the sub-caption “Application of Pledged Revenues”. Amounts on deposit in the Residual Account will be delivered to the holder of the Residual Certificate as described below.

Application of Pledged Revenues

Unless otherwise specified in the Indenture, the Trustee will deposit all Pledged Revenues received by it in the Pledged Revenues Account.

(A) No later than five (5) Business Days following each deposit of Pledged Revenues to the Pledged Revenues Account (but in no event later than the next Distribution Date), the Trustee will withdraw Pledged Revenues on deposit in the Pledged Revenues Account and transfer such amounts as follows and in the following order of priority; provided, however, that investment earnings on amounts in the funds and accounts (other than the Debt Service Reserve Account, investment earnings on which shall be retained therein until the amounts on deposit therein are at least equal to the Debt Service Reserve Requirement, and on the fifth Business Day preceding each Distribution Date amounts on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement may, at the direction of the Authority, be deposited directly to the Debt Service Account) will be deposited directly to the Debt Service Account; and provided, further, that upon the occurrence of a Payment Default, Pledged

Revenues shall be transferred as set forth in clauses (i), (ii) and (iv) below and then all remaining Pledged Revenues shall be applied to make Extraordinary Prepayments as described in clause (D) below.

(i) (a) to the Authority Operating Subaccount, the amount required to pay (i) Trustee fees and expenses (including reasonable attorneys' fees, if applicable) reasonably expected to be due during the next Fiscal Year and (ii) an amount specified by an Officer's Certificate for operating and administrative expenses incurred by the Authority for the next Fiscal Year (provided that such amounts paid pursuant to this clause (a) shall not exceed the "**Operating Cap**" (\$316,692.52 in the Fiscal Year ending June 30, 2019 and inflated annually in each following Fiscal Year in accordance with the Indenture) and such operating expenses shall not include any termination payments or loss amounts on Related Contracts, if any) and (b) to the State Attorney General Operating Subaccount, the amount required to pay any expenses incurred by the State Attorney General relating to the enforcement of the MSA, the Qualifying Statute and the Complementary Legislation in an amount not to exceed \$2,500,000 for the next Fiscal Year (the operating expenses described in clause (a) and the enforcement expenses described in clause (b) are referred to herein as "**Operating Expenses**");

(ii) to the Debt Service Account an amount sufficient to cause the amount therein (together with interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next Distribution Date), to equal interest (including interest at the stated rate on the principal of Outstanding Bonds, and on overdue interest, if any) due on the next succeeding Distribution Date;

(iii) to the Debt Service Account, exclusive of the amounts deposited therein pursuant to clause (ii) above, an amount sufficient to cause the amount on deposit therein (together with any Partial Lump Sum Payment to be applied to the payment of principal or Sinking Fund Installments (if any) on the next succeeding June 1 and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next succeeding June 1 to the extent not counted for purposes of clause (ii) above), to equal the principal and Sinking Fund Installments (if any) due on the next succeeding June 1;

(iv) to the Debt Service Account, exclusive of the amount on deposit therein under clauses (ii) and (iii) above, an amount sufficient to cause the amount therein (together with interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the second succeeding Distribution Date to the extent not counted for purposes of clause (ii) or (iii) above), to equal interest (including interest at the stated rate on the principal of Outstanding Bonds, and on overdue interest, if any) due on the second succeeding Distribution Date;

(v) to replenish the Debt Service Reserve Account until the amount on deposit therein equals the Debt Service Reserve Requirement;

(vi) in the amounts and to the Funds and Accounts established by Series Supplement for Junior Payments; and

(vii) to the Residual Account, the remaining Pledged Revenues (the "**Residual Revenues**").

On the first Business Day of the calendar month preceding a month in which a Distribution Date occurs, the Trustee will compare (i) the liquidation value of the aggregate amount on deposit in the Pledged Accounts (which excludes the State's Unsold Assets in the Tobacco Assets Account), other than amounts set aside for the payment of Bonds, to (ii) the principal amount of and accrued interest (if any) on Bonds that will remain Outstanding after the application of amounts described below on such

Distribution Date, and if the amount in clause (i) is greater than the amount described in clause (ii) as of such Distribution Date, then the Trustee will, at the direction of the Authority, liquidate the investments in the Pledged Accounts and will withdraw from the Pledged Accounts an amount sufficient to, and shall, retire the Bonds in full on such Distribution Date.

(B) Unless a Payment Default shall have occurred, on each Distribution Date (except with respect to clause (i) below), the Trustee will apply amounts in the various Accounts in the following order of priority:

(i) at any time, from (A) the Authority Operating Subaccount, to the parties entitled thereto, to pay the expenses of Authority described in clause (a) of the definition of Operating Expenses, in the amount specified in an Officer's Certificate of the Authority and (B) the State Attorney General Operating Subaccount, to pay the expenses of the State Attorney General described in clause (b) of the definition of the Operating Expenses, in the amount specified in a certificate delivered by an Authorized Officer of the State Attorney General;

(ii) from the Debt Service Account (and to the extent that amounts in the Debt Service Account are insufficient therefor, from amounts that shall be transferred on such Distribution Date to the Debt Service Account from the Debt Service Reserve Account), to pay interest on the Outstanding Bonds (including interest on overdue interest, if any) due on such Distribution Date, plus any such unpaid interest due on prior Distribution Dates;

(iii) from the Debt Service Account (and to the extent that amounts in the Debt Service Account are insufficient therefor, from amounts that shall be transferred on such Distribution Date to the Debt Service Account from the Debt Service Reserve Account), to pay, in order of Maturity Dates and Sinking Fund Installment Dates (if any), the principal and Sinking Fund Installments (if any) due on Distribution Date; and

(iv) from the Funds and Accounts therefor, to make Junior Payments.

(C) Promptly, and in no event more than five (5) Business Days after the deposit of such funds in the Residual Account, the Residual Revenues shall be transferred to the registered owner of the Residual Certificate.

(D) Upon the occurrence of a Payment Default, the Trustee shall transfer Pledged Revenues in accordance with the priorities and purposes set forth in clauses (A)(i), (ii) and (iv) above and then, together with all funds on deposit in the Debt Service Reserve Account and all Partial Lump Sum Payments in the Lump Sum Account, shall apply any remaining funds to redeem Bonds on each Distribution Date, Pro Rata as to principal amount among maturities and within a maturity, without regard to Authorized Denominations, at the redemption price of 100% of the Outstanding principal amount thereof plus accrued interest to the date of redemption ("**Extraordinary Prepayment**").

Events of Default and Remedies

Under the Indenture, any one of the following events is an "**Event of Default**":

(a) principal or Sinking Fund Installments (if any) of or interest on any Bond has not been paid, when due (a "**Payment Default**");

(b) the Authority fails to observe or perform any other provision of the Indenture, which failure is not remedied within 60 days after written notice thereof is given to the Authority by the Trustee

or to the Authority and the Trustee by the Bondholders of at least 25% in principal amount of the Bonds then Outstanding; provided that if such default cannot be corrected within the 60-day period and is diligently pursued until the default is corrected, it shall not constitute an Event of Default if corrective action is instituted by the Authority within the 60-day period and diligently pursued until the default is corrected;

(c) the State fails to observe or perform its covenants in the Indenture or the Sale Agreement, which failure is not remedied within 60 days after written notice thereof is given to the Authority and the State by the Trustee or to the Authority and the Trustee by the Bondholders of at least 25% in principal amount of the Bonds then Outstanding; or

(d) 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 Authority and, if instituted against the Authority, are not dismissed within 60 days after such institution.

If an Event of Default occurs, the Trustee may, and upon written request of the Bondholders of 25% in principal amount of the Bonds Outstanding shall, in its own name by action or proceeding in accordance with the law:

(i) enforce all rights of the Bondholders and require the Authority or, to the extent permitted by law, the State to carry out its agreements with the Bondholders and to perform its duties under the Sale Agreement;

(ii) sue upon such Bonds;

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

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

In no event shall the principal of any Bond be declared due and payable in advance of its stated maturity.

Upon a Payment Default or a failure actually known to an Authorized Officer of the Trustee to make any other payment required under the Indenture within seven days after the same becomes due and payable, the Trustee must give written notice thereof to the Authority. The Trustee is required to proceed for the benefit of the Bondholders in accordance with the written direction of a Majority in Interest of the Outstanding Bonds.

Notwithstanding the foregoing, the Act and the Indenture provide that injunctive relief shall be the sole remedy available to the Trustee for any breach of the pledge and agreement of the State to diligently enforce the Qualifying Statute against all tobacco products manufacturers selling tobacco products in the State that are not in compliance with the Qualifying Statute.

Upon a Payment Default, the Bonds are subject to redemption, on each Distribution Date, Pro Rata by principal amount among maturities and within a maturity, at a redemption price equal to 100% of the principal amount of Bonds to be redeemed, plus interest accrued thereon to the redemption date, from Extraordinary Prepayments derived from amounts on deposit in the Pledged Revenues Account (after application to Operating Expenses as set forth in the Indenture and after funding amounts attributable to

interest on the Bonds due on such Distribution Date and the next succeeding Distribution Date), from funds on deposit in the Debt Service Reserve Account, and from Partial Lump Sum Payments in the Lump Sum Account.

Refunding Bonds

The Authority may authorize, issue, sell and deliver Bonds under the Indenture from time to time in such principal amounts as the Authority may determine but solely to refund Outstanding Bonds, by exchange, purchase, redemption or payment, and establish such escrows therefor as it may determine (“**Refunding Bonds**”). In accordance with the Indenture, no such Refunding Bonds may be issued that mature on or after the final maturity date of the Bonds to be refunded. No other additional bonds may be issued under the Indenture with a parity claim against the Pledged Revenues.

THE SERIES 2017 BONDS

The following summary describes certain terms of the Series 2017 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 2017 Bonds. Copies of the Indenture may be obtained upon written request to the Trustee.

The Series 2017 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 2017 Bonds. Individual purchases of beneficial ownership interests in the Series 2017 Bonds may be made for principal amounts of \$5,000 or any integral multiple thereof (an “**Authorized Denomination**”). Except under the limited circumstances described herein, no Beneficial Owner (as defined herein) of the Series 2017 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Bonds. See “APPENDIX F — BOOK-ENTRY ONLY SYSTEM”.

For each Distribution Date, payments will be made to registered owners of the Series 2017 Bonds (the “**Holders**”) as of the last Business Day of the calendar month immediately preceding the calendar month in which a Distribution Date occurs (the “**Record Date**”). The Trustee and the Authority may establish special record dates for the determination of the Holders for various purposes of the Indenture, including giving consent or direction to the Trustee.

Payments of Interest

Interest on the outstanding principal amount of the Series 2017 Bonds will be payable on each June 1 and December 1, commencing June 1, 2018, until the Maturity Date or earlier redemption of such Series 2017 Bond. Interest on Series 2017 Bonds will accrue from the Closing Date of the Series 2017 Bonds, or from the most recent Distribution Date on which interest has been paid, to but excluding the subsequent Distribution Date on which interest is payable. Interest on the Series 2017 Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. Amounts on deposit in the Debt Service Reserve Account are available to make payments of interest on the Series 2017 Bonds. If on any Distribution Date there are insufficient funds to pay all interest then due on the Series 2017 Bonds, this will constitute a Payment Default under the Indenture, and the Bonds shall be subject to Pro Rata redemption among maturities from Extraordinary Prepayments on each Distribution Date thereafter.

Payments of Principal

The Series 2017 Bonds are issued as serial bonds subject to redemption prior to maturity as described below. A failure to pay principal of a Series 2017 Bond on its Maturity Date will constitute a Payment Default under the Indenture, and the Series 2017 Bonds shall be subject to Pro Rata redemption among maturities from Extraordinary Prepayments on each Distribution Date thereafter.

Except to the extent redemption of Series 2017 Bonds is to be by Pro Rata selection, including within a maturity, if less than all of the Series 2017 Bonds of any maturity are to be redeemed, the Holders of the Series 2017 Bonds of such maturity will be paid as described under the caption “– Partial Redemptions” below.

Optional Redemption

The Series 2017 Bonds maturing on and after June 1, 2027 are subject to redemption, in whole or in part, on any date on and after June 1, 2026, at the option of the Authority, from any source including the proceeds of Refunding Bonds or other refunding obligations, at a redemption price equal to 100% of the principal amount of Series 2017 Bonds to be redeemed, plus interest accrued thereon to the redemption date.

Extraordinary Prepayments

Following the occurrence of a Payment Default, the Series 2017 Bonds are subject to mandatory redemption, on each Distribution Date, pro rata as to principal amount among maturities and within a maturity, at a redemption price equal to 100% of the principal amount of Series 2017 Bonds to be redeemed, plus interest accrued thereon to the redemption date, from Extraordinary Prepayments derived from amounts on deposit in the Pledged Revenues Account (after application to Operating Expenses (subject to the Operating Cap and the limitation on State Attorney General Operating Expenses) as set forth in the Indenture and after funding amounts attributable to interest on the Bonds), from funds on deposit in the Debt Service Reserve Account, and from Partial Lump Sum Payments in the Lump Sum Account.

Optional Clean-Up Call

The Bonds are subject to redemption on any Distribution Date, at the option of the Authority, at a redemption price equal to 100% of the principal amount of Bonds to be redeemed, plus interest accrued thereon to the redemption date, in the event liquidation of the aggregate amount on deposit in the Pledged Accounts (which excludes the State’s Unsold Assets in the Tobacco Assets Account), other than amounts set aside for the payment of Bonds, is greater than the principal amount of and accrued interest (if any) on the Bonds after the application of Pledged Revenues in accordance with the Indenture on such Distribution Date.

Redemption from Partial Lump Sum Payments and Lump Sum Payments

The Indenture provides that Partial Lump Sum Payments are to be deposited in the Lump Sum Account and shall be transferred to the Debt Service Account at the times and in the amounts necessary to pay the principal or Sinking Fund Installments (if any) of the Bonds on the respective Distribution Dates covered by such Partial Lump Sum Payments. The Indenture provides that any Lump Sum Payments shall be placed into a defeasance escrow to pay or redeem the Bonds, Pro Rata by principal amount among maturities and within a maturity, in an aggregate principal amount equal to the amount of such Lump Sum Payments.

Partial Redemptions

Unless otherwise subject to redemption selection pro rata within a maturity, if less than all of the Series 2017 Bonds of a maturity are to be redeemed, the particular Series 2017 Bonds within such maturity to be redeemed will be selected by the Trustee on such basis as the Trustee deems fair and appropriate, and which may provide for the selection for redemption of portions (equal to any authorized denominations) of the principal of Series 2017 Bonds of a denomination larger than the minimum authorized denomination. So long as Cede & Co. is the registered owner of the Series 2017 Bonds, as nominee of DTC, all notices of redemption, including partial redemptions, will go only to DTC. In the case of a partial redemption of the Series 2017 Bonds, DTC will determine the amount of the interest of each Direct Participant (as defined by DTC) to be redeemed.

Notice of Redemption

When a Series 2017 Bond is to be redeemed prior to its stated Maturity Date, the Trustee will give notice to the Holder thereof in the name of the Authority, which notice will identify the Series 2017 Bond to be redeemed, state the date fixed for redemption, and state that such Series 2017 Bond will be redeemed at the Corporate Trust Office of the Trustee or a Paying Agent. The notice will further state that on such date there will become due and payable upon each Series 2017 Bond to be redeemed the redemption price thereof, together with interest accrued to the date fixed for redemption, and that money therefor having been deposited with the Trustee or Paying Agent, from and after such date, interest on the Series 2017 Bonds to be redeemed will cease to accrue.

The Trustee will give at least 20 days' notice (or such shorter period permitted by DTC so long as DTC remains the registered Bondholder) by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions under the Indenture, to the registered owners of any Series 2017 Bonds that are to be redeemed, at their addresses shown on the registration books of the Authority. Such notice may be waived by any Holders holding Series 2017 Bonds to be redeemed. Failure by a particular Holder to receive notice, or any defect in the notice of such Holder, will not affect the redemption of any other Series 2017 Bond. Any notice of redemption given pursuant to the Indenture may be rescinded by written notice to the Trustee by the Authority no later than five days prior to the date specified for redemption. The Trustee will give notice of such rescission as soon thereafter as practicable in the same manner and to the same persons as notice of such redemption was given as described above.

THE AUTHORITY

The Authority is a special purpose corporation and a body corporate and politic of, but having a legal existence independent and separate from, the State, and was established under the Railsplitter Tobacco Settlement Authority Act (30 ILCS §171/3-1 et seq.) (as amended from time to time, the "Act"). Pursuant to the provisions of the Act, the Authority is governed by a three-member board, consisting of the Director of the Governor's Office of Management and Budget, and two other members appointed by the Governor. The Authority has no staff and will rely on the services of staff from the Governor's Office of Management and Budget. The Chief Financial Officer appointed by the Authority is at present the Director of Capital Markets of the Governor's Office of Management and Budget. The Act provides that the Authority and its corporate existence are to continue until six months after all its liabilities (including the Bonds) have been met or otherwise discharged, at which time all of its rights and property shall pass to and be vested in the State.

PLAN OF FINANCE

The Authority will use proceeds from the issuance of the Series 2017 Bonds, together with certain amounts held in trust for the Series 2010 Bonds, to (i) refund a portion equal to \$682,375,000 aggregate principal amount of the Series 2010 Bonds and (ii) pay costs of issuance in connection with the issuance of the Series 2017 Bonds. See “ESTIMATED SOURCES AND USES OF FUNDS” and “VERIFICATION OF MATHEMATICAL COMPUTATIONS”. Following the refunding of such portion of the Series 2010 Bonds, \$385,125,000 aggregate principal amount of Series 2010 Bonds will remain outstanding under the Indenture.

Upon the modification of the definition of Debt Service Reserve Requirement as described above under “SECURITY FOR THE BONDS—Consent to Amendment to Indenture”, amounts then on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement will be released to the State as holder of the Residual Certificate.

ESTIMATED SOURCES AND USES OF FUNDS

Estimated sources and uses of funds are as follows:

Sources of Funds

Principal Amount of Series 2017 Bonds	\$670,965,000
Plus: Original Issue Premium	90,804,355
Amounts Held Under the Indenture	<u>6,423,277</u>
Total Sources	<u>\$768,192,632</u>

Uses of Funds

Refunding of Series 2010 Bonds	\$756,954,987
Release of Excess Debt Service Reserve to State	6,423,277
Costs of Issuance*	<u>4,814,368</u>
Total Uses	<u>\$768,192,632</u>

* Costs of issuance include underwriters’ discount, legal fees, municipal advisory fees, rating agency fees, verification agent fees, printing costs and certain other expenses related to the issuance of the Series 2017 Bonds.

TABLE OF BOND DEBT SERVICE AND COVERAGE

The following table sets forth the debt service requirements and projected debt service coverage for the Bonds based on the application of the Pledged Settlement Payments Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under “PLEGGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS”. Further, the table assumes that the Bonds are not optionally redeemed prior to their stated maturity.

No assurance can be given that actual cigarette consumption in the U.S. will be as assumed, or that the other assumptions underlying the Pledged Settlement Payments Projection Methodology and Assumptions, including the market shares of the OPMs and the SPMs, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Pledged Settlement Payments Projection Methodology and Assumptions and Bond Structuring Assumptions, the amount of Pledged Revenues available to the Authority to pay the principal of and interest on the Bonds could be adversely affected. See “RISK FACTORS” herein.

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Projected Debt Service and Debt Service Coverage for the Bonds

Projected Debt Service and Debt Service Coverage for the Bonds

Year	Projected Pledged Settlement Payments ⁽¹⁾	Operating Expenses ⁽¹⁾	Net Revenues Available for Debt Service	Principal		Interest	Bond Debt Service	Debt Service Reserve Account Earnings ⁽¹⁾	Net Debt Service	Bond Debt Service Coverage ⁽²⁾
				2010 Bonds	2017 Bonds					
				2018	\$325,435,992					
2019	323,769,229	(2,826,193)	320,943,036	93,620,000	-	46,567,147	140,187,147	(1,404,619)	138,782,528	2.31x
2020	322,356,529	(2,835,979)	319,520,550	98,565,000	-	41,622,256	140,187,256	(1,404,619)	138,782,638	2.30x
2021	321,393,352	(2,846,058)	318,547,293	103,900,000	-	36,291,588	140,191,588	(1,404,619)	138,786,969	2.30x
2022	320,698,592	(2,856,440)	317,842,152	-	109,655,000	30,806,875	140,461,875	(1,404,619)	139,057,256	2.29x
2023	320,462,535	(2,867,133)	317,595,402	-	112,260,000	25,259,000	137,519,000	(1,404,619)	136,114,381	2.33x
2024	320,634,671	(2,878,147)	317,756,523	-	109,745,000	19,708,875	129,453,875	(1,404,619)	128,049,256	2.48x
2025	321,244,081	(2,889,492)	318,354,589	-	107,305,000	14,282,625	121,587,625	(1,404,619)	120,183,006	2.65x
2026	322,197,676	(2,901,177)	319,296,500	-	105,370,000	8,965,750	114,335,750	(1,404,619)	112,931,131	2.83x
2027	323,387,119	(2,913,212)	320,473,907	-	103,360,000	3,747,500	107,107,500	(1,404,619)	105,702,881	3.03x
2028	324,720,837	(2,925,608)	321,795,229	-	23,270,000	581,750	23,851,750	(702,309)	23,149,441	13.90x

(1) Based on application of the Pledged Settlement Payments Projection Methodology and Assumptions (including forecasts for cigarette consumption prepared by IHS Global) described in “PLEGGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS” herein. Totals may not add due to rounding.

(2) Bond Debt Service Coverage equals Net Revenues Available for Debt Service divided by Bonds Net Debt Service.

BREAKEVEN CONSUMPTION AND REVENUE DECLINE RATES BY MATURITY

The following table sets forth the “breakeven” annual rate of consumption decline at which each maturity of the Bonds would be paid in full at maturity.

The table below assumes that Pledged Revenues are received based on the application of the Pledged Settlement Payments Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under “PLEDGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS” with the exception that the Volume Adjustment utilizes the “breakeven” assumption for cigarette consumption in the U.S. as described in the table. Further, the table assumes that the Bonds are not optionally redeemed prior to their maturity.

No assurance can be given that actual cigarette consumption in the U.S. will be as assumed, or that the other assumptions underlying the Pledged Settlement Payments Projection Methodology and Assumptions, including the market shares of the OPMs and the SPMs, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Pledged Settlement Payments Projection Methodology and Assumptions and Bond Structuring Assumptions, the amount of Pledged Revenues available to the Authority to pay the principal of and interest on the Bonds could be adversely affected. See “RISK FACTORS” herein.

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Breakeven Consumption Decline Rates By Maturity

Bonds Breakeven Consumption Decline Rates By Maturity⁽¹⁾

Maturity	Series	Principal	Consumption Decline in 2017 ⁽²⁾	Maximum Constant Consumption Declines 2018 - 2027 ⁽²⁾
6/1/2018	2010	\$89,040,000	-100.00%	N/A
6/1/2019	2010	93,620,000	-5.00%	-100.00%
6/1/2020	2010	98,565,000	-5.00%	-76.00%
6/1/2021	2010	103,900,000	-5.00%	-54.98%
6/1/2022	2017	109,655,000	-5.00%	-40.86%
6/1/2023	2017	112,260,000	-5.00%	-32.52%
6/1/2024	2017	109,745,000	-5.00%	-27.82%
6/1/2025	2017	107,305,000	-5.00%	-24.33%
6/1/2026	2017	105,370,000	-5.00%	-22.26%
6/1/2027	2017	103,360,000	-5.00%	-20.58%
6/1/2028	2017	23,270,000	-5.00%	-20.56%

(1) Assumes the Debt Service Reserve Account is used to pay debt service on or prior to maturity of each Bond without a payment default.

(2) With the exception that the Volume Adjustment utilizes the above listed annual declines in cigarette consumption for 2017 and in each year thereafter, the table assumes that Pledged Settlement Payments are received based on the application of the Pledged Settlement Payments Projection Methodology and Assumptions and the Bonds Structuring Assumptions described herein under "PLEGDED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

PLEGDED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS

Introduction

The following discussion describes the methodology and assumptions used to project the amount of Pledged Settlement Payments to be received by the Authority (the “**Pledged Settlement Payments Projection Methodology and Assumptions**”) as well as the methodology and assumptions used to calculate debt service coverage on the 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. Actual results will differ from those assumed, and any such difference could have a material effect on the receipt of Pledged Revenues. See “RISK FACTORS” and “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments” herein. The discussions are followed by a table of projected Pledged Settlement Payments to be received by the Trustee.

In projecting the amount of Pledged Settlement Payments, (a) the forecast of cigarette consumption in the U.S. developed by IHS Global as described in the Tobacco Consumption Report is assumed to represent actual cigarette shipments measured pursuant to the MSA for the years covered by the report, and (b) such forecast is applied to calculate Annual Payments to be made by the PMs pursuant to the MSA. See “RISK FACTORS—Risks Relating to the Tobacco Consumption Report” herein. The calculation of payments required to be made was performed in accordance with the terms of the MSA; however, as described below, certain further assumptions were made with respect to shipments of cigarettes in the U.S. and the applicability to such payments of certain adjustments and offsets set forth in the MSA. Such further assumptions may differ materially from the actual information utilized by the MSA Auditor in calculating payments due under the MSA.

It was assumed, among other things described below, that:

- the PMs make all payments required to be made by them pursuant to the MSA,
- the aggregate Market Share of the OPMs remains constant throughout the forecast period at 84.41447%, based on the NAAG-reported market share for OPMs in sales year 2016 (measuring roll-your-own shipments at 0.0325 ounces per cigarette conversion rate), and
- the aggregate Market Share of the SPMs remains constant at 8.72350%, based on the NAAG-reported market share for SPMs in sales year 2016 (measuring roll-your-own shipments at 0.09 ounces per cigarette conversion rate).

Pledged Settlement Payments Projection Methodology and Assumptions

Cigarette Shipments under the MSA

In applying the consumption forecast from the Tobacco Consumption Report, it was assumed that U.S. consumption forecasted by IHS Global was equal to the number of cigarettes shipped in and to the U.S., the District of Columbia and Puerto Rico, which, when adjusted by the aggregate OPM Market Share, is the number used to determine the Volume Adjustment. The Tobacco Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time. IHS Global’s forecast for U.S. cigarette consumption is set forth in the

Tobacco Consumption Report in “APPENDIX A—TOBACCO CONSUMPTION REPORT.” The Tobacco Consumption Report contains a discussion of the assumptions underlying the projections of cigarette consumption contained therein. No assurance can be given that future consumption will be consistent with that projected in the Tobacco Consumption Report. See “RISK FACTORS – Risks Relating to the Tobacco Consumption Report.”

Annual Payments

In accordance with the Pledged Settlement Payments Projection Methodology and Assumptions, the anticipated amounts of Annual Payments for the years 2018-2028 to be made by the OPMs were calculated by applying the adjustments applicable to the base amounts of Annual Payments set out in the MSA, in order, as described below. The anticipated amounts of Annual Payments for the years 2018-2028 to be made by the SPMs were calculated by (i) multiplying the base amounts of Annual Payments by the Adjusted SPM Market Share (as described below) and (ii) then applying the adjustments applicable to the Annual Payments set out in the MSA, in order, as described below.

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 adjustment rate is compounded annually at the greater of 3.0% or the percentage increase in the actual Consumer Price Index for all Urban Consumers (“CPI-U”) in the prior calendar year as published by the Bureau of Labor Statistics (released each January). The calculations of Annual Payments for the years 2018-2028 assumes the minimum Inflation Adjustment Percentage provided in the MSA of 3.0% in every year since inception, except for calendar years 2000, 2004, 2005, and 2007 where the actual percentage increases in CPI-U of approximately 3.387%, 3.256%, 3.416%, and 4.081%, respectively, were used. Thereafter, the annual Inflation Adjustment Percentage was assumed to be the 3.0% minimum provided in the MSA. See “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—*Inflation Adjustment*” for a description of the formula used to calculate the Inflation Adjustment.

Volume Adjustment. Next, the Annual Payments calculated for the years 2018-2028 in each case after application of the Inflation Adjustment were adjusted for the Volume Adjustment by multiplying the forecast for U.S. cigarette consumption contained in the Tobacco Consumption Report by the assumed aggregate OPM Market Share of the OPMs (84.41447% as described above). 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, amounts calculated for each year after application of the Inflation Adjustment and the Volume Adjustment were reduced by the Previously Settled States Reduction, which applies only to the payments owed by the OPMs. The Previously Settled States Reduction is not applicable to Annual Payments owed by the SPMs. The Previously Settled States Reduction is 11.0666667% for each year.

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 Pledged Settlement Payments Projection Methodology and Assumptions include an assumption that the State will remain a party to the MSA.

NPM Adjustment. Pursuant to the MSA, the NPM Adjustment will not apply to the Annual Payments payable to any state that enacts and diligently enforces a Qualifying Statute so long as such statute is not held to be unenforceable. The PMs have disputed Annual Payments attributable to sales years 2003 through 2016 and a portion of such payments have either been withheld or deposited in the

Disputed Payments Account in each year since 2006. See “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Payments Made to Date.” The Bond Structuring Assumptions assume 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 Tobacco Consumption Report. For a discussion of the State’s Qualifying Statute, see “STATE LAWS RELATED TO THE MSA.”

Offset for Miscalculated or Disputed Payments. The Pledged Settlement Payments Projection 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 Pledged Settlement Payments Projection Methodology and Assumptions include an assumption that the Litigating Releasing Parties Offset will have no effect on payments.

Offset for Claims-Over. The Pledged Settlement Payments Projection Methodology and Assumptions include an assumption that the Offset for Claims-Over will have no effect on payments.

Subsequent Participating Manufacturers. The Pledged Settlement Payments Projection Methodology and Assumptions treat the SPMs as a single manufacturer having executed the MSA on or prior to February 22, 1998 for purposes of calculating Annual Payments under Section IX(i) of the MSA. Further, the Market Share (as defined in the MSA) of the SPMs remains constant at 8.72350% (measuring roll your own cigarettes at 0.09 ounces per cigarette conversion rate) as described above. Because the 8.72350% Market Share exceeds the greater of (i) the SPM’s 1998 Market Share or (ii) 125% of its 1997 Market Share, the SPMs are assumed to make Annual Payments in each year. For purposes of calculating Annual Payments owed by the SPMs, their aggregate adjusted Market Share (“**Adjusted SPM Market Share**”) is equal to (y) the SPM Market Share (assumed at 8.72350%) less the Base Share (assumed at 3.493414%) divided by (z) the aggregate Market Share of the OPMs at 84.63826% (measuring roll your own cigarettes at 0.09 ounces per cigarette conversion rate), or 6.17934%.

Projection of Pledged Settlement Payments to be Received by the Trustee

The following table shows the projections of total Pledged Settlement Payments to be received by the Trustee through the year 2028, calculated in accordance with the Pledged Settlement Payments Projection Methodology and Assumptions and utilizing the base case forecast from the Tobacco Consumption Report.

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Projection of Pledged Settlement Payments to be Received by the Trustee

Sales Year	Payment Year	IHS Global Consumption Decline Forecast	IHS Global Forecast of Cigarette Consumption	Estimated OPM Consumption	Base Annual Payment	Inflation Adjustment	Volume Adjustment	Previously Settled State's Reduction	Total Adjusted Annual Payments by OPMs	Pledged Settlement Revenues Allocation	OPM Annual Payments	SPM Annual Payments	Total Annual Payments to Trustee
2017	2018	-3.585%	250,855,486,472	211,758,329,371	\$9,000,000,000	\$7,111,589,400	(\$8,760,059,149)	(\$813,569,350)	\$6,537,960,901	4.6542472%	\$304,292,862	\$21,143,130	\$325,435,992
2018	2019	-3.566%	241,909,528,620	204,206,646,464	9,000,000,000	7,594,937,100	(9,281,058,683)	(809,402,547)	6,504,475,870	4.6542472%	302,734,386	21,034,843	323,769,229
2019	2020	-3.495%	233,455,183,456	197,069,955,802	9,000,000,000	8,092,785,600	(9,810,819,782)	(805,870,886)	6,476,094,932	4.6542472%	301,413,467	20,943,062	322,356,529
2020	2021	-3.360%	225,609,985,750	190,447,473,738	9,000,000,000	8,605,569,600	(10,345,361,750)	(803,463,005)	6,456,744,846	4.6542472%	300,512,866	20,880,485	321,393,352
2021	2022	-3.282%	218,206,253,813	184,197,652,663	9,000,000,000	9,133,736,400	(10,889,223,021)	(801,726,150)	6,442,787,229	4.6542472%	299,863,244	20,835,348	320,698,592
2022	2023	-3.141%	211,351,637,953	178,411,365,015	9,000,000,000	9,677,748,600	(11,438,567,691)	(801,136,023)	6,438,044,886	4.6542472%	299,642,524	20,820,012	320,462,535
2023	2024	-3.016%	204,977,040,456	173,030,282,323	9,000,000,000	10,238,081,400	(11,995,011,997)	(801,566,350)	6,441,503,053	4.6542472%	299,803,475	20,831,195	320,634,671
2024	2025	-2.881%	199,071,360,891	168,045,034,218	9,000,000,000	10,815,223,500	(12,558,387,653)	(803,089,836)	6,453,746,011	4.6542472%	300,373,293	20,870,788	321,244,081
2025	2026	-2.776%	193,545,094,693	163,380,065,896	9,000,000,000	11,409,679,800	(13,131,302,428)	(805,473,765)	6,472,903,607	4.6542472%	301,264,935	20,932,741	322,197,676
2026	2027	-2.706%	188,307,825,374	158,959,052,758	9,000,000,000	12,021,970,500	(13,716,723,861)	(808,447,297)	6,496,799,342	4.6542472%	302,377,101	21,010,018	323,387,119
2027	2028	-2.666%	183,288,243,501	154,721,799,324	9,000,000,000	12,652,629,300	(14,317,254,258)	(811,781,507)	6,523,593,535	4.6542472%	303,624,169	21,096,668	324,720,837

Bond Structuring Assumptions

Delivery Date

The Series 2017 Bonds are assumed to be delivered on December 27, 2017.

Issue Size

The objective in issuing the Series 2017 Bonds is to provide proceeds in an amount sufficient to: (1) refund a portion equal to \$682,375,000 aggregate principal amount of the Series 2010 Bonds and (2) pay the costs of issuance of the Series 2017 Bonds.

Maturities; Fixed Amortization

The schedules of stated maturity dates of the Series 2017 Bonds are set forth on the inside cover page hereof.

Series 2010 Bonds

\$385,125,000 aggregate principal amount of Series 2010 Bonds will remain Outstanding under the Indenture after the issuance of the Series 2017 Bonds and the defeasance of such portion of the Series 2010 Bonds described above.

Interest Rates

The Series 2017 Bonds bear interest at the rates shown on the inside cover page hereof. Interest is calculated on the basis of a 360-day year consisting of twelve 30-day months.

Debt Service Reserve Account

The Debt Service Reserve Account will be fully funded on the Closing Date of the Series 2017 Bonds at the Debt Service Reserve Requirement of \$140,461,875.00 (pursuant to the amendment of the definition of Debt Service Reserve Requirement contained in the Series 2017 Supplement; see “SECURITY FOR THE BONDS—Consent to Amendment to Indenture”). It has been assumed that no surety, guaranty or similar agreement will be deposited in lieu of cash in the Debt Service Reserve Account.

Operating Expense Assumptions

Annual operating expenses of the Authority have been assumed at the Operating Cap limit, which is \$316,692.52 for the Fiscal Year ending June 30, 2019 and is assumed to be inflated at 3% per year for each year thereafter. No operating expenses in excess of the annual Operating Cap are assumed. The annual enforcement expenses of the Office of the Attorney General of State that are paid as Operating Expenses are capped at \$2.5 million.

Interest Earnings

The Bond Structuring Assumptions assume that the Trustee will receive the Authority’s share of the Annual Payments owed by the PMs ten days after April 15th in 2018 and each year thereafter. Earnings are assumed at 0% per annum on the Annual Payments from the date of receipt by the Trustee until the applicable Distribution Date.

Moneys deposited in the Debt Service Reserve Account are assumed to be invested at 1.00% per annum.

Miscellaneous

The Pledged Settlement Payments Projection Methodology and Assumptions and Bond Structuring Assumptions assume that no Event of Default occurs, that no PM makes a Lump Sum Payment or Partial Lump Sum Payment under the MSA, that no Refunding Bonds are issued and that there is no optional redemption or Optional Clean-Up Call exercised by the Authority from balances in the Debt Service Reserve Account. It is further assumed that all Distribution Dates occur on the first day of each June and December, whether or not such date is a Business Day.

RISK FACTORS

The Series 2017 Bonds differ from many other state and local governmental securities in a number of respects. Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2017 Bonds, as well as the other information contained in this Offering Circular. One or a combination of the risk factors set forth below, and other risks, may materially adversely affect the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full, and could have a material adverse effect on the liquidity and/or market value of the Series 2017 Bonds.

The discussion of certain risks 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 currently 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) 551-8090; e-mail: publicinfo@sec.gov). To the extent that any risk discussed in this section describes the domestic tobacco industry and litigation relating thereto, the Authority does not warrant the accuracy or completeness of such information.

The list of risks set forth herein is not a complete list of the risks associated with the Pledged Settlement Payments, nor does the order of presentation necessarily reflect the relative importance of the various and separate risks. Certain general categories of risks discussed below include, among others, payment decreases under the terms of the MSA, declines in cigarette consumption, litigation and bankruptcy. There can be no assurance that other risk factors will not become material in the future. See also "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT," "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" and "APPENDIX A—TOBACCO CONSUMPTION REPORT." Additional risk factors are set forth in "LEGAL CONSIDERATIONS."

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. Any such adjustment could trigger the Offset for Miscalculated or Disputed Payments. See "—Disputed MSA Payments and Potential for Significant Future Year Offsets to MSA Payments" and "—NPM Adjustment" below for a description of disputes concerning MSA payments and the calculation thereof, including pending arbitration regarding the 2004 NPM Adjustment. Any such adjustments could materially adversely affect the amount and/or timing of the Pledged Settlement

Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

An amendment to the MSA (as described further herein, the “**PSS Credit Amendment**”) has been proposed that would allow SPMs to elect to receive a reduction in their MSA payments in an amount equal to a percentage of the fees paid to Previously Settled States pursuant to state legislation in the Previously Settled States requiring tobacco product manufacturers that did not sign onto the Previously Settled State Settlements to pay a fee to such Previously Settled States. The State of Illinois executed the PSS Credit Amendment on January 5, 2008 and reaffirmed on December 22, 2009. The PSS Credit Amendment is not currently in effect, because by its terms it will only take effect if and when all Settling States having aggregate Allocable Shares equal to at least 99.937049% (the equivalent of the aggregate Allocable Share of the 46 states that are Settling States), and all OPMs and Commonwealth Brands, Inc., have executed the PSS Credit Amendment. No assurance can be given as to if or when such an amendment will take effect. No assurance can be given as to whether the PSS Credit Amendment, if and when it takes effect, will reduce the amount of Pledged Settlement Payments available to the Authority to pay debt service on the Series 2017 Bonds. See “RISK FACTORS—Other Risks Relating to the MSA and Related Statutes—Amendments, Waivers and Termination” and “—Reliance on State Enforcement of the MSA; State Impairment” and “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—Previously Settled States Reduction—PSS Credit Amendment.”

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

Disputes concerning Annual Payments (as well as Strategic Contribution Payments) and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments that arise in prior years may result in the application of offsets against subsequent payments. Disputes could result in the future diversion of disputed payments to the Disputed Payments Account (the “**DPA**”), the withholding of all or a portion of any disputed amounts, or the application of offsets against future payments. Any such disputes or the resolution thereof could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

Miscalculations or recalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA 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, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—*Offset for Miscalculated or Disputed Payments*”.

The Pledged Settlement Payments Projection Methodology and Assumptions and Bond Structuring Assumptions used to prepare the coverage table herein do not factor in an offset for miscalculated or disputed payments. See “PLEGGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS”. Adjustments in future Pledged Settlement Payments could be different from those projected.

Growth of NPM Market Share and Other Factors

Should a decline in cigarette 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 that have negotiated with the PMs alternative arrangements to the NPM Adjustment or have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and are thus exempt from the NPM Adjustment. Such reductions of Annual Payments could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

NPM market share could grow due to a variety of reasons, including, among others, a failure of Settling States to enforce their Qualifying Statutes and Allocable Share Release Amendments (see “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—MSA Provisions Relating to Model/Qualifying Statutes”), relative ease of entry into the market, and increased profit margins on account of lower sales prices, operating costs and litigation costs.

NPM Adjustment

General. 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. Under 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 a Settling 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 such Settling State in the year following such determination could be as great as the amount of Annual Payments that could otherwise have been received by such Settling State in such year.

According to OPM SEC filings, certain PMs, including the OPMs, and the Settling States entered into three separate agreements (covering sales years 2007 to 2009, 2010 to 2012, and 2013 to 2014, respectively) wherein the Settling States would not contest that the disadvantages of the MSA were a significant factor contributing to the Market Share loss experienced by the PMs in those years. The stipulation pertaining to each of the years covered by the agreements became effective in February of the year a final determination by the firm of independent economic consultants would otherwise have been expected if the issue had been arbitrated on the merits. Pursuant to such agreements, the parties agreed that all the conditions for the NPM Adjustment were met for 2014 on February 1, 2017, permitting those PMs, including the OPMs, to deposit their portion of the 2014 NPM Adjustment into the Disputed Payments Account in April 2017.

In February 2017, the State informed the MSA Auditor that the State does not contest that the MSA was a significant factor contributing to the Market Share loss for 2015. Reynolds Tobacco deposited its portion of the State’s allocable share of the NPM Adjustments for 2014 (as described in the preceding paragraph) and for 2015 (as a result of the State’s February 2017 communication with the MSA Auditor as described in the preceding sentence) into the Disputed Payments Account in connection with its April 2017 MSA payment. Subsequently, in April 2017, certain PMs, including Reynolds Tobacco, and certain Settling States, including the State, entered into a fourth agreement for the period 2015 to 2017. Similar to the prior agreements, the parties agreed that all the conditions for the NPM Adjustment

will have been met for 2015 on February 1, 2018, for 2016 on February 1, 2019, and for 2017 on February 1, 2020. Therefore, other than adjustments permitted by the MSA to be made with respect to prior years' amounts, Reynolds Tobacco will not deposit to the Disputed Payments Account amounts relating to the NPM Adjustment for 2015 with respect to the State in connection with Reynolds Tobacco's MSA payment due in April 2018. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Payments Made to Date."

The State and certain other Settling States are currently in arbitration regarding the 2004 NPM Adjustment. No assurance can be given that the State will be found by the relevant arbitration panel to have diligently enforced its Qualifying Statute for such sales year or any subsequent sales year. The Pledged Settlement Payments Projection Methodology and Assumptions and Bond Structuring Assumptions contain an assumption that the State will diligently enforce its Qualifying Statute in all years that the Bonds are Outstanding and therefore that the State will not be subject to the NPM Adjustment. No assurance can be given that the assumptions underlying the Pledged Settlement Payments Projection Methodology and Assumptions and Bond Structuring Assumptions will be consistent with future events.

Declines in Cigarette Consumption

Cigarette consumption in the U.S. has declined significantly over the last several decades. According to the Centers for Disease Control ("CDC"), the smoking rate for adults in the United States fell to approximately 15.8% in 2016, from 16.8% in 2014, and from 20.9% in 2004. NAAG reported that total industry domestic cigarette shipment volume was 260.2 billion cigarettes in sales year 2016, as compared to shipments of approximately 404.4 billion in 2004. 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. U.S. cigarette consumption in recent years has been reduced because of price increases, restrictions on advertising and promotions, increases in excise taxes, smoking bans in public places, the raising of the minimum age to possess or purchase tobacco products, other increased regulation such as state and local bans on characterizing flavors, a decline in the social acceptability of smoking, health concerns, funding of smoking prevention campaigns, increased pressure from anti-tobacco groups, increased usage of alternative products such as e-cigarettes and other vapor products, curtailments in the chain of distribution, and other factors. U.S. cigarette consumption is expected to continue to decline for the reasons stated above and others. Continuing declines in cigarette consumption could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. The following factors, among others, may negatively impact cigarette consumption in the U.S.

The Regulation of Tobacco Products by the FDA May Adversely Affect Overall Consumption of Cigarettes in the U.S.

The Family Smoking Prevention and Tobacco Control Act (the "FSPTCA"), signed by President Obama on June 22, 2009, granted the U.S. Food and Drug Administration (the "FDA") broad authority over the manufacture, sale, marketing and packaging of tobacco products. The legislation, among other things, requires larger and more severe health warnings on cigarette packs and cartons, bans the use of certain descriptors on tobacco products, requires the disclosure of ingredients and additives to consumers, requires FDA pre-market review for new or modified products, and allows the FDA to place more severe restrictions on the advertising, marketing and sales of cigarettes. Since the passage of the FSPTCA, the FDA, among other things, has prohibited fruit, candy or clove flavored cigarettes (menthol is currently exempted from this ban), prohibited misleading marketing terms ("Light," "Low," and "Mild") for tobacco products, rejected applications for the introduction of new tobacco products into the market, and

issued its final rule subjecting e-cigarettes and certain other tobacco products to FDA regulations. Most recently, in July 2017, the FDA announced its intent to develop a comprehensive plan for tobacco and nicotine regulation and is considering the issues surrounding the presence of menthol and the level of nicotine in cigarettes. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues—FSPTCA.”

Tobacco manufacturers have filed suit regarding certain provisions of the FSPTCA and actions taken thereunder. In August 2009, a group of tobacco manufacturers and a tobacco retailer filed a complaint against the United States in the U.S. 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 U.S. 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. However, the Sixth Circuit affirmed the district court’s grant of summary judgment to plaintiff manufacturers on the unconstitutionality of the FSPTCA’s restriction of tobacco advertising to black and white text. 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, tobacco companies 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 August 24, 2012, the U.S. Court of Appeals for the District of Columbia Circuit affirmed a February 29, 2012 decision of the district court that invalidated the graphic warning rule. On March 19, 2013, the FDA announced that it would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA and would propose a new graphic warnings rule in the future. The FDA has not provided a timeline for a new rule. In October 2016, several public health groups filed suit in federal court to force the FDA to issue final rules requiring graphic warnings on cigarette packs and advertising. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues” for a discussion of this case and several other cases.

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 (including an outright ban thereof) or decreasing the permitted level of nicotine (though not to zero), as discussed herein, 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 FDA’s rules regarding clearance for new or modified cigarette products brand names could adversely impact PMs’ access to the market and could result in the removal of products from the market. 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 materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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 of Illinois) sent a letter to the FDA in support of a ban on menthol-flavored cigarettes. In an August 2016 letter, the African American Tobacco Control Leadership Council asked President Obama to direct the FDA to issue a proposed rule to remove all flavored tobacco products, including mentholated cigarettes, from the marketplace. 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 that sell large quantities of mentholated cigarettes, especially Reynolds Tobacco, a significant portion of whose sales, after the merger with Lorillard, are dependent on the Newport brand of mentholated cigarettes.

The FSPTCA established the Tobacco Products Scientific Advisory Committee (“TPSAC”) and 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 a March 2011 meeting, TPSAC presented its findings that menthol likely increases experimentation and regular smoking, menthol likely increases the likelihood and degree of addiction for youth smokers, non-white menthol smokers (particularly African-Americans) are less likely to quit smoking and are less responsive to certain cessation medications, and consumers continue to believe that smoking menthol cigarettes is less harmful than smoking nonmenthol cigarettes as a result of the cigarette industry’s historical marketing. TPSAC’s overall recommendation to the FDA was that “removal of menthol cigarettes from the marketplace would benefit public health in the United States.” In July 2013, the FDA released a preliminary evaluation on menthol cigarettes, finding among other things that menthol cigarettes likely pose a public health risk above that seen with non-menthol cigarettes. In July 2017, as part of the FDA’s announcement of its intent to develop a comprehensive plan for tobacco and nicotine regulation, the FDA announced its intent to issue Advance Notices of Proposed Rulemaking requesting public stakeholder input on the impact of flavors (including menthol) in increased initiation among youth and young adults. The FDA is not required to follow the TPSAC’s recommendations, and the FDA has not yet taken any definitive action with respect to menthol use. There is no timeline or statutory requirement for the FDA to act on the TPSAC’s recommendations. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues—*FSPTCA Litigation*” for a discussion on litigation regarding the TPSAC.

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. According to a report by the Federal Trade Commission released in 2016, menthol cigarettes made up 31% of the U.S. cigarette market in 2013. 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 materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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. All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in calendar year 2017 ranged from \$0.17 per pack in Missouri to \$4.35 per pack in New York, according to the Campaign for Tobacco-Free Kids. Since January 1, 2002, 48 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, such as New York, Philadelphia and Chicago. In November 2013, New York City passed an ordinance that set a minimum price of \$10.50 for every pack of cigarettes sold in New York City, and in August 2017 New York City raised the price of a pack of cigarettes to \$13, effective June 1, 2018. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, between the end of 1998 (the year that the MSA was executed) and October 23, 2017, the weighted-average state and certain local cigarette excise taxes increased from \$0.36 to \$1.75 per pack. In addition, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, as of October 23, 2017 Rhode Island, Delaware, Oklahoma and Puerto Rico enacted cigarette excise tax increases in 2017, although in August 2017 the Oklahoma Supreme Court found that Oklahoma's tobacco tax increase, labeled as a "smoking cessation fee," was unconstitutional because the legislature failed to abide by the state's procedures for passing a tax measure. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues—*Excise Taxes*" for a further description of excise taxes on cigarettes.

It is expected that states and local governments will continue to raise excise taxes on cigarettes in future years. Increased excise taxes are likely to result in declines in overall sales volume and shifts by consumers to less expensive brands, deep discount brands, untaxed cigarettes sold on certain Native American reservations and duty-free shops, counterfeit brands or pipe tobacco for roll-your-own consumers. Such trends and reductions in consumption will lead to reductions of payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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. All states and the District of Columbia have enacted statutes generally prohibiting the sale of tobacco products to individuals under the age of 18. The minimum age to purchase tobacco products rose to 21 in the State of Hawaii effective as of January 1, 2016 (the first state to do so), and subsequently, California (effective June 2016), New Jersey (July 2017 legislation, effective November 2017), Maine (August 2017 legislation, effective July 2018) and Oregon (August 2017 legislation, effective January 2018) have raised the minimum age to purchase tobacco products to 21. According to the Campaign for Tobacco-Free Kids, at least 255 localities have raised the tobacco age to 21, including New York City, Chicago, Boston, Cleveland, St. Louis and both Kansas Cities. According to the Tobacco Consumption Report, proposals to raise the minimum age to 21 have been introduced in at least twenty four states. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, the minimum age in Alabama, Alaska and Utah is 19. On March 12, 2015, the Institute of Medicine of the National Academy of Sciences released a report

recommending that the minimum age of legal access to tobacco products be raised to 21 and concluding that raising the minimum legal age to 21 would likely decrease smoking prevalence by 12% among today's teenagers when they become adults. In October 2015, the American Academy of Pediatrics issued a policy statement strongly recommending that the age for the purchase of tobacco products be raised to 21 as a means to decrease reduce youth smoking rates. In November 2017, U.S. Congresswoman Diana DeGette introduced the Tobacco to 21 Act (H.R. 4273), a bicameral legislation that would prohibit the sale of tobacco products to anyone under age 21. Declines in consumption due to increasing the minimum age to possess or purchase tobacco products could lead to reductions of payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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, public housing, 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 could lead to reductions of payments under the MSA and could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. 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 and Vaporizers, Sales of Which Do Not Currently Result in Payments Under the MSA

Certain of the major cigarette makers have developed (or acquired) and marketed alternative cigarette products the shipments of which do not give rise to payment obligations under the MSA. 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 currently constitute "cigarettes" within the meaning of the MSA (as deemed by the manufacturers and certain states) because they do not contain or burn or heat tobacco. The fastest growth in this area comes from devices called "vaporizers", which are larger, customizable devices that 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. E-cigarettes and other vapor products are currently not subject to the advertising restrictions to which tobacco products are subject. In addition, most jurisdictions do not subject electronic cigarettes or other vapor products to excise taxes.

According to the Tobacco Consumption Report, 2015 sales of electronic cigarettes in the U.S. have been estimated at over \$3 billion, though growth is slowing after years of rapid gains. The CDC in September 2014 reported results of a survey that indicated that in 2013 approximately 8.5% of the adult

population (representing approximately two-and-a-half times the 2010 estimates), and 36.5% of smokers (representing approximately four times the 2010 estimates), had tried e-cigarettes at some time. In April 2016, the CDC's National Youth Tobacco Survey found that e-cigarette use among high school students had increased to 16% in 2015, from 1.5% in 2011. The CDC in June 2016 released survey results showing that 45% of high school students had tried e-cigarettes in 2015, compared with only 32% who had tried cigarettes. In December 2014 the University of Michigan's Survey for Research Center reported its findings that e-cigarette use exceeded traditional cigarette smoking among teens in 2014. The National Health Survey of the CDC reported that in 2016, 15.4% of adults had tried e-cigarettes, and 3.2% were current users. In September 2017, Philip Morris International announced that it would contribute approximately \$80 million each year for the following 12 years to a non-profit organization called the Foundation for a Smoke-Free World, to fund research on smoke-free alternatives, among other things.

On May 5, 2016, the FDA released its final rule, which subjects manufacturers, importers and/or retailers of e-cigarettes and certain other tobacco related products (including cigars and pipe tobacco) to the same and, in some cases additional, regulations applicable to cigarettes, cigarette tobacco and smokeless tobacco. Among other things, the rule bans sales of e-cigarettes and other vapor products, cigars, hookah tobacco, pipe tobacco and other products to people under 18 and requires new health warnings for these products. In addition, manufacturers must seek federal permission to continue marketing all e-cigarettes and other such products launched since 2007 (making up virtually all of the market). The rule does not restrict flavored products, online sales or advertising. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues—*FSPTCA*." No assurance can be given that regulation of e-cigarettes by the FDA will alter the trend of increased sales of e-cigarettes.

Cigarette manufacturers also market other types of alternative products, such as moist snuff, "snus" (a smokeless, spitless tobacco product that originated in Sweden), disposable nicotine discs, and dissolvable tobacco tablets, orbs, strips and sticks. Sales of moist snuff products have increased by 65.6% between 2005 and 2011, according to the National Center for Biotechnology Information. A June 2014 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.

Electronic cigarettes, vapor products, heated tobacco products and smokeless tobacco products are viewed by some as alternatives to cigarette smoking that may lead to cigarette smoking cessation. It has been reported that increases in cigarette taxes have caused an increase in the sale of e-cigarettes and other alternatives to cigarettes. According to the Tobacco Consumption Report, certain sources have shown that e-cigarette use is associated with quit attempts by smokers; that youth use of e-cigarettes is unlikely to increase the number of future cigarette smokers; and that the substantial increase in e-cigarette use among U.S. adult smokers this decade was associated with a statistically significant increase in the smoking cessation rate at the population level. Growth in the electronic cigarette, vapor product and smokeless tobacco product markets may have an adverse effect on the traditional cigarette market. If consumers use such alternative products in lieu of traditional cigarettes containing nicotine or to quit smoking, it could reduce the size of the cigarette market. In addition, recreational marijuana, which has been legalized in Alaska, Colorado, Oregon, Washington, California, Maine, Massachusetts and Nevada, may be an alternative to cigarette smoking and reduce the size of the cigarette market. Furthermore, while 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 may decrease, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE

DOMESTIC TOBACCO INDUSTRY—E-Cigarettes and Vapor Products” and “—Smokeless Tobacco Products.”

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. Under the FSPTCA, which grants authority over the regulation of tobacco products to the FDA, 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 for PMs to maintain sales volume of cigarettes in the U.S., which could lead to reductions of payments under the MSA and could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

As discussed above, electronic cigarettes and other vapor products are not currently subject to the advertising restrictions to which tobacco products are subject, and the FDA did not include advertising restrictions in its final regulations on e-cigarettes and other vapor products. Therefore, e-cigarettes and other vapor products, which can currently be marketed more extensively than traditional cigarettes and other tobacco products, could gain market share to the detriment of the traditional cigarette market. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—E-Cigarettes and Vapor Products.”

The Distribution Chain for Cigarettes May Continue to be Curtailed, which could Negatively Impact Sales Volume

Certain stores have ceased the sale of tobacco products. The retail chain store Target reportedly stopped selling tobacco products in 1996. In September 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. According to the American Nonsmokers’ Rights Foundation (“ANRF”), as of October 2, 2017, 168 municipalities have tobacco-free pharmacy laws. In addition, Costco has also reportedly reduced the number of locations that sell cigarettes because of slowing demand, according to news reports in March 2016. Continued curtailment in the distribution of cigarettes could negatively impact sales volume, which could lead to reductions of payments under the MSA and could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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 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. Certain health insurance policies, including Medicaid and Medicare, cover various forms of smoking cessation treatments, making smoking cessation treatments more affordable for covered smokers. 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, which could lead to reductions of payments under the MSA and could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. 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 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 and the Pledged Settlement Payments available to the Authority to pay debt service on the Series 2017 Bonds, 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 a material adverse effect on the sales volume of the PMs, resulting in lower payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

General Economic and Other Conditions May Materially Adversely Affect Consumption of Cigarettes and the Ability of the PMs to Continue to Operate, Reducing Their Sales of Cigarettes and 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. 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, or travelling to purchase untaxed NPM cigarettes on Native American reservations. Reductions in cigarette consumption or changes in consumption habits to NPM cigarettes could lead to reductions of payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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 their ability to access the capital markets on favorable terms. In addition, the ability of the PMs to continue their operations manufacturing cigarettes is dependent on, among other things, their production facilities, shifts in crops, government mandated prices, economic trade sanctions, geopolitical instability and production control programs. To the extent that overall economic or other conditions or constrained capital access materially adversely impacts their operations, the PMs may manufacture and sell fewer cigarettes, potentially resulting in reduced payments under the MSA and reduced Pledged Settlement Payments available to the Authority to pay debt service on the Series 2017 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 manufacturers, cigarette wholesalers, cigarette importers, cigarette distributors, 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 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, federal civil rights laws, state consumer protection laws, bankruptcy laws, federal cigarette advertising and labeling law, and unfair competition laws, and 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, an injunction barring the PMs from collecting cigarette price increases related to the MSA, a determination that the MSA is void or unenforceable, and an injunction 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.

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. Courts rendering those decisions include the U.S. Courts of Appeals for the Second Circuit in *Freedom Holdings v. Cuomo* and *Grand River Enterprises Six Nations, Ltd. v. King*; 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 Fifth Circuit in *Xcaliber Int'l Ltd. v. Caldwell* and *S&M Brands v. Caldwell*; the Sixth Circuit in *S&M Brands v. Cooper*, *S&M Brands, Inc. v. Summers*, *Tritent Inter'l Corp. v. Commonwealth of Kentucky* and *VIBO*

Corporation, Inc. d/b/a/ General Tobacco v. Conway, et al.; the Eighth Circuit in *Grand River Enterprises v. Beebe*; the Ninth Circuit, in *Sanders v. Brown*; the Tenth Circuit in *KT & G Corp. v. Edmondson*, and *Hise v. Philip Morris Inc.*; and multiple lower courts. In addition, 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, Qualifying Statutes or related legislation would be binding everywhere in the United States, including in the State.

The MSA, Qualifying Statutes and related state legislation may continue to be challenged in the future. A determination by a court having jurisdiction over the State and the Authority that the MSA, the Qualifying Statutes or related state legislation is void or unenforceable could have a material adverse effect on the payments by the PMs under the MSA, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. Although a determination that a Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA, such a determination could have a material adverse effect on payments to be made under the MSA and Pledged Settlement Payments available to the Authority if an NPM were to gain market share in the future and there occurred an impact on the market share of the PMs under the MSA. 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. 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". For a description of the opinion of Bond Counsel addressing such matters, see "LEGAL CONSIDERATIONS—MSA and Qualifying Statute Enforceability".

Litigation Seeking Monetary and Other 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 materially adversely affected, which in turn could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation" for more information regarding the litigation described below.

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

Numerous legal actions, proceedings and claims arising out of the sale, distribution, manufacture, development, advertising, marketing and claimed health effects of cigarettes are pending against the PMs and it is likely that similar claims will continue to be filed for the foreseeable future. The claimants have sought recovery on a variety of legal theories, including, among others, negligence, fraud, misrepresentation, strict liability in tort, design defect, breach of warranty, enterprise liability (including claims asserted under the Racketeer Influenced and Corrupt Organizations Act (“**RICO**”)), civil conspiracy, intentional infliction of harm, injunctive relief, indemnity, restitution, unjust enrichment, public nuisance, unfair trade practices, claims based on antitrust laws and state consumer protection acts, and claims based on failure to warn of the harmful or addictive nature of tobacco products. Various forms of relief are sought, including compensatory and, where available, punitive damages in amounts ranging in some cases into the hundreds of millions or even billions of dollars. Claimants in some of the cases have sought treble damages, statutory damages, disgorgement of rights, equitable and injunctive relief and medical monitoring and smoking cessation programs, 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. Furthermore, even if the PMs are successful in defending some or all of the tobacco-related lawsuits against them, 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 a material 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 materially adversely affect the amounts of payments under the MSA and the Pledged Settlement Payments available to the Authority to pay debt service on the Series 2017 Bonds. 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, although the Florida Supreme Court vacated the punitive damages award and determined that the case could not proceed further as a class action, it permitted members of the *Engle* class to file individual claims, including claims for punitive damages, and 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, including 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. In the wake of the Florida Supreme Court ruling, thousands of individuals filed separate lawsuits seeking to benefit from the *Engle* findings. Altria and/or Philip Morris are defendants in approximately 2,500 cases involving approximately 3,200 plaintiffs (according to Altria in its Form 10-Q filed with the SEC for the nine-

month period ended September 30, 2017) pending in various state and federal courts in Florida that were filed by members of the Engle class (the “**Engle Progeny Cases**”) (although most federal cases were settled, as discussed herein).

At the beginning of the *Engle Progeny Cases* litigation, a central issue was the proper use of the preserved *Engle* findings. The tobacco manufacturers had argued that use of the *Engle* findings to establish individual elements of progeny claims (such as defect, negligence and concealment) was a violation of federal due process, but in 2013, both the Florida Supreme Court (in the *Douglas* case) and the Eleventh Circuit (in the *Duke* and *Walker* cases) rejected that argument, and the U.S. Supreme Court denied the tobacco manufacturers’ petitions for writ of certiorari in all of those cases. As discussed herein, in May 2017, in the *Graham* case, the en banc Eleventh Circuit rejected the due process and implied preemption arguments of the tobacco manufacturer, holding that giving preclusive effect to the findings of negligence and strict liability by the *Engle* jury in individual *Engle Progeny Case* actions against the tobacco companies is not preempted by federal tobacco laws and does not deprive the tobacco companies of due process. Other issues with respect to the *Engle Progeny Cases* were decided or remain pending on appeal. It is not possible to predict the final outcomes of any of the *Engle Progeny Cases*, but such outcomes may materially adversely affect the operations of the defendants and thus payments under the MSA and the Pledged Settlement Payments available to the Authority to pay debt service on the Series 2017 Bonds. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation—*Engle Progeny Cases*”.

A December 2008 decision by the U.S. Supreme Court could limit the ability of cigarette manufacturers to contend that certain claims asserted against them in product liability litigation are barred, and could encourage litigation involving cigarettes labeled as “lights” or “low tar”

In December 2008, the U.S. 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. 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 (defined below) on an annual basis when calculated, the PMs have stated in SEC filings that (i) their management has concluded that it is not probable that a loss has been incurred in any material pending litigation against them, (ii) their management is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome of any material pending litigation due to the many variables, uncertainties and complexities, and (iii) accordingly, their management has not provided any amounts in their consolidated financial statements for possible losses related to material pending 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, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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 materially impair the affected PMs' ability to make payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation" and "LEGAL CONSIDERATIONS".

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 6 other U.S. 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. If the volume of cigarette sales by the PMs were materially reduced, these payment obligations could materially adversely affect the financial condition of the PMs and potentially the ability of PMs to make payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT".

The verdict returned in the federal government's reimbursement case could materially 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 also placed certain prohibitions on the manner in which defendants market their cigarette products and enjoined any use of “lights” or similar product descriptors. On November 27, 2012, the district court released the text of the corrective statements that the defendants must make. In January 2013, defendants appealed to the U.S. Court of Appeals for the District of Columbia Circuit the district court’s November 2012 ruling on the text of the corrective statements, claiming a violation of free speech rights. On June 2, 2014, the U.S. District Court for the District of Columbia approved a joint motion by the U.S. government and the defendant tobacco companies, pursuant to which, 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 February 8, 2016, the district court issued an order on the content of the corrective statements, in April and May 2016 the defendants filed notices of appeal to the U.S. Court of Appeals, including on the content of the corrective statements. In April 2017, the U.S. Court of Appeals reversed in part the district court’s decision on the content of the corrective communications, striking certain content (the statement “Here is the Truth”) and remanding to the district court the decision on how to revise certain other content. In June 2017, the U.S. District Court for the District of Columbia issued an order adopting modified corrective statements, featuring a preamble to the effect that a federal court has ordered the OPMs to make the specified statements, and featuring statements regarding the adverse health effects of smoking, the addictiveness of smoking and nicotine, the lack of significant health benefit from smoking “low tar”, “light”, “ultra light”, “mild” and “natural” cigarettes, the manipulation of cigarette design and composition to ensure optimum nicotine delivery, and the adverse health effects of exposure to second hand smoke. A remaining issue pending on appeal is whether the corrective statements must be placed on point-of-sale displays.

According to an October 2017 court order, beginning in November 2017, the OPMs will run court-mandated announcements containing the agreed-upon corrective statements. Television announcements will be between 30 and 45 seconds long and will run in prime time five days a week for 52 weeks. Full-page print ads will appear in at least 45 newspapers and will run on five weekends spread over approximately four months, and will also appear on the newspapers’ websites. The corrective statements will also appear on company-owned websites and in “onserts” affixed to cigarette packs, and the parties are in the process of finalizing the details for the company-owned websites and onserts. Altria has stated that it will spend \$31 million to implement the court-ordered corrective statements. It is possible that the district court’s 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, which could materially adversely affect their payments under the MSA, which in turn could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See “CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation—*Health-Care Cost Recovery Cases.*”

Risks Relating to the Tobacco Consumption Report

The Pledged Settlement Payments projections developed using the Pledged Settlement Payments Projection Methodology and Assumptions and described in “PLEDGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS” are based in part upon the tobacco consumption forecast contained in the Tobacco Consumption Report. No assurance can be given that actual future consumption will be consistent with that which is projected in the Tobacco Consumption Report. The prior IHS Global tobacco consumption report delivered to the Authority in

2010 by IHS Global projected consumption to be more than that which actually occurred. See “APPENDIX A—TOBACCO CONSUMPTION REPORT”.

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. 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, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See “—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—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 Authority is not a party to the MSA; accordingly, the Authority does not have any right to challenge any such amendment, waiver or termination. While the economic interests of the State and the holders of the Series 2017 Bonds are expected to be the same in many circumstances, no assurance can be given that such an amendment, waiver or termination of the MSA would not have a material adverse effect on the Authority and its ability to pay debt service on the Series 2017 Bonds. See “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Amendments and Waivers”.

Reliance on State Enforcement of the MSA; State Impairment

The State may not convey and has not conveyed to the Authority or the Bondholders any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Failure by the State to enforce the MSA may have a material adverse effect on the receipt of Pledged Settlement Payments by the Authority. It is also possible that the State could attempt to claim some or all of the Pledged Settlement Payments for itself or otherwise interfere with the security for the Series 2017 Bonds. In that event, the Bondholders, the Trustee or the Authority may assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims. See “LEGAL CONSIDERATIONS.”

Amendment to the State’s Qualifying Statute

The MSA provides that 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. No assurance can be provided that a PM would not assert that, or a court or arbitrator would not determine that, the State’s Qualifying Statute, if amended, would not continue to constitute a Qualifying Statute. Should it be determined that any amendments to the State’s Qualifying Statute cause it to no longer be a Qualifying Statute, then the State would no longer be entitled to any protection from the NPM Adjustment, and there could be substantial reductions in the

amount of Pledged Settlement Payments available to the Authority to make payments on the Series 2017 Bonds. See “LEGAL CONSIDERATIONS—MSA and Qualifying Statute Enforceability.”

Bankruptcy of a PM May Delay, Reduce or Eliminate Payments Under the MSA

If one or more PMs were to become a debtor in a case under Title 11 of the United States Code (the “**Bankruptcy Code**”) and, as a result, there were delays in or reductions or elimination of the debtor PMs payments under the MSA, the annual Pledged Settlement Payments received by the Authority could be reduced.

In the event of the bankruptcy of a PM, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the Authority, the Trustee or the holders or the beneficial owners of the Series 2017 Bonds to collect any tobacco settlement payments or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying the tobacco settlement payments, 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 tobacco settlement payments. If the MSA is determined in a bankruptcy case to be an “executory contract” under the Bankruptcy Code, the bankrupt PM could seek court approval to reject the MSA and stop making payments under it.

Furthermore, payments previously made to the holders or beneficial owners of the Series 2017 Bonds could be avoided as preferential payments, so that such holders or beneficial owners would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection of the State, the Authority, the Trustee or the holders and beneficial owners of the Series 2017 Bonds. Finally, while there are provisions of the MSA purporting 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. NAAG has stated that it actively monitors any bankruptcy related activity of the PMs with the goals of preventing the debtors from using bankruptcy law to avoid their MSA payment obligations to the Settling States and ensuring that Settling 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 and/or reductions in, or elimination of, tobacco settlement payments under the MSA. Regardless of any specific adverse determination in a PM bankruptcy proceeding, the fact of a PM bankruptcy proceeding could have a material adverse effect on the timing of receipt, amount and value of the Pledged Settlement Payments.

For a description of certain legal opinions to be delivered by Bond Counsel with respect to PM bankruptcy matters, see “LEGAL CONSIDERATIONS”.

Failures by PMs to Make Payments Under the MSA Could be Coupled with an Inability on the Part of the Settling States to Enforce and Collect Defaulted Payments

A PM could discontinue making required payments under the MSA for any reason. Any attempts to enforce payments under the MSA from a PM in breach could be costly and time consuming as well as 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 could be coupled with an inability on the part of the Settling States to enforce and collect defaulted payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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.

Series 2017 Bonds Secured Solely by the Collateral

Investors in the Series 2017 Bonds must look solely to the Collateral pledged under the Indenture for repayment of their investment. The Series 2017 Bonds do not constitute an indebtedness or an obligation of the State or any subdivision thereof, within the purview of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them. No owner of any Series 2017 Bond has the right to compel the exercise of the taxing power of the State to pay any amounts owing on the Series 2017 Bonds. The assets of the Authority (other than the Collateral) are not pledged to the payment of, nor are they security for, the Series 2017 Bonds. The Authority’s only source of funds for payments on the Series 2017 Bonds is the Pledged Revenues and amounts on deposit in pledged funds and accounts pursuant to the Indenture. The Series 2017 Bonds are not secured by the proceeds thereof. The Authority has no taxing power.

Limited Remedies

The Trustee is limited under the terms of the Sale Agreement to enforcing the terms of such agreement and to receiving the Pledged Settlement Payments and applying them in accordance with the Indenture. If an Event of Default occurs, the Trustee cannot sell or foreclose on the Pledged Settlement Payments or its rights under the Sale Agreement. Pursuant to the Act, the Sale Agreement provides that the remedies available to the Bondholders for any breach of the pledges and agreements of the State will

be limited to injunctive relief. In any suit against the State or the Authority, the State or the Authority may seek to assert statutory or constitutional defenses and limitations on remedies and payment of claims.

Limited Liquidity; Price Volatility

There is currently a limited secondary market for securities such as the Series 2017 Bonds. There can be no assurance that a secondary market for the Series 2017 Bonds will develop, or if a secondary market does develop, that it will provide holders of the Series 2017 Bonds with liquidity or that it will continue for the life of the Series 2017 Bonds. Consequently, any purchaser of the Series 2017 Bonds must be prepared to hold such securities for an indefinite period of time or until final redemption of such securities. Tobacco settlement bonds generally have also exhibited greater price volatility than traditional municipal bonds.

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

In recent years, rating agencies, including S&P Global Ratings (the rating agency rating the Series 2017 Bonds) (“**S&P**” or the “**Rating Agency**”), 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 and settlements relating to MSA payments.

S&P revised its assumptions for all tobacco settlement securitizations in October 2011 and then placed 86 classes from 23 tobacco settlement securitizations on CreditWatch Negative. On January 27, 2012, S&P lowered its ratings on 87 classes from 22 tobacco settlement securitizations, among other actions. There is no assurance that S&P, the sole rating agency rating the Series 2017 Bonds, will not change its assessment of unenhanced tobacco settlement bonds as a class of securities in a way that would result in a reduction, suspension or withdrawal of the ratings of the Series 2017 Bonds.

Most recently, in June 2016, Fitch Ratings withdrew its outstanding structured finance ratings on all of its rated U.S. tobacco asset-backed securities. In its May 2016 announcement of its intention to withdraw the ratings, Fitch Ratings said the primary reason for the withdrawal was that individual, custom modifications (by several participants) to material calculations originally part of the MSA eroded Fitch Ratings’ confidence that ratings “can be consistently maintained, as insufficient information exists to predict the likelihood and effect of future modifications or that insufficient information will exist to support new, material variables included in them.”

The ratings for the Series 2017 Bonds address only the likelihood that the Authority will pay the interest on and principal of the Series 2017 Bonds when due. The respective ratings of the Series 2017 Bonds are not a recommendation to purchase, hold or sell such Series 2017 Bonds and such ratings will not address the marketability of such Series 2017 Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by S&P if, in its judgment, circumstances so warrant based on factors prevailing at the time, including, but not limited to, the evaluation by S&P of the financial outlook for the tobacco industry. See “**RATINGS**” herein.

Risk Related to Lump Sum Payments and Partial Lump Sum Payments

In the event of a Lump Sum Payment or Partial Lump Sum Payment resulting in the retirement of less than all of the Bonds, it is possible that following such retirement the Authority will not have sufficient funds to pay debt service when due on certain maturities of the Outstanding Series 2017 Bonds under certain circumstances.

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal issues that could adversely affect the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full, and could have an adverse effect on the liquidity and/or market value of the Series 2017 Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the Pledged Settlement Payments 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 Authority, the Trustee and the holders of the Series 2017 Bonds as collateral assignees) and of the obligations of a PM under the MSA are subject to the Bankruptcy Code and to other applicable insolvency, moratorium or similar laws relating to or affecting the enforcement of creditors' rights generally. Some of the risks associated with a bankruptcy of a PM are described below and include the risks of delay in or reduction of amount of the payment or of nonpayment under the MSA and the risk that the State (and, thus, the Authority) may be stayed for an extended time from enforcing any rights under the MSA or with respect to the payments owed by the bankrupt PM or from commencing legal proceedings against the bankrupt PM. As a result, if a PM becomes a debtor in a bankruptcy case and defaults in making payments required under the MSA, Pledged Settlement Payments available to the Authority to pay holders of the Series 2017 Bonds may be reduced or eliminated. Furthermore, certain payments previously made to holders of the Series 2017 Bonds could be avoided as preferential payments, so that holders of the Series 2017 Bonds 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 an 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 held 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.

Bond Counsel will render an opinion to the Rating Agency that, subject to all the assumptions, qualifications and limitations set forth therein, if a PM became the debtor in a case under the Bankruptcy Code commenced after the date of issuance of the Series 2017 Bonds, and the matter were properly briefed and presented to a federal court with jurisdiction over such bankruptcy case, the court, exercising reasonable judgment after full consideration of all relevant factors, would hold that the MSA is an “executory contract” under Section 365 of the Bankruptcy Code. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Bond Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that a particular court would not hold that the MSA is not an executory contract, thus resulting in delays or reductions in, or elimination of, payments on the Series 2017 Bonds.

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.

However, if a bankrupt PM decides to reject the MSA and a court approves such a decision, the State (and thus the Authority, the Trustee and the holders of the Series 2017 Bonds, as collateral assignees) may then have a prepetition unsecured, nonpriority claim for damages. Rejection of an executory contract should be treated as a breach of the contract by the PM. However, under the Bankruptcy Code, the State (and thus the Authority, the Trustee and the holders of the Series 2017 Bonds) nevertheless may not, without the permission of the bankruptcy court, commence or continue any action against the PM to enforce remedies under the MSA (including an action to collect payments due under the MSA). In addition, because amounts owed by the PM under the MSA are not fixed, legal proceedings may be necessary to quantify the claims of the State (and thus the Authority, the Trustee and the holders of the Series 2017 Bonds) for damages as a result of the PM’s rejection of the MSA. Such legal proceedings could be time consuming and could result in delays, reductions, or elimination of, payments by the bankrupt PM.

Modification of MSA Obligations. If the MSA is determined not to be an “executory contract”, the PM determines to reject the MSA or the PM is otherwise not authorized to make payments under the MSA, then a bankruptcy of the PM could result in long delays and possibly in large reductions in the amount of Pledged Settlement Payments available to pay the holders of the Series 2017 Bonds because, under the Bankruptcy Code, the obligations of the PM under the MSA could be modified or discharged in their entirety. For example, the bankruptcy court may approve a plan of reorganization or liquidation of the PM that alters the timing or the amount of payments to be made by the PM under the MSA to the State (and, thus, to the Authority, the Trustee and holders of the Series 2017 Bonds).

MSA and Qualifying Statute Enforceability

Certain 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. See “RISK FACTORS—If

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation Were Successful, Payments Under the MSA Might be Suspended or Terminated”.

Bond Counsel will render an opinion on the Closing Date of the Series 2017 Bonds to the Rating Agency that, subject to all the assumptions, qualifications, and limitations set forth therein, if the matter were properly briefed and presented to a court, the court, applying existing legal principles to the facts and exercising reasonable judgment after full consideration of all relevant factors, would hold that under United States federal law (a) the MSA is a valid and enforceable agreement and (b) the State’s Qualifying Statute is valid, enforceable, and constitutional in all material respects. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Bond Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. Bond Counsel will assume, among other things, that the State’s Qualifying Statute (including all amendments thereto) is a “Qualifying Statute” within the meaning of the MSA. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, the matter is not free from doubt, and there can be no assurance that a court applying existing legal principles would not hold otherwise. Accordingly, no assurance can be given that a particular court would not hold that the MSA is not valid or enforceable, or that the State’s Qualifying Statute is not valid, enforceable, or constitutional, thus resulting in delays or reductions in, or elimination of, payments on the Series 2017 Bonds.

The opinions as to the enforceability of the MSA and the obligations of the aforementioned signatories are also subject to the effect of bankruptcy, insolvency, and other laws affecting creditors’ rights or remedies and general principles of equity, regardless of whether such enforceability is considered in a proceeding in equity or at law.

Limitations on Certain Opinions of Counsel

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

Enforcement of Rights to Pledged Settlement Payments

It is possible that the State could in the future attempt to claim some or all of the Pledged Settlement Payments for itself, or otherwise interfere with the security for the Series 2017 Bonds. In that event, the holders of the Series 2017 Bonds, the Trustee or the Authority could assert claims based on contractual or constitutional rights.

Contractual Remedies. Under State law, settlements are treated as contracts and may be enforced according to their terms. The Consent Decree coupled with the MSA is a court-approved settlement of lawsuits that establishes the State’s right to receive the Tobacco Assets (including the Pledged Settlement

Payments). Pursuant to the Sale Agreement, the State has pledged and agreed, for the benefit of the owners of the Bonds, to neither amend the MSA or the Consent Decree nor take any other action in any way that would materially adversely (A) impair the Authority's right to receive Pledged Settlement Payments, or (B) limit or alter the rights vested in the Authority to fulfill the terms of its agreements with the Beneficiaries, or (C) impair the rights and remedies of the Beneficiaries 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 proceedings by or on behalf of the Beneficiaries, are fully paid and discharged. If the State violates such pledge and agreement so as to impair the Authority's right to the Pledged Settlement Payments, the Trustee, as assignee of the Authority's rights under the Sale Agreement, could seek to compel the State to honor such pledge and agreement. In general, as interested parties, the Authority on its own behalf and the Trustee on behalf of the holders of the Series 2017 Bonds could also seek to enforce the State's rights under the MSA, although, as third parties to the MSA, their rights to do so are uncertain.

Based on the U.S. Supreme Court's standard of review for Contract Clause challenges in *Energy Reserves Group, Inc. v. Kansas Power Light Co.*, 459 U.S. 400 (1983), the State must justify the exercise of its inherent police power to safeguard the vital interests of its people before the State may alter contracts similar to the MSA or the financing arrangements in a manner that would substantially impair the rights of the holders of the Series 2017 Bonds to be paid from the Pledged Settlement Payments. 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 holders of the Series 2017 Bonds to be paid from the Pledged Settlement Payments, 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 rights of the holders of the Series 2017 Bonds are based upon reasonable conditions and are of a character appropriate to the public purpose justifying the legislation's adoption.

Constitutional Rights. Holders of the Series 2017 Bonds may also have constitutional claims under the Due Process Clauses of the United States Constitution and State Constitution in the event the State attempts to claim some or all of the Pledged Settlement Payments for itself, or otherwise interferes with the security for the Series 2017 Bonds.

No Assurance As to the Outcome of Litigation or Arbitration Proceedings

With respect to all matters of litigation or arbitration proceedings mentioned herein that have been brought and may in the future be brought against the PMs, or involving the enforceability or constitutionality of the MSA and/or the State's related legislation, Qualifying Statute or the enforcement of the right to the Pledged Settlement Payments or otherwise filed in connection with the tobacco industry, the outcome of such litigation or arbitration proceedings, in general, cannot be predicted with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and arbitration panels and (ii) the courts or panels, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, courts and panels 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 materially adversely affect the amount and/or timing of the Pledged Settlement Payments and the ability of the Authority to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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 B. Several amendments have been made to the MSA which are not included in APPENDIX B. Except for those amendments pursuant to which certain tobacco companies became SPMs, such amendments involve technical and administrative provisions not material to the summary below. See “RISK FACTORS” and “LEGAL CONSIDERATIONS” herein for a discussion of certain risks related to the MSA.

General

The MSA is an industry-wide settlement of litigation between the Settling States (including the State) and the four original OPMs that was entered into between the attorneys general of the Settling States and the original OPMs on November 23, 1998. The MSA provides for other tobacco companies (the “SPMs”) to become parties to the MSA. The OPMs together with the 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 original OPMs prior to the adoption of the MSA (the “**Previously Settled States**”). According to NAAG, the following PMs are parties to the MSA (as of December 8, 2017, NAAG’s most recent reference date):

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OPMs		SPMs
Philip Morris USA Inc. (formerly Philip Morris Incorporated)	Bekenton, S.A. ⁽¹⁾	Liggett Group LLC
R.J. Reynolds Tobacco Company (formerly R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation (2004 merger) and Lorillard Tobacco Company (2015 merger))	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 ⁽¹⁾ 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) ⁽²⁾ 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. ITG Brands, LLC (formerly known as Lignum-2, LLC) ⁽³⁾ Japan Tobacco International USA, Inc. King Maker Marketing Konci Group (USA) Inc. (formerly known as Konci G&D Management Group (USA) Inc.) Kretek International Liberty Brands, LLC ⁽¹⁾	Mac Baren Tobacco Company A/S Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.) NASCO Products, LLC ⁽⁴⁾ 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 Cigarettenfabriken 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., LLC ⁽⁵⁾ 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

⁽¹⁾ Has filed for bankruptcy relief. There may be other PMs that have filed for bankruptcy relief, of which the Authority is not aware. NAAG reports that other tobacco manufacturers that had been SPMs are no longer SPMs due to dissolution from bankruptcy or otherwise.

⁽²⁾ Ceased production of cigarettes and other tobacco products.

⁽³⁾ OPM with respect to those cigarette brands purchased from Reynolds Tobacco and Lorillard.

⁽⁴⁾ Acquired by 22nd Century Group, Inc. in August 2014, with 22nd Century Group, Inc. and its subsidiaries becoming signatories to an adherence agreement to the MSA, according to news reports.

⁽⁵⁾ Altria acquired Sherman Group Holdings, LLC and its subsidiaries in January 2017.

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

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: (i) any Settling State’s subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (ii) persons or entities acting in a *parens patriae*, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in the MSA (a) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of such Settling State, as opposed solely to private or individual relief for separate and distinct injuries, or (b) to the extent that any such entity (as opposed to an individual) is seeking recovery of healthcare expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State. All such persons or entities are referred to collectively in the MSA as “**Releasing Parties**”.

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

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

However, the term “Released Parties” does not include any person or entity (including, but not limited to, an affiliate) that is an NPM at any time after the MSA execution date, unless such person or entity becomes a PM.

Overview of Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Payments, as discussed below.* These payments (with the exception of the upfront Initial Payment) are subject to various adjustments and offsets, some of which could be material. See “—Adjustments to Payments” and “—Subsequent Participating Manufacturers” below. SPMs were not required to make Initial Payments. The OPMs have made all of the Initial Payments. Thus far, most of the PMs[†] have made the Annual Payments due in 2000 through, and including, 2017, and Strategic Contribution Payments due in 2008 through, and including, 2017, which was the last year in which such Strategic Contribution Payments were due (subject, in each case, to certain withholdings and payments into the Disputed Payments Account (the “DPA”) under the MSA, including as described in “—NPM Adjustment Claims”). See “—Payments Made to Date”.

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, 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. In connection with the execution of the Sale Agreement, the State, through the Attorney General, irrevocably directed the MSA Auditor and the MSA Escrow Agent to transfer all Tobacco Assets directly to the Trustee as the assignee of the Authority.

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. In December 1998, the OPMs collectively made an up-front Initial Payment of \$2.40 billion. The 2000 Initial Payment, which had a scheduled base

* Other payments that are required to be made by the PMs, such as payments of attorneys’ fees and payments to a national foundation established pursuant to the MSA, are not allocated to the Settling States (and thus not allocated to the Authority) and are not available to the holders of the Bonds, 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.

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 DPA. Approximately \$204 million, which was substantially all of the money previously deposited in the DPA 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 other PMs are required to make Annual Payments on each April 15 in perpetuity. Most of the PMs made the Annual Payments due April 15 in each of the years 2000 through 2017. The scheduled base amounts of Annual Payments are set forth in the following table:

Base Amounts of Annual Payments⁽¹⁾

<u>Payment Year</u>	<u>Base Amount</u>	<u>Payment Year</u>	<u>Base Amount</u>
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		

(1) The Annual Payments from 2000 through 2017 have been made. Adjustments to Annual Payments for a given year may impact Annual Payments due in subsequent years. This table reflects base amounts of Annual Payments only, and does not reflect adjustments. Actual payments received have been substantially lower than the base amounts due to the application of adjustments. See “—Payments Made to Date” below.

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 of the Annual Payments due to the State under the MSA from the scheduled base amounts for the years 2000 through 2017, as discussed below under the caption “—Payments Made to Date”.

Strategic Contribution Payments

The OPMs were required to make Strategic Contribution Payments on April 15 of each year from 2008 through 2017. Most of the PMs made the Strategic Contribution Payments due April 15 in each of the years 2008 through 2017. The base amount of each Strategic Contribution Payment was \$861 million. The respective portion of the base amount applicable to each OPM was calculated by multiplying the base amount by the OPM’s Relative Market Share during the preceding calendar year. The SPMs were required to make Strategic Contribution Payments if their Market Share increased above their respective Base Shares. See “—Subsequent Participating Manufacturers” below.

The base amounts of the Strategic Contribution Payments were subject to the adjustments as described in “—Annual Payments” above, except for the Previously Settled States Reduction, which was not applicable to Strategic Contribution Payments. Application of the adjustments resulted in a material reduction of the Strategic Contribution Payments due to the State under the MSA from the scheduled base amount for the years 2000 through 2017, as discussed below under the caption “—Payments Made to Date”. No Strategic Contribution Payments were due after the 2017 Strategic Contribution Payment.

Adjustments to Payments

The base amounts of the Initial Payments and Strategic Contribution Payments were, and of the Annual Payments 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 Strategic Contribution Payments were, and 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 and Strategic Contribution 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 and Strategic Contribution Payments, after application of the Inflation Adjustment) multiplied by a ratio, the numerator of which is the Actual Volume and the denominator of which is the Base Volume.

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

Certain PMs and Settling States were in dispute regarding whether the “roll-your-own” tobacco conversion for OPMs 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 (as Settling States contended), or, rather, a 0.09 ounce conversion (as PMs contended). Forty-three jurisdictions (including the State) entered into arbitration, and in an award dated January 21, 2013, the arbitration panel held that the MSA Auditor is to use the 0.0325 ounce conversion method for OPMs for purposes of roll-your-own tobacco.

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

PSS Credit Amendment. Most of the Settling States have executed documentation approving an amendment to the MSA that would allow SPMs to elect to receive a reduction in their MSA payments in an amount equal to a percentage (100% or a lesser percentage, depending on the SPM's election and the number of years the amendment has been in effect) of the fees paid to Previously Settled States pursuant to state legislation in the Previously Settled States requiring tobacco product manufacturers that did not sign onto the Previously Settled State Settlements to pay a fee to such Previously Settled States (the "**PSS Credit Amendment**"). The PSS Credit Amendment would also provide for certain increases in the electing SPMs' MSA payments. Three Previously Settled States impose a fee on tobacco product manufacturers that did not sign onto the applicable state's Previously Settled State Settlement (\$0.50 per pack of 20 cigarettes in Minnesota, \$0.27, adjusted for inflation, per pack of 20 cigarettes in Mississippi, and \$0.55 per pack of 20 cigarettes in Texas; see "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues—Excise Taxes" for a discussion of litigation relating to the Texas fee). The State of Illinois executed the PSS Credit Amendment on January 5, 2008 and reaffirmed on December 22, 2009. The PSS Credit Amendment is not currently in effect, because by its terms it will only take effect if and when all Settling States having aggregate Allocable Shares equal to at least 99.937049% (the equivalent of the aggregate Allocable Share of the 46 states that are Settling States), and all OPMs and Commonwealth Brands, Inc., have executed the PSS Credit Amendment. No assurance can be given as to if or when the PSS Credit Amendment will take effect. Further, no assurance can be given as to whether the PSS Credit Amendment, if and when it takes effect, will reduce the amount of Pledged Settlement Payments available to the Authority to pay debt service on the Series 2017 Bonds. See "RISK FACTORS—Other Risks Relating to the MSA and Related Statutes—Amendments, Waivers and Termination" and "—Reliance on State Enforcement of the MSA; State Impairment."

Non-Settling States Reduction

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

Non-Participating Manufacturers Adjustment

The "**NPM Adjustment**" under the MSA 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 be proven to not have diligently enforced their Model Statutes. 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 (as occurred with respect to certain years discussed below under "*—Term Sheet Non-Signatories' Ongoing NPM Adjustment Claims*"), 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. The NPM Adjustment, after conclusion of the applicable arbitration regarding diligent enforcement for the relevant

sales year, is applied to the subsequent year's Annual Payment and Strategic Contribution Payment and the decrease in total funds available as a result of the NPM Adjustment is then allocated on a Pro Rata basis among those Settling States that have been found (i) to not diligently enforce their Qualifying Statutes, or (ii) to have enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction.

According to OPM SEC filings, certain PMs, including the OPMs, and the Settling States entered into three separate agreements (covering sales years 2007 to 2009, 2010 to 2012, and 2013 to 2014, respectively) wherein the Settling States would not contest that the disadvantages of the MSA were a significant factor contributing to the Market Share loss experienced by the PMs in those years. The stipulation pertaining to each of the years covered by the agreements became effective in February of the year a final determination by the firm of independent economic consultants would otherwise have been expected if the issue had been arbitrated on the merits. Pursuant to such agreements, the parties agreed that all the conditions for the NPM Adjustment were met for 2014 on February 1, 2017, permitting those PMs, including the OPMs, to deposit their portion of the 2014 NPM Adjustment into the Disputed Payments Account in April 2017.

In February 2017, the State informed the MSA Auditor that the State does not contest that the MSA was a significant factor contributing to the Market Share loss for 2015. Reynolds Tobacco deposited its portion of the State's allocable share of the NPM Adjustments for 2014 (as described in the preceding paragraph) and for 2015 (as a result of the State's February 2017 communication with the MSA Auditor as described in the preceding sentence) into the Disputed Payments Account in connection with its April 2017 MSA payment. Subsequently, in April 2017, certain PMs, including Reynolds Tobacco, and certain Settling States, including the State, entered into a fourth agreement for the period 2015 to 2017. Similar to the prior agreements, the parties agreed that all the conditions for the NPM Adjustment will have been met for 2015 on February 1, 2018, for 2016 on February 1, 2019, and for 2017 on February 1, 2020. Therefore, other than adjustments permitted by the MSA to be made with respect to prior years' amounts, Reynolds Tobacco will not deposit to the Disputed Payments Account amounts relating to the NPM Adjustment for 2015 with respect to the State in connection with Reynolds Tobacco's MSA payment due in April 2018.

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:

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

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

The NPM Adjustment is also state-specific in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute. Any Settling State that adopts and diligently enforces the Model Statute or a Qualifying Statute is exempt from the NPM Adjustment. The decrease in total funds available due to the NPM Adjustment is allocated on a Pro Rata basis among those Settling States that either (i) did not enact and diligently enforce the Model Statute or Qualifying Statute, or (ii) enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. 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 DPA, 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 (such as in the NPM Adjustment Settlement Term Sheet discussed below). If the PMs make a claim for an NPM Adjustment for any particular year and a state is determined to be one of a few states (or the only state) not to have diligently enforced its Model Statute or Qualifying Statute in such year, the amount of the NPM Adjustment applied to such state in the year following such determination could be as great as the amount of Annual Payments and Strategic Contribution Payments that could otherwise have been received by such state in such year. See “—NPM Adjustment Claims” below.

If a Settling State enacts and diligently enforces a Qualifying Statute that is the Model Statute but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment for any given year will not exceed 65% of the amount of such state’s allocated payment for the subsequent year. If a Qualifying Statute that is not the Model Statute is held invalid or unenforceable, however, such state is not entitled to any protection from the NPM Adjustment. Moreover, if a state adopts 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 “RISK FACTORS—Payment Decreases Under the Terms of the MSA” above and “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—MSA Provisions Relating to Model/Qualifying Statutes” below. See also “—Most Favored Nation Provisions”. For a discussion of the State’s Qualifying Statute, Complementary Legislation and enforcement framework, see “STATE LAWS RELATING TO THE MSA” below.

Offset for Miscalculated or Disputed Payments

If the MSA Auditor receives notice of a miscalculation of an Annual Payment or a Strategic Contribution Payment made by a PM within four years, the MSA Auditor will recalculate the payment and make provisions for rectifying the error (the “**Offset for Miscalculated or Disputed Payments**”). There are no time limits specified for recalculations although the MSA Auditor is required to determine amounts promptly. Disputes as to determinations by the MSA Auditor may be submitted to binding arbitration governed by the Federal Arbitration Act. In the event that mispayments have been made, they will be corrected through payments with interest (in the event of underpayments) or withholdings with interest (in the event of overpayments). Interest will be at the prime rate, except where a party fails to pay undisputed amounts or fails to provide necessary information readily available to it, in which case a penalty rate of prime plus 3% applies. If a PM disputes any required payment, it must determine whether any portion of the payment is undisputed and pay that amount for disbursement to the Settling States. The disputed portion may be paid into the Disputed Payments Account pending resolution of the dispute, or may be withheld. Failure to pay such disputed amounts into the Disputed Payments Account can result in liability for interest at the penalty rate if the disputed amount was in fact properly due and owing. See “RISK FACTORS—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 (i) reduce or credit against any judgment or settlement such Releasing Party obtains against the Non-Released Party the full amount of any judgment or settlement such Non-Released Party may obtain against the Released Party, and (ii) obtain from such Non-Released Party for the benefit of such Released Party a satisfaction in full of such Non-Released Party's judgment or settlement against the Released Party. In the event that such reduction or satisfaction in full does not fully relieve the Released Party of its duty to pay to the Non-Released Party, the PM is entitled to a dollar-for-dollar offset from its payment to the applicable Settling State (the "**Offset for Claims-Over**"). For purposes of the Offset for Claims-Over, any person or entity that is enumerated in the definition of Releasing Party set forth above is treated as a Releasing Party without regard to whether the applicable attorney general had the power to release claims of such person or entity. The Offset for Claims-Over is state-specific and would apply only to MSA payments owed to the Settling State of the Releasing Party.

Subsequent Participating Manufacturers

SPMs are obligated to make Annual Payments (and were obligated to make Strategic Contribution Payments), which are made at the same times as the corresponding payments to be made by OPMs. Such payments for SPMs are calculated differently, however, from such 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, according to NAAG.

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 (i) the difference between that SPM's Market Share for the preceding year and its Base Share, divided by (ii) the aggregate Market Share of the OPMs for the preceding year. Other than the application of the Volume Adjustment, payments by the SPMs are 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. In certain circumstances, an increase in the market share of the SPMs could increase the aggregate amount of Annual Payments because the Annual Payments to be made by the SPMs are not adjusted for the Previously Settled States Reduction. However, in other circumstances, an increase in the market share of the SPMs could decrease the aggregate amount of Annual Payments because the SPMs are not required to make any Annual Payments unless their market share increases above their Base Share, or because of the manner in which the Inflation Adjustment is applied to each SPM's payments.

Certain PMs and Settling States were in dispute regarding whether the payment obligations of one SPM (Liggett Group LLC) should continue to be determined based on the "net" number of cigarettes on which federal excise tax is paid (as Settling States contended), or, rather, an "adjusted gross" number of cigarettes (as PMs contended). Forty-three jurisdictions (including the State) entered into arbitration, and in an award dated January 21, 2013, the arbitration panel held that the MSA Auditor is to use the market share for Liggett Group LLC 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.

Payments Made to Date

As required, the OPMs made all of the Initial Payments due in the years 1998 to 2003 (the last year such payments were due), and most PMs made the Strategic Contribution Payments due in the years 2008 to 2017 (the last year such payments were due). Most PMs have made Annual Payments each year since 2000, the first year that Annual Payments were due. The MSA Escrow Agent has disbursed to the State (and following the execution of the Sale Agreement, to the Authority) its allocable portions thereof and certain other amounts under the MSA. Under the MSA, the computation of Annual Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA. The Authority's sole sources of information regarding the computation and amount of such payments are the reports and accountings furnished to it by the State.

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The following table sets forth for each of the preceding 10 years the base amount of Annual Payments and Strategic Contribution Payments allocable to the State pursuant to the MSA, and the amounts actually received in such year, as described below. The amounts actually received may reflect adjustments attributable to prior years' payments.

Year ⁽¹⁾	Base Payment Allocable to the State⁽²⁾	Actual Receipts⁽³⁾
2008 Annual Payment and Strategic Contribution Payment	\$402,202,000	\$310,002,000 ⁽⁴⁾
2009 Annual Payment and Strategic Contribution Payment	402,202,000	340,173,000 ⁽⁴⁾
2010 Annual Payment and Strategic Contribution Payment	402,202,000	283,887,000 ⁽⁴⁾
2011 Annual Payment and Strategic Contribution Payment	402,202,000	268,168,000 ⁽⁵⁾
2012 Annual Payment and Strategic Contribution Payment	402,202,000	273,127,000 ⁽⁵⁾
2013 Annual Payment and Strategic Contribution Payment	402,202,000	273,496,000 ⁽⁵⁾
2014 Annual Payment and Strategic Contribution Payment	402,202,000	271,222,000 ⁽⁵⁾
2015 Annual Payment and Strategic Contribution Payment	402,202,000	265,106,000 ⁽⁵⁾
2016 Annual Payment and Strategic Contribution Payment	402,202,000	275,538,000 ⁽⁵⁾
2017 Annual Payment and Strategic Contribution Payment	402,202,000	250,341,000 ⁽⁵⁾⁽⁶⁾

⁽¹⁾ Annual Payments are, and Strategic Contribution Payments were, due from the PMs on April 15 of the applicable calendar year (payment year) pursuant to the MSA. Actual receipts are listed as of June 30 (the end of the State's and the Authority's fiscal year) of each year.

⁽²⁾ Rounded. The State's allocable portion of base payments as represented in this table consists of the State's 4.6542472% share of Annual Payments under the MSA, and the State's 2.7169243% share of Strategic Contribution Payments under the MSA.

⁽³⁾ Rounded. Reflects adjustments, including the NPM Adjustment (see note (6) below with respect to payment year 2017). Amounts are set forth to the best of the State's and the Authority's knowledge, as applicable. Any adjustment is reflected in the period in which it was actually made.

⁽⁴⁾ Payment years prior to the execution of the Sale Agreement. Payable to the State.

⁽⁵⁾ Payment years following the execution of the Sale Agreement. Payable to the Trustee. Reflects the Pledged Settlement Payments only; does not reflect the State's Unsold Assets.

⁽⁶⁾ Reynolds Tobacco deposited its portion of the State's allocable share of the NPM Adjustments for 2014 and 2015 into the Disputed Payments Account in connection with its April 2017 MSA payment. See "—Adjustments to Payments—Non-Participating Manufacturers Adjustment" above.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the captions "—Annual Payments", "—Strategic Contribution Payments" and "—Adjustments to Payments". One or more of the PMs are disputing or have disputed the calculations of some of the Annual Payments for the years 2000 through 2017 and Strategic Contribution Payments for the years 2008 through 2017, 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 Annual Payments and Strategic Contribution Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

Most Favored Nation Provisions

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

In the event that any Settling State should reach a settlement of released claims with NPMs that provides more favorable terms to the NPMs than the MSA does to the PMs, or relieves in any respect the obligation of any PM to make payments under the MSA, the terms of the MSA will be deemed modified to match the NPM settlement or such payment terms, but only with respect to the particular Settling State. In no event will the adjustments discussed in this paragraph modify the MSA with regard to other Settling States. See “RISK FACTORS—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 (i) such state has settled its pending or potential litigation against the tobacco companies with a consent decree, which decree has been approved and entered by a court within the Settling State and (ii) the time for all appeals against the consent decree has expired. All Settling States have achieved State-Specific Finality. State-Specific Finality for the State was achieved on December 8, 1998, through the Consent Decree and Final Judgment of the Circuit Court of Cook County, Illinois (the “**Consent Decree**”), dated December 8, 1998, in the action entitled *People of the State of Illinois v. Philip Morris Incorporated, et al.*

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

Disbursement of Funds from Escrow

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

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

Advertising and Marketing Restrictions; Educational Programs

The MSA prohibits the PMs from certain advertising, marketing and other activities that may promote the sale of cigarettes and smokeless tobacco products (“**Tobacco Products**”). Under the MSA, the PMs are generally prohibited from targeting persons under 18 years of age within the Settling States in the advertising, promotion or marketing of Tobacco Products and from taking any action to initiate,

maintain or increase smoking by underage persons within the Settling States. Specifically, the PMs may not: (i) use any cartoon characters in advertising, promoting, packaging or labeling Tobacco Products; (ii) distribute any free samples of Tobacco Products except in a restricted facility where the operator thereof is able to ensure that no underage persons are present; or (iii) provide to any underage person any item in exchange for the purchase of Tobacco Products or for the furnishing of 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: (i) the sponsorship of any athletic, musical, artistic or other social or cultural event in exchange for the use of tobacco brand names as part of the event; (ii) the making of payments to anyone to use, display, make reference to or use as a prop any Tobacco Product or item bearing a tobacco brand name in any motion picture, television show, theatrical production, music performance, commercial film or video game; and (iii) 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 of each year on and after 2004 (as may be adjusted) 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 shall render the PM liable for interest thereon from the date such payment is due to (but not including) the date paid at the prime rate published from time to time by *The Wall Street Journal* or, in the event *The Wall Street Journal* is no longer published or no longer publishes such rate, an equivalent successor reference 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 (i) the MSA or consent decree in that jurisdiction is disapproved by a court and the time for an appeal has expired, the appeal is dismissed or the disapproval is affirmed, or (ii) the representations and warranties of the attorney general of that jurisdiction relating to the ability to release claims are breached or not effectively given. In addition, in the event that a PM enters bankruptcy and fails to perform its financial obligations under the MSA, the Settling States, by vote of at least 75% of the Settling States, both in terms of number and of entitlement to the proceeds of the MSA, may terminate certain financial obligations of that particular manufacturer under the MSA, although this provision may not be enforceable. See “LEGAL CONSIDERATIONS—Bankruptcy of a PM”.

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 non-severable 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 of the PMs affected by the amendment and by all of the Settling States affected by the amendment. The terms of any amendment will not be enforceable against any PM or 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 State has enacted the Model Statute, which is a Qualifying Statute. The MSA also provides a procedure by which a Settling State may enact a statute that is not the Model Statute and receive a determination from a nationally recognized firm of economic consultants that such statute is a Qualifying Statute. See “RISK FACTORS—Payment Decreases under the Terms of the MSA” and “RISK FACTORS—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 that 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 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. See “—NPM Adjustment Claims” below and “STATE LAWS RELATED TO THE MSA” herein.

Summary of the Model Statute

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

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

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

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 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 by the applicable Qualifying Statute, 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. NPMs also include Native American tobacco manufacturers that manufacture and sell, directly or through other Native American retailers, cigarettes to consumers from their own or other Native American reservations and who assert their rights under various treaties and agreements with the United States and with states to manufacture and sell the cigarettes free of state and local taxes and, generally, free from the constraints and burdens of state and local laws. Enforcement of the Model Statute against any of such manufacturers may be difficult. See "STATE LAWS RELATED TO THE MSA".

Complementary Legislation

Most of the Settling States (including the State) have passed legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making escrow payments required by

* The Missouri Attorney General reported February 8, 2016 that Missouri had negotiated with the PMs to resolve Missouri's dispute with the PMs with respect to the NPM Adjustment for years 2003-2014, contingent upon the Missouri legislature adopting an Allocable Share Release Amendment. However, the Missouri legislature failed to adopt an Allocable Share Release Amendment by the April 15, 2016 deadline in agreement negotiated by the Missouri Attorney General.

the states' respective Qualifying Statutes, as well as other legislation to assist in the regulation of tobacco sales. See "STATE LAWS RELATED TO THE MSA—Illinois Complementary Legislation".

All of the OPMs and other PMs have provided written assurances that the Settling States have no duty to enact Complementary Legislation, that the failure to enact such legislation will not be used in determining whether a Settling State has diligently enforced its Qualifying Statute pursuant to the terms of the MSA, and that diligent enforcement obligations under the MSA shall not apply to the Complementary Legislation. In addition, the written assurances contain an agreement that the Complementary Legislation will not constitute an amendment to a Settling State's Qualifying Statute. However, a determination that a Settling State's Complementary Legislation is invalid may make enforcement of its Qualifying Statute more difficult.

NPM Adjustment Claims

Settlement of 1999 through 2002 NPM Adjustment Claims

In June 2003, the OPMs, certain SPMs and the Settling States settled all NPM Adjustment claims for the payment years 1999 through 2002, subject, however, under limited circumstances, to the reinstatement of a PM's right to an NPM Adjustment for the payment years 2001 and 2002. In connection therewith, such PMs and the Settling States agreed prospectively that PMs claiming an NPM Adjustment for any year will not make such a deposit into the Disputed Payments Account or withhold payment with respect thereto unless and until the selected economic consultants determine that the disadvantages of the MSA were a significant factor contributing to the Market Share loss giving rise to the alleged NPM Adjustment. If the selected economic consultants make such a "significant factor" determination regarding a year for which one or more PMs have claimed an NPM Adjustment, such PMs may, in fact, either make a deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment. As discussed below under "*—Term Sheet Non-Signatories' Ongoing NPM Adjustment Claims,*" the Settling States have since agreed that no "significant factor" determination will be necessary for certain years.

NPM Adjustment Claims for 2003 Onward, 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 \$12 billion, for the sales years 2003 through 2016 (payment years 2004 through 2017) as part of the NPM Adjustment. No provision of the MSA 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. As discussed further below, the State had been a contested state in the 2003 NPM Adjustment dispute and was determined by the Arbitration Panel to have diligently enforced its Qualifying Statute during sales year 2003 and was thus not subject to the 2003 NPM Adjustment. The State and certain other Settling States are currently in arbitration regarding the 2004 NPM Adjustment. No assurance can be given as to the outcome of any pending or future arbitration regarding NPM Adjustment claims. The State's Attorney General's office maintains that the State has been and is diligently enforcing its Qualifying Statute. The Pledged Settlement Payments Projection Methodology and Assumptions and Bond Structuring Assumptions contain an assumption that the State will diligently enforce its Qualifying Statute in all years that the Bonds are Outstanding and therefore that the State will not be subject to the NPM Adjustment. No assurance can be given that the assumptions underlying the Pledged Settlement Payments Projection Methodology and Assumptions and Bond Structuring Assumptions will be consistent with future events. If the assumptions are not realized and future NPM Adjustments, withholdings or Disputed Payments are

taken against MSA payments to the State, it could have a material adverse effect on the payments by PMs under the MSA, and could have a material adverse effect on the amount and/or timing of Pledged Settlement Payments available to the Authority to pay debt service on the Bonds.

2003 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 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 Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, with one exception (Montana), the courts have ruled that the states' claims of diligent enforcement are to be submitted to arbitration. 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 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.

The OPMs and approximately 25 other PMs entered into an agreement regarding arbitration with 45 states and territories concerning the 2003 NPM Adjustment. The agreement effectively provided 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 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 under "*—NPM Adjustment Settlement and Award*", leaving 15 states (including the State) contested in the 2003 NPM Adjustment arbitration proceedings. A common issues hearing was held in April 2012 and state-specific evidentiary hearings began in May 2012 and were completed in May 2013. The decisions of the Arbitration Panel with regard to those 15 states (including the State) and their enforcement in 2003 of their Qualifying Statutes are discussed below under "*—2003 NPM Adjustment Arbitration Results and Disputes Concerning the NPM Adjustment Settlement Term Sheet and Stipulated Partial Settlement and Award*". Several of those 15 states subsequently joined the NPM Adjustment Settlement Term Sheet, as discussed below.

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, the OPMs and certain SPMs regarding claims related to the 2003 through 2012 NPM Adjustments and the determination of subsequent 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. In April 2013, Oklahoma joined the NPM Adjustment Settlement Term Sheet; in May 2013, Connecticut and South Carolina joined the NPM Adjustment Settlement Term Sheet; in June 2014, Kentucky and Indiana joined the NPM Adjustment Settlement Term Sheet (on modified terms); and in April 2017, Rhode Island and Oregon joined the NPM Adjustment Settlement Term Sheet, bringing the total number of jurisdictions that have joined the settlement to 26. The State has not signed onto the NPM Adjustment Settlement Term Sheet. 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, although with potentially different and potentially less favorable payment obligations than those 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**”). In the NPM Adjustment Stipulated Partial Settlement and Award, the Arbitration Panel, as a threshold matter, ruled that it had 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 (the “**Term Sheet Non-Signatories**”) (including the State), (iii) to determine how the 2003 NPM Adjustment Settlement would 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.

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 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 2013 MSA payment and 12.5% to be applied against each of the April 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.

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 would create 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 Term Sheet Non-Signatories that were found to be non-diligent filed motions in their MSA state courts objecting to the *pro rata* reduction method; see “—2003 NPM Adjustment Arbitration Results and Disputes Concerning the NPM Adjustment Settlement Term Sheet and Stipulated Partial Settlement and Award” below for a discussion of such motions. 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.

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 is 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 is 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 (thus, creating a safe harbor) if (i) escrow was deposited on at least 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.

Non-SET-Paid NPM Sales (“**Non-SET-Paid NPM Sales**”) will be handled as to the Term Sheet Signatories per the terms of the MSA, with the following adjustments. A data clearinghouse (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 2016, for Non-SET-Paid NPM Sales, the total NPM Adjustment liability, if any, of each Term Sheet Signatory under the original formula for a year would be reduced by a percentage specified in the NPM Adjustment Settlement Term Sheet. The NPM Adjustment Settlement Term Sheet also provides that, except in certain cases, 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.

2003 NPM Adjustment Arbitration Results and Disputes Concerning the NPM Adjustment Settlement Term Sheet and Stipulated Partial Settlement and Award

On September 11, 2013, the Arbitration Panel released its decisions in connection with the 2003 NPM Adjustment disputes with respect to each of the fifteen contested states that were Term Sheet Non-Signatories. 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 approximately 14.68%) did not diligently enforce their respective Qualifying Statutes during 2003. As a result, the nine states that

were determined to have diligently enforced their respective Qualifying Statutes (including the State), 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.

The Arbitration Panel's decisions regarding 2003 diligent enforcement 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."

Several states, including all six states that were found to be non-diligent, 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 (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 various Term Sheet Non-Signatories in their respective MSA courts to vacate and/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 (but 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 status of the motions filed by the six states that were determined by the Arbitration Panel in the 2003 NPM Adjustment dispute not to have diligently enforced their Qualifying Statutes in sales year 2003, is as follows. Indiana and Kentucky joined the NPM Adjustment Settlement Term Sheet in 2014 and those states stayed any further proceedings on their motions. In Pennsylvania, the state court entered an order that modified the judgment reduction method that had been adopted by the Arbitration Panel: the Pennsylvania court ruled that the states that signed the NPM Adjustment Settlement Term Sheet 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. Upon appeal, in April 2015, the intermediate appellate court in Pennsylvania upheld the trial court ruling. The Pennsylvania Supreme Court declined to take the PMs' appeal of that ruling. The defendant PMs filed a petition for writ of certiorari with the U.S. Supreme Court in April 2016, which was denied in October 2016. Similar to Pennsylvania, the state court in Missouri entered an order that modified the judgment reduction method that had been adopted by the Arbitration Panel, which order reduced Missouri's share of the NPM Adjustment allocation. Upon appeal, in September 2015, the intermediate appellate court in Missouri reversed the trial court ruling. Missouri appealed that ruling to the Missouri Supreme Court, and on February 14, 2017, the Supreme Court of Missouri issued a ruling affirming the trial court decision and overturning the intermediate appellate court decision. The Missouri Supreme Court's decision found in part that the Arbitration Panel exceeded its authority by deeming the Term Sheet Signatories diligent for purposes of reallocation and applying the pro rata judgment reduction. The Supreme Court of Missouri, in its February 14, 2017 decision, also denied Missouri's motion to order the PMs to arbitrate the question of Missouri's diligent enforcement in a single-state arbitration for 2004. In addition, Missouri had negotiated a settlement with PMs regarding the NPM Adjustment but failed to consummate that settlement because the Missouri legislature did not adopt an Allocable Share Release Amendment by the April 15, 2016 deadline that had been a condition to the settlement. In Maryland, that state's motion challenging the judgment reduction method adopted by the Arbitration Panel was denied by its state court. Upon appeal, in October 2015, the intermediate appellate court in Maryland reversed the trial court, the effect of which was to reduce Maryland's share of the NPM Adjustment allocation. The Maryland Supreme Court declined to take the PMs' appeal of that ruling. The PMs filed a petition for writ of certiorari with the U.S. Supreme Court in June 2016, which was denied in October 2016. Lastly, the New Mexico court granted that state's motion challenging the judgment reduction method that had been adopted by the Arbitration Panel, thereby reducing that state's share of the NPM Adjustment allocation. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, Philip Morris appealed the New Mexico trial court's decision regarding the pro rata judgment reduction but, in March 2017, the trial court ruled that, notwithstanding the pendency of the appeal, Philip Morris must return the applicable portion of the NPM Adjustment, which it did, and, in September 2017, voluntarily dismissed its appeal.

Term Sheet Non-Signatories' Ongoing NPM Adjustment Claims

For 2003-2014, all conditions for the NPM Adjustment were met, either by determination or agreement among the parties, and, in April 2017, the parties agreed that all the conditions for the NPM Adjustment will have been met for 2015 on February 1, 2018, for 2016 on February 1, 2019, and for 2017 on February 1, 2020, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

The 2004 NPM Adjustment proceeding (including with respect to the State) is currently pending before two separate arbitration panels, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. The two arbitration panels have two arbitrators in common. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, Missouri had obtained an order from the Missouri court of appeals for a separate state specific arbitration of the diligent enforcement issue, but on appeal, the Missouri Supreme Court in February 2017 ordered Missouri to participate in the nationwide arbitration of the 2004 NPM Adjustment. In addition, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, in December 2015 a Wisconsin trial court ruled that Wisconsin must arbitrate its claim of diligent enforcement for 2004. As a result of those decisions, Missouri and Wisconsin joined the 2004 multi-state diligent enforcement arbitration. Furthermore, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, the PMs informed the arbitration panels in June 2017 that they no longer contest Alaska's and Massachusetts' diligent enforcement claims for 2004. The arbitration

panels' decisions with respect to the contested jurisdictions as to 2004 diligent enforcement are not expected until late 2018 or after, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. No assurance can be given that the State will be determined by the relevant arbitration panel to have diligently enforced its Qualifying Statute for sales year 2004.

Certain Term Sheet Non-Signatories are not currently part of the pending 2004 NPM Adjustment arbitration. Montana obtained a ruling from the Montana Supreme Court that the issue of diligent enforcement under the MSA must be heard before that state's MSA court. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, Montana filed a motion in March 2017 for a declaratory order from its state court stating that Montana diligently enforced its escrow statute during 2004, but no hearings have yet been held by the Montana state court to determine whether Montana diligently enforced during 2004. In addition, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, a New Mexico trial court in November 2016 ruled that New Mexico must arbitrate its diligent enforcement claim for 2004 in multi-state arbitration, but New Mexico is appealing that ruling and has not yet joined the multi-state arbitration.

According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, proceedings regarding diligent enforcement claims for 2005 and subsequent years have not yet been scheduled, and no assurance can be given as to when proceedings for 2005 and subsequent years will be scheduled or the precise form those proceedings will take. Altria stated in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 that the availability and amount of any NPM Adjustment for 2004 and subsequent years will not be finally determined in the near term.

Altria stated in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 that it continues to pursue the NPM Adjustments against jurisdictions that have not signed onto settlements (such as the State).

Other Settlements

In October 2015, New York State entered into a settlement agreement with the OPMs and certain SPMs pursuant to which the 2004-2014 NPM Adjustment disputes were settled with respect to New York and pursuant to which a methodology for the NPM Adjustments for sales years 2015 onward is determined for such state, involving an adjustment for NPM cigarettes on which New York SET is paid, and credits to PMs for tribal NPM sales.

No prediction can be given as to whether or when any other Term Sheet Non-Signatories will enter into settlements with respect to their NPM Adjustment disputes, what form those settlements may take, or what effect, if any, such settlements will have on Term Sheet Non-Signatories such as the State.

STATE LAWS RELATED TO THE MSA

Illinois Qualifying Statute

Both houses of the State Legislature passed a Qualifying Statute, cited as the Tobacco Product Manufacturers' Escrow Act, codified as 30 ILCS §168/1 et seq., which became effective on June 30, 1999. By letter dated September 27, 1999, counsel to the OPMs confirmed that the OPMs will not dispute that the State Qualifying Statute constitutes the Model Statute under the MSA. By Public Act 93-446 effective January 1, 2004, Illinois adopted the Allocable Share Release Amendment.

Illinois Complementary Legislation

Pursuant to the provisions of the Tobacco Products Manufacturers' Escrow Enforcement Act of 2003, codified as 30 ILCS §167/1 et seq. (together with the Attorney General Rules Implementing the Tobacco Product Manufacturers' Escrow Enforcement Act, the “**State’s Complementary Legislation**”), every tobacco product manufacturer whose cigarettes are sold in the State whether directly or through a distributor, retailer or similar intermediary or intermediaries is required to execute and deliver on a form prescribed by the Attorney General of the State (through its Tobacco Enforcement Bureau) a certification to the Attorney General, annually, no later than the thirtieth day of April each year, with an officer, principal or director of each tobacco product manufacturer certifying under penalty of perjury that as of the date of the certification, the tobacco product manufacturer either (i) is a participating manufacturer and has generally performed its financial obligations under the MSA or (ii) is in full compliance with the Tobacco Product Manufacturers' Escrow Act (the Qualifying Statute), including all quarterly installment payments. In addition, pursuant to the State’s Complementary Legislation, no stamps or imprints may be affixed to a package or other container of cigarettes of a tobacco product manufacturer or brand family not included in the Attorney General’s directory (maintained by the Tobacco Enforcement Bureau) listing all tobacco product manufacturers that have provided current and accurate annual certifications, and no cigarettes of a tobacco product manufacturer or brand family not included in such directory may be sold, offered for sale or possessed for sale in the State or imported for personal consumption in the State. In addition to any other penalties that may be imposed by law, the Director of Revenue of the State may revoke or suspend the license of any distributor that violates the law described in the preceding sentence, and any cigarettes that have been sold, offered for sale or possessed for sale in the State or imported for personal consumption in the State in violation of the law described in the preceding sentence are subject to seizure and forfeiture.

Statutory Enforcement Framework and Enforcement Agencies

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 Illinois includes the:

- Illinois Qualifying Statute, as amended, including the Allocable Share Release Amendment previously described herein,
- Complementary Legislation, known as the Tobacco Products Manufacturers' Escrow Enforcement Act of 2003,
- Cigarette Tax Act & Cigarette Use Tax Act (including Illinois cigarette tax stamping requirements and tax rates),
- Tobacco Products Tax Act of 1995 which include tobacco products such as cigars, other smoking tobacco, pipe tobacco, among other products,
- Tobacco Accessories and Smoking Herbs Control Act of 1982, as amended in 1991 (prohibiting the sale of cigarette rolling papers and other accessories to minors and prohibiting outright the sale of “bidi” leaf cigarettes and vending machine sales of cigarette paper),
- Prevention of Tobacco Use by Minors and Sale and Distribution of Tobacco Products Act,

- Prevention of Cigarette Sales to Minors Act of 2004 (prohibiting shipment or delivery of cigarettes in Illinois by any common carrier without proof of legal age),
- Display of Tobacco Products Act,
- Cigarette Fire Safety Standard Act of 2008 (requiring self-extinguishing cigarettes and cross-certification of compliance by the State Fire Marshall), and
- various implementing regulations promulgated by the Office of the Illinois Attorney General and the Illinois Department of Revenue.

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), the Family Smoking Prevention and Tobacco Control Act of 2009 (“**FSPTCA**”) (amending the FDA’s Food, Drug and Cosmetics Act), the Prevention of All Cigarette Trafficking (“**PACT**”) Act of 2010, and the Contraband Cigarette Trafficking Act (“**CCTA**”), which renders unlawful the shipment, transport, reception, possession, selling, distribution or purchase of 10,000 or more unstamped cigarettes.

This statutory enforcement framework is administered and enforced by the Office of the Illinois Attorney General’s Tobacco Enforcement Bureau and by the Illinois Department of Revenue’s office, including its Excise Taxes Division and its Bureau of Criminal Investigations, among other agencies and divisions.

Attorney General Tobacco Enforcement Bureau. The Tobacco Enforcement Bureau of the Office of the Illinois Attorney General (the “**Bureau**”) is responsible for enforcing the MSA, maintaining the State of Illinois Directory of Participating Manufacturers (including brand-specific information) and the State of Illinois Directory of Compliant NPMs, and for receiving the annual compliance certifications from PMs and NPMs. Tobacco product manufacturers report directly to the Bureau within the Office of the Illinois Attorney General and senior officers or directors of the manufacturers must file annual certifications of compliance under penalty of perjury. Cigarette distributor licensees must file with the Bureau a quarterly report of sales of NPM brands and such sales must bear Illinois cigarette tax stamps and distributors that are licensed to pay the tobacco products tax must file quarterly reports for sales of NPM RYO. New NPMs and NPMs with a history of less than complete compliance are required to file and pay quarterly. Cigarette and roll-your-own brands that are not listed, together with the manufacturer, on either the State of Illinois Directory of Participating Manufacturers or the State of Illinois Directory of Compliant NPMs, and that do not bear Illinois cigarette tax stamps, may not be sold in Illinois. Both directories are published on the Attorney General’s website at www.IllinoisAttorneyGeneral.gov. The PM certifications required by the Bureau were recently amended to incorporate supplemental certifications of compliance with the “light”, “mild”, and “low”, descriptor requirements and prohibitions, and the bans on certain additives, including artificial or natural flavors that are characterizing flavors of tobacco products, in the federal FSPTCA.

The Bureau and its predecessor units have brought numerous enforcement actions and have been responsible since inception for pursuing non-compliant NPMs. The State believes there currently are no non-compliant NPMs for which licensed distributors have reported sales of units sold in the State of Illinois and that the market share of all NPMs for which licensed distributors have reported sales of units sold in the State has been de minimis (approximately 1% or less) in each year from and including 2003 to present. The State estimates that the market share of NPMs in Illinois in each year since 2004 has been less than 1% and believes that all NPMs listed on the Directory of Compliant NPMs currently are in compliance with their NPM escrow obligations under the Illinois Qualifying Statute.

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 \$2.5 million for the State of Illinois. After working with other states for several years, in February 2010, the Bureau de-listed another PM (Vibo d/b/a General Tobacco) from the State's Directory of Participating Manufacturers for non-payment of its MSA payments. Two other states have filed suit seeking full payment by General Tobacco of its MSA Payment obligations. Such actions will benefit all Settling States, including the State, if payments are ordered and made. The Bureau also has participated actively in various multi-state initiatives against certain OPMs to enforce the advertising and promotion restrictions in the MSA.

The Office of the Illinois Attorney General's Criminal Prosecutions and Trial Assistance Bureau also represents the State Department of Revenue in administrative and judicial proceedings involving the seizure and forfeiture of contraband, unstamped cigarettes possessed in Illinois.

Department of Revenue Actions Seeking Penalties, Seizure and Forfeiture of Contraband Cigarettes. The Illinois Department of Revenue, Bureau of Criminal Investigation coordinates with the U.S. Bureau of Alcohol Tobacco and Firearms in investigating and seizing unstamped cigarettes and referring the results of its investigations to the Office of the Illinois Attorney General Criminal Enforcement Division for forfeiture proceedings. The Illinois Department of Revenue of the State may revoke or suspend the license of any distributor that violates these laws, and any cigarettes that have been sold, offered for sale or possessed for sale in the State or imported for personal consumption in the State in violation of the law described in the preceding sentence are deemed "contraband" and subject to seizure and forfeiture. The Illinois Department of Revenue website contains numerous reported administrative decisions regarding the seizure and forfeiture of unstamped cigarettes seized by the Department.

Department of Revenue Role. The Department of Revenue is responsible for licensing all cigarette distributors and manufacturers and ensuring tobacco taxes are properly paid. Its Alcohol and Tobacco Processing Division works closely with the Department's Bureau of Criminal Enforcement, Audit Division and the Attorney General's Office to ensure compliance with State and federal laws regulating the sale and distribution of cigarettes and to prevent the sale and distribution of contraband cigarettes. The Alcohol and Tobacco Processing Division of the Department Excise Tax Division reviews returns and supporting schedules filed by licensed distributors and manufacturers to identify potential illegal activity, track shipments of cigarettes in and out of Illinois and ensure proper payment of taxes. When requested, it shares this data with other state and federal law enforcement officials. Under the Cigarette Tax Act and Cigarette Use Tax Act, tax is due on all cigarettes sold or used in Illinois, regardless of whether they are purchased at a physical location in Illinois or obtained through an internet sale. Under the 2010 PACT Act, persons who sell and ship cigarettes across state lines to a purchaser, other than persons licensed with Illinois, are required to make a monthly report of their sales to the Department of Revenue (using Form PA-1). The Department then uses information that is reported to ensure that taxes are paid on cigarettes obtained through remote sales. This information not only assists in enforcing Cigarette Use Tax that is due, but also in obtaining the Use Tax (sales tax) that is due on these purchases. Returns and schedules filed by licensed distributors do not identify internet transactions separately from other types of transactions. Similarly, Use Tax returns do not identify whether a purchase was made over the internet or in some other manner. As a result, returns filed with the Department provide little information on internet sales transactions.

Absence of Tribal Reservations. There are no federally recognized Native American reservation lands located within the borders of the State of Illinois. Accordingly, unlike some other states, the State

does not experience off-reservation Tribal sales of cigarettes within the State from reservations located within its borders.

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 currently 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) 551-8090; e-mail: publicinfo@sec.gov). The following information does not, nor is it intended to, provide a comprehensive description of the domestic tobacco industry, the business, legal and regulatory environment of the participants therein, or the financial performance or capability of such participants. Although the Authority has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Authority has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. To the extent that reports submitted to the MSA Auditor by the PMs pursuant to the requirements of the MSA provide information that is pertinent to the following discussion, including market share information, the Attorney General of the State has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2017 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2017 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 OPMs and reflected in the chart below entitled “Manufacturers’ Domestic Market Share of Cigarettes” is different from that utilized in the bond structuring assumptions. See “PLEGGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS”.

Industry Overview

According to publicly available documents of the OPMs, at year-end 2016 the OPMs collectively accounted for approximately 83.7% of the domestic cigarette retail industry, as discussed in “Industry Market Share” below. The market for cigarettes in the U.S. divides generally into premium and discount sales.

Philip Morris USA Inc. (“**Philip Morris**”), a wholly-owned subsidiary of Altria Group, Inc. (“**Altria**”), is the largest tobacco company in the U.S. Prior to a name change on January 27, 2003, Altria was named Philip Morris Companies Inc. In its Form 10-Q filed with the SEC for the nine-month period

ended September 30, 2017, Altria reported that Philip Morris's domestic cigarette market share for such period 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). In its Form 10-K filed with the SEC for calendar year 2016, Altria reported that Philip Morris's domestic cigarette market share for calendar year 2016 was 51.4%, compared to its reported domestic market share of 51.3% for calendar year 2015. Philip Morris's major premium brands are Marlboro, Virginia Slims and Parliament (with Marlboro representing approximately 85.8% of Philip Morris's domestic cigarette shipment volume during the nine months ended September 30, 2017, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017). Marlboro is also the largest selling cigarette brand in the U.S., with approximately 43.4% and 43.7% of the U.S. domestic retail share for the nine-month periods ended September 30, 2017 and September 30, 2016, respectively, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, 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 Company LLC ("**UST**"), is the leading producer of smokeless tobacco in the U.S.

R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") is the second-largest tobacco company in the U.S. Reynolds Tobacco is a wholly-owned subsidiary of Reynolds American Inc. ("**Reynolds American**"), which in turn is a wholly-owned subsidiary of British American Tobacco p.l.c. ("**BAT**") following BAT's acquisition on July 25, 2017 of the approximately 58% of Reynolds American stock not then owned by BAT. As a result of the acquisition by BAT, Reynolds American no longer files quarterly or annual reports with the SEC. BAT is subject to applicable SEC reporting obligations as a foreign private issuer. BAT is responsible for Reynolds Tobacco's payment obligations under the MSA as a result of the acquisition of Reynolds Tobacco's parent company Reynolds American. In an earlier merger, in June 2015, Reynolds American acquired Lorillard, Inc., the parent company of Lorillard Tobacco Company ("**Lorillard**"), the then third-largest tobacco company in the U.S., with Reynolds Tobacco continuing as the surviving entity. In yet an earlier merger, in July 2004, the U.S. operations of Brown & Williamson Tobacco Corporation ("**B&W**") (the then third-largest tobacco company in the U.S.) were combined with Reynolds Tobacco. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2017 (which, on account of the acquisition by BAT, is the final periodic report filed by Reynolds American with the SEC), Reynolds American reported that Reynolds Tobacco's domestic retail cigarette market share at June 30, 2017 was 32.1% (based on shipments to retail outlets and information submitted by wholesale locations and processed and managed by MSAI). In its Form 10-K filed with the SEC for the calendar year 2016, Reynolds American reported that Reynolds Tobacco's domestic retail cigarette market share at December 31, 2016 and December 31, 2015 was 32.3%. Reynolds Tobacco's major premium brands are Newport (which it acquired in the 2015 merger with Lorillard) and Camel, and its discount brands include Pall Mall and Doral. BAT, through Reynolds American, is also the parent company of American Snuff Company, LLC, the second-largest smokeless tobacco products manufacturer in the U.S., and Santa Fe Natural Tobacco Company, Inc. ("**Santa Fe Natural Tobacco Company**"), an SPM that manufactures a super-premium cigarette brand.

Contemporaneous with the 2015 merger of Lorillard, Inc. into Reynolds American, Imperial Tobacco Group PLC ("**Imperial Tobacco**") (through its subsidiary ITG Brands, LLC, an SPM under the MSA) purchased Reynolds Tobacco's Kool, Salem and Winston cigarette brands, Lorillard, Inc.'s Maverick cigarette brand and blu eCig electronic cigarette brand, and other assets. Imperial Tobacco is listed on the London Stock Exchange and does not file quarterly or annual reports with the SEC. According to Imperial Tobacco's announcement released November 7, 2017 containing preliminary results for the fiscal year ended September 30, 2017, Imperial Tobacco's market share in the U.S. tobacco market at fiscal year-end 2017 was 8.9% (representing a decrease from 9.2% at fiscal year-end 2016), making it the third-largest tobacco company in the U.S. market. Imperial Tobacco's annual report containing final results for the fiscal year ended September 30, 2017 did not disclose market share in the

U.S. tobacco market. In accordance with 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 from Reynolds Tobacco and Lorillard have been assumed and continued by Imperial Tobacco. Imperial Tobacco also is the parent company of Commonwealth Brands, Inc. (“**CBI**”), an SPM under the MSA, which markets deep discount brands in the U.S., including USA Gold, Sonoma and Fortuna.

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market in 2017 was held by a number of other cigarette manufacturers, including Liggett Group LLC (“**Liggett**”) (the operating successor to the Liggett & Myers Tobacco Company) and Vector Tobacco Inc. (“**Vector Tobacco**”), each SPMs under the MSA and each wholly-owned subsidiaries of Vector Group Ltd. (“**Vector Group Ltd.**”). In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, Vector Group Ltd. reported that the domestic market share of its subsidiaries Liggett and Vector Tobacco in the calendar year 2016 was 3.3%, measured by MSAI shipment volume data, and that all of Vector Group Ltd.’s tobacco sales in 2017 and 2016 were in the discount category. Vector Group Ltd. reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 that Liggett and Vector Tobacco are required to make payments under the MSA to the extent such companies’ market shares exceed approximately 1.65% and approximately 0.28%, respectively, of the U.S. cigarette market (with the MSA payment obligations based on each respective company’s incremental market share above the aforementioned minimum thresholds). Vector Group Ltd.’s brands include Pyramid, Eagle 20’s, Grand Prix and Liggett Select.

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Industry Market Share

The following table sets forth the approximate comparative market share positions of the leading producers of cigarettes in the U.S. tobacco industry. Lorillard is included for historical comparison. Individual domestic manufacturers' market shares presented below are derived from the publicly available documents of the respective manufacturers and, as a result of differing methodologies used by the manufacturers to calculate market share, may not be accurate.

Manufacturers' Domestic Market Share of Cigarettes¹

<u>Manufacturer</u>	<u>Calendar Year</u>					
	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Philip Morris	49.0%	49.8%	50.7%	50.9%	51.3%	51.4%
Reynolds Tobacco ²	27.4	26.5	26.0	26.5	32.0	32.3
Imperial Tobacco ³	----	----	----	----	9.5	9.2
Lorillard ⁴	14.1	14.4	14.9	15.1	----	----
Other ⁵	9.5	9.3	8.4	7.5	7.2	7.1

¹ Aggregate market share as reported above is different from that utilized in the Pledged Settlement Payments Projection Methodology and Assumptions. In addition, aggregate market share for a given year is as reported in SEC filings for such year and has not been restated due to changes in reporting for subsequent years, if any, or otherwise. Shipments to retail outlets as reported by MSAI do not reflect actual consumer sales and do not track all volume and trade channels, and accordingly, the data may overstate or understate actual market share.

² Reynolds Tobacco's market share for 2014 and prior years is based on market share information prior to the merger with Lorillard. Reynolds Tobacco's 2015 market share assumes that cigarette brands acquired in the merger were part of Reynolds Tobacco's portfolio for the entire period, and also reflects for that entire period the divestiture of assets to Imperial Tobacco.

³ As of fiscal year-end September 30. According to Imperial Tobacco's annual report for its fiscal year ended September 30, 2015, the 2015 amount shown reflects the combined performance of U.S. operations before and after the acquisition of the above-described assets of Reynolds Tobacco and Lorillard, which occurred in such fiscal year. For fiscal years 2014 and prior, Imperial Tobacco is included in "Other".

⁴ Lorillard utilized 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.

⁵ The market share specified in "Other" has been determined by subtracting the total market share percentages of Philip Morris, Reynolds Tobacco, Imperial Tobacco and Lorillard 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

According to NAAG data, domestic U.S. cigarette shipments over the past 10 reported sales years were approximately as set forth in the table below.

<u>Sales Year</u>	<u>Overall No. of Cigarettes (in billions) (with 0.0325 oz. RYO conversion)</u>	<u>% Change From Prior Year (with 0.0325 oz. RYO conversion)¹</u>	<u>OPM No. of Cigarettes (in billions) (with 0.0325 oz. RYO conversion)</u>	<u>% Change From Prior Year (with 0.0325 oz. RYO conversion)¹</u>
2016	260.183	(3.96)%	220.818	(2.39)%
2015	270.903	1.91	226.214	(0.15)
2014	265.819	(3.83)	226.553	(3.53)
2013	276.403	(4.86)	234.841	(4.34)
2012	290.520	(1.90)	245.486	(1.99)
2011	296.159	(2.75)	250.461	(3.09)
2010	304.547	(6.36)	258.440	(3.96)
2009	325.226	(9.09)	269.095	(10.35)
2008	357.738	(3.79)	300.161	(3.92)
2007	371.833	(4.96)	312.411	(4.50)

¹ Percentage change calculated after rounding of shipment volume.

According to data from the U.S. 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) for the past 10 calendar years was approximately as set forth in the table below.

<u>Calendar Year</u>	<u>No. of Cigarettes (in billions)</u>	<u>Percent Change From Prior Year¹</u>
2016	257.419	(3.89)%
2015	267.835	1.95
2014	262.704	(4.05)
2013	273.787	(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)

¹ Percentage change calculated after rounding of shipment volume.

According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, total cigarette industry volumes declined by an estimated 3.5% in that period.

The MSA payments are calculated in part on shipments by the OPMs in or to the U.S., rather than total industry shipments (as shown in the tables above), and rather than consumption. The information in the foregoing tables, which has been obtained from publicly available documents but has not been

independently verified, may differ materially from the amounts used by the MSA Auditor for calculating Annual Payments and Strategic Contribution Payments under the MSA.

Physical Plant, Raw Materials, Distribution and Competition

The production facilities of the OPMs tend to be highly concentrated. 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. In addition, shifts in crops (such as those driven by economic conditions and adverse weather patterns), government mandated prices, economic trade sanctions, geopolitical instability and production control programs may increase or decrease the cost or reduce the supply or quality of tobacco and other agricultural products used to manufacture tobacco products. Any significant change in the price, quality or availability of tobacco leaf or other agricultural products used to manufacture tobacco products could restrict the cigarette manufacturers' ability to continue marketing existing products.

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. The retail chain store Target reportedly stopped selling tobacco products in 1996. In September 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. CVS recently reported that a year after it stopped selling cigarettes, cigarette sales across all retailers have dropped in 13 states where it has sizable market share. 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. According to the American Nonsmokers' Rights Foundation ("ANRF"), as of October 2, 2017, 168 municipalities have tobacco-free pharmacy laws. In addition, Costco has also reportedly removed tobacco products from a majority of its U.S. locations, according to news reports in March 2016. 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, product attributes and packaging, consumer loyalty, advertising, 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. According to the Tobacco Consumption Report, premium brands are typically \$1.00 to \$2.00 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 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.

E-Cigarettes and Vapor Products

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, burn or heat tobacco, the manufacturers (and certain states) do not deem e-cigarettes to constitute “cigarettes” within the meaning of the MSA. Electronic nicotine products also include 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 generally are cheaper than e-cigarettes. As discussed below, in May 2016, the U.S. Food and Drug Administration (“FDA”) released its final rule which subjects manufacturers, importers and/or retailers of e-cigarettes, other vapor products and certain other tobacco related products to the same and additional regulations applicable to cigarettes, cigarette tobacco, roll-your-own tobacco and smokeless tobacco. However, e-cigarettes and vapor products are currently not subject to the advertising restrictions to which tobacco products are subject. According to the American Lung Association, there are nearly 500 brands and 7,700 flavors of e-cigarettes on the market.

The parent companies of each of the OPMs have launched e-cigarette brands. Reynolds American markets the e-cigarette product VUSE and introduced its VUSE Fob power unit, which offers an on-device display with information about battery and cartridge levels, in March 2016, and began national distribution of its VUSE Vibe high-volume cartridge and closed-tank system, with a stronger and longer-lasting battery, in November 2016. Altria’s subsidiary Nu Mark LLC introduced e-vapor products under the “MarkTen” brand in 2013 and expanded MarkTen nationally during 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. In April 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 April 2012 Lorillard, Inc. acquired the blu eCigs brand, which it sold to Imperial Tobacco contemporaneously with the Lorillard, Inc. merger into Reynolds American in 2015. In addition, Vector Group Ltd.’s subsidiary Zoom E-Cigs LLC rolled out its Zoom e-cigarette brand nationally 2014.

Altria, through its subsidiaries, has also developed alternative cigarettes, Accord and Iqos, in which the tobacco is electronically heated rather than burned. According to news reports, in December 2016 Philip Morris International Inc. filed a modified risk tobacco product application with the FDA to market Iqos in the U.S. as a “less harmful” tobacco product than traditional cigarettes and in March 2017 filed the corresponding pre-market tobacco production application with the FDA. Altria has stated that it considers Iqos and other products in which tobacco is heated rather than burned as “tobacco products” under the MSA.

E-cigarette and vapor product sales were an estimated \$3.5 billion in 2015 and \$4 billion in 2016, according to news reports. Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 that its subsidiaries believe that a significant number of adult tobacco consumers switch between tobacco categories, use multiple forms of tobacco products and try innovative tobacco products, such as e-vapor products and that, although the e-vapor category grew rapidly from 2012 through 2015, the category has slowed since that time. Altria’s subsidiary Nu Mark believes that the e-vapor category will continue to be dynamic as adult tobacco consumers explore a variety of tobacco product options, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. In September 2017, Philip Morris International announced that it would contribute approximately \$80 million each year for the following 12 years to a non-profit organization called the Foundation for a Smoke-Free World, to fund research on smoke-free alternatives, among other things.

The CDC in September 2014 reported results of a survey that indicated that in 2013 approximately 8.5% of the adult population (representing approximately two-and-a-half times the 2010 estimates), and 36.5% of smokers (representing approximately four times the 2010 estimates), had tried e-cigarettes at some time. In January 2016 the CDC reported that in 2014 approximately 2.4 million middle and high school students were users of electronic cigarettes in the preceding 30 days. The CDC also reported that 16% of high school students used e-cigarettes in 2015 (compared to 1.5% in 2011). The CDC in June 2016 released survey results showing that 45% of high school students had tried e-cigarettes in 2015, compared with only 32% who had tried cigarettes. In December 2014 the University of Michigan's Survey for Research Center ("UMSRC") reported its findings that e-cigarette use exceeded traditional cigarette smoking among teens in 2014. In December 2015, the UMSRC reported its findings that in 2015, a substantially higher percentage of adolescents used e-cigarettes in the last 30 days than had smoked regular cigarettes and that cigarette smoking among teens continued a decades-long decline in 2015 and reached the lowest levels recorded since annual tracking began over 40 years ago. In addition, it has been reported that increases in taxes on traditional cigarettes have caused an increase in the sale of e-cigarettes. According to the Tobacco Consumption Report, certain sources have shown that e-cigarette use is associated with quit attempts by smokers; that youth use of e-cigarettes is unlikely to increase the number of future cigarette smokers; and that the substantial increase in e-cigarette use among U.S. adult smokers this decade was associated with a statistically significant increase in the smoking cessation rate at the population level.

On May 5, 2016, the FDA released final rules that extend its regulatory authority to electronic cigarettes and certain other tobacco products under the FSPTCA (following an April 25, 2014 release of proposed rules). The rules ban sales of e-cigarettes and other vapor products, cigars, hookah tobacco, pipe tobacco and other products to people under 18, effective August 2016. The rules also require new health warnings for these products, and manufacturers must seek FDA permission to continue marketing all such products launched since 2007 (comprising virtually all of the market), as discussed below under "—Regulatory Issues—FSPTCA". Manufacturers have a grace period to submit their product information to the FDA. In addition, the rules require that product manufacturers register with the FDA and report product and ingredient listings; only make direct and implied claims of reduced risk if the FDA confirms that scientific evidence supports the claim and that marketing the product will benefit public health as a whole; not distribute free samples; and not sell products in vending machines, unless in a facility that never admits youth. The rules do not restrict flavored products, online sales or advertising for e-cigarettes and vapor products. Various manufacturers have sued the FDA over the final rules.

On March 2, 2016, the U.S. Department of Transportation announced a final rule that explicitly bans the use of e-cigarettes and other vaping devices on commercial flights and applies to all scheduled flights of U.S. and foreign carriers involving transportation in, to, and from the U.S.; the U.S. Court of Appeals District of Columbia Circuit upheld the rule in July 2017. On January 28, 2016, President Obama signed the Child Nicotine Poisoning Prevention Act into law which requires containers for liquid nicotine used in e-cigarettes to have child-proof packaging.

Electronic cigarettes are currently not subject to federal excise taxes. For a description of state taxes imposed on vapor products, see "—Regulatory Issues—Excise Taxes" below.

Certain legislation has been passed by states and localities restricting the use and sale of electronic cigarettes and other vapor products. According to ANRF as of October 2, 2017, ten U.S. states and two territories (California, Connecticut, Delaware, Hawaii, Maine, New Jersey, North Dakota, Oregon, Utah, Vermont, the Northern Mariana Islands and Puerto Rico) and 688 municipalities have banned the use of e-cigarettes in smoke-free venues, and 15 states have restricted e-cigarette use in other venues. In addition, New York State enacted a law effective November 2017 that bans e-cigarettes and other vapor products from anywhere traditional cigarettes are already prohibited. On December 19, 2013,

the New York City Council approved legislation that prohibits the use of e-cigarettes in indoor public places and in places of employment (where smoking of traditional cigarettes is prohibited), and on January 3, 2017 a New York appellate panel affirmed the constitutionality of the ban. Chicago, Los Angeles, San Francisco and Philadelphia passed similar legislation in 2014.

In December 2014, Representatives Henry Waxman and Frank Pallone and Senator Dick Durbin sent letters to 29 Attorneys General urging them to classify e-cigarettes as cigarettes under the MSA in order to prevent e-cigarette companies from targeting youth and getting them addicted to their products. In February 2015, eight Attorneys General sent a response letter stating their position that the MSA does not cover e-cigarettes.

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, including “snus” (originated in Sweden), 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 OPMs entered the market of smokeless tobacco products, including Philip Morris’s introduction of Taboka, a snuff product, and Reynolds American’s introduction of Camel snus. Philip Morris also markets Marlboro snus and Marlboro Smokeless Tobacco Stick. In October 2007, Altria announced that it would accelerate the development of snuff and less-harmful cigarettes to counter a decline in smoking. In 2009 Reynolds American began testing dissolvable tobacco products Camel Sticks (a twisted, dissolvable stick made of tobacco), Camel Orbs (dissolvable tobacco tablets) and Camel Strips (dissolvable tobacco strips), but in recent years has scaled back marketing of these 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.

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. Sales of moist snuff products increased by 65.6% between 2005 and 2011, according to an October 2012 report by the National Center for Biotechnology Information. According to Altria’s Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, its subsidiary UST estimates that the smokeless products category volume grew approximately 0.5% over the period ended September 30, 2017. According to Altria’s Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, smokeless tobacco products accounted for approximately 8.3% of Altria’s tobacco product net revenues for the nine months ended September 30, 2017, compared with approximately 8.1% for the nine months ended September 30, 2016. A June 2014 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. The U.S. Department of Health and Human Services reports that 3.5% of all adults use smokeless tobacco.

For a description of federal and state taxes imposed on smokeless tobacco products, see “—Regulatory Issues—Excise Taxes” below.

On June 10, 2014, Swedish Match submitted an application to the FDA to (i) authorize under the FDA’s premarket tobacco application pathway the marketing and sale of updated versions of eight of its snus products under the “General” brand name and (ii) approve the snus products as a “modified risk tobacco product” (“**M RTP**”) allowing the manufacturer to alter or remove certain warning labels from its packages and to make claims that its products present a lower risk than cigarettes. The FDA announced in November 2015 that it had for the first time authorized the marketing of a new tobacco product through the premarket tobacco application process by granting Swedish Match’s application with respect to the marketing and sale of its snus products. In December 2016 the FDA denied Swedish Match’s request to remove one of the required warning statements for eight snus products under the “General” brand name, and the FDA provided recommendations related to Swedish Match’s other requests and provided an opportunity for Swedish Match to amend its MRTP applications.

Smoking Cessation Products

A variety of smoking cessation products and services have been 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. Alternative therapies, such as psychotherapy and hypnosis, are also in use and available to individuals.

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 October 2015 found that in 2013, approximately two-thirds of smokers had made a quit attempt in the past year (although state proportions ranged from 56.2% to 76.4%). The CDC in January 2017 released the results of a study of quitting smoking, which found that in 2015, 68.0% of smokers wanted to stop smoking, 55.4% had made a quit attempt in the past year, 7.4% had recently quit, 57.2% had been advised by a health professional to quit, and 31.2% had used counseling and/or medications when they tried to quit. According to the CDC, the smoking rate for adults in the United States fell to 16.8% in 2014 and 15.8% in 2016. It is possible that many former smokers were aided by smoking cessation products.

Gray Market

A price differential (principally resulting from differing tax rates) exists between cigarettes manufactured for sale abroad and cigarettes manufactured for U.S. sale. Such differential increases as excise taxes in the U.S. are increased. Consequently, a domestic gray market has developed for cigarettes that are manufactured for sale abroad, but instead are diverted for domestic sales at substantially lower prices 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. Smuggling activities and other illicit trade in cigarettes can adversely impact the sale of cigarettes by PMs, and certain PMs engage in a variety of initiatives to help prevent illicit trade and have taken legal action against certain distributors and retailers who engage in such illicit trade practices.

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives

The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of “flavored” cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, 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. Federal law currently allows insurance companies to charge smokers up to 50% higher premiums than non-smokers, and several large corporations are now charging smokers higher premiums.

Federal Regulation

During the past five 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 Administration Reorganization Act was signed into law. This act required states to adopt a law prohibiting any manufacturer, retailer, or distributor of tobacco products to sell or distribute any such product to any individual under the age of 18 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.

FSPTCA

The federal Family Smoking Prevention and Tobacco Control Act of 2009 (“**FSPTCA**”) (amending the FDA’s Food, Drug and Cosmetics Act) (“**FD&C Act**”), signed by President Obama on June 22, 2009, 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;
- 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;
- imposes restrictions on the advertising, promotion, sale and distribution of tobacco products, including at retail;
- requires larger and more severe health warnings on cigarette packs and cartons;
- bans the use of descriptors on tobacco products, such as “low tar”, “mild” and “light”, when used as descriptors of modified risk unless expressly authorized by the FDA;
- 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, among others:

- 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 on tobacco marketing, including 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;
- is considering new graphic warnings to appear on cigarette packages and in cigarette advertisements;
- required warning labels for smokeless tobacco products;
- authorized the sale and marketing of new tobacco products and rejected applications to introduce certain new tobacco products into the market;
- issued its final rule subjecting e-cigarettes and certain other tobacco products to FDA regulation (as discussed under “—E-Cigarettes and Vapor Products” above); and
- is considering the issues surrounding the presence of menthol and the level of nicotine in cigarettes.

Marketing Rule. As required by the FSPTCA, the FDA re-promulgated in March 2010 a wide range of advertising and promotion restrictions in substantially the same form as regulations that were previously adopted in 1996 (but never imposed on tobacco manufacturers due to a United States Supreme Court ruling). This marketing ruling banned the use of color and graphics in tobacco product labeling and advertising (which ban was ruled to be unenforceable, as described under “—*FSPTCA Litigation*” below); prohibits the sale of cigarettes and smokeless tobacco to underage persons; restricts the use of non-tobacco trade and brand names on cigarettes and smokeless tobacco products (the FDA is currently not issuing enforcement actions with regard to this restriction, as described under “—*FSPTCA Litigation*” below); requires the sale of cigarettes and smokeless tobacco in direct, face-to-face transactions; prohibits sampling of cigarettes and prohibits sampling of smokeless tobacco products except in qualified adult-only facilities; prohibits gifts or other items in exchange for buying cigarettes or smokeless tobacco products; prohibits the sale or distribution of items such as hats and tee shirts with tobacco brands or logos; and prohibits brand name sponsorship of any athletic, musical, artistic or other social or cultural event, or any entry or team in any event. Except as noted above, the marketing ruling took effect in June 2010.

Warnings. 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 proposed new warnings consisted of nine new textual warning statements accompanied by color pictures depicting the negative health consequences of smoking. The proposed warnings would appear on the upper portion of the front and rear panels of each cigarette package and comprise at least the top 50% of these panels, and would also appear in each cigarette advertisement and occupy at least 20% 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 district court enjoined the FDA from enforcing the rule, the appellate court affirmed the district court's decision invalidating the graphic warning rule, and the FDA did not seek further review. The FDA has announced that it would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA and would propose a new graphic warnings rule in the future.

Dissolvable Tobacco Products. In July 2010, the TPSAC conducted hearings on the impact of dissolvable tobacco products 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.

Menthol. The TPSAC and the Menthol Report Subcommittee held meetings throughout 2010 and 2011 to consider the issues surrounding the use of menthol in cigarettes. At its March 2011 meeting, TPSAC presented its report and recommendations on menthol, which 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." At the July 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 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**") for public comment, 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 the FDA 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 allowed to rely on the TPSAC's report but is not required to follow the TPSAC's recommendations, and the FDA has not yet taken any action with respect to menthol use. See "*FSPTCA Litigation*" below for a description of litigation regarding the composition of the TPSAC and reliance upon the menthol report.

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 with respect to the *Newport* brand mentholated cigarettes, which is owned by BAT through its subsidiary Reynolds American (following the Reynolds American merger with Lorillard, Inc.). According to a report by the Federal Trade Commission released in 2016, menthol cigarettes made up 31% of the U.S. cigarette market in 2013.

Pre-Market Review for New and Modified Products. The FSPTCA imposes restrictions on marketing new and modified tobacco products, requiring FDA review in order for a manufacturer to begin marketing a new product or continue marketing a modified product. Unless a manufacturer can demonstrate that its products are “substantially equivalent” to products commercially marketed as of February 15, 2007, the FDA could require the removal of such products or subject them to the new product application process and, if any such new product applications are denied, prevent the continued distribution and sale of such products. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, a new tobacco product applications would need to demonstrate that the marketing of the product would be appropriate for the protection of the public health, and it is uncertain how the FDA will interpret the requirements for obtaining a new tobacco product marketing order (although, as noted below, the FDA has indicated its intention to issue appropriate regulations to clarify the requirements).

According to FDA guidance issued in January 2011, for cigarettes, cigarette tobacco and smokeless tobacco products modified or first introduced into the market between February 15, 2007 and March 22, 2011 for which a manufacturer submitted substantial equivalence reports that the FDA determines are not “substantially equivalent” to products commercially marketed as of February 15, 2007, the FDA could require the removal of such products from the marketplace. In its May 2016 final rule on e-cigarettes and other vapor products, the FDA left the “grandfather” date of February 15, 2007 in place for e-cigarettes and e-vapor products. For e-cigarettes and other vapor products modified or first introduced into the market between February 15, 2007 and August 8, 2016, if a manufacturer submits substantial equivalence reports for products that the FDA determines are not “substantially equivalent” to products commercially marketed as of February 15, 2007, or rejects a new tobacco product application submitted by a manufacturer, the FDA could require the removal of such products from the marketplace. Few, if any, e-cigarettes were on the market as of February 15, 2007, and thousands of such products subsequently entered into commerce. To address this issue, the FDA established a compliance policy regarding its premarket review requirements for all products (such as e-cigarettes and other vapor products) deemed by the May 2016 final rule to be tobacco products that are not grandfathered products but were on the market as of August 8, 2016. The FDA will allow such products to remain on the market so long as the manufacturer has filed the appropriate premarket tobacco application (“PMTA”) by a specific deadline. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, in August 2017 the FDA extended the filing deadlines for combustible non-cigarette products, such as cigars and pipe tobacco, to August 8, 2021, and for non-combustible products, such as e-cigarettes, other vapor products and oral nicotine products, to August 8, 2022. The FDA will permit manufacturers to continue to market such products until the FDA renders a decision on the applicable substantial equivalence report or new tobacco product application.

In addition, modifications to currently-marketed products, including modifications that result from, for example, a supplier being unable to maintain the consistency required in ingredients or a manufacturer being unable to obtain the ingredients with the required specifications, can trigger the FDA’s pre-market review process described above.

In March 2015 and September 2015, the FDA issued draft guidance that announced that certain label changes and changes to the quantity of tobacco products in a package would each require submission of substantial equivalence reports and authorization from the FDA prior to marketing tobacco

products with such changes, even when the tobacco product itself is not changed. As discussed under “—*FSPTCA Litigation*” below, in response to a legal challenge from the tobacco manufacturers, the United States District Court for the District of Columbia found that labeling changes do not require a substantial equivalence review, but product quantity changes require a substantial equivalence review. In December 2016, the FDA issued a revised final guidance document entitled, “Demonstrating the Substantial Equivalence of a New Tobacco Product: Response to Frequently Asked Questions (Edition 3)” as a result of the court decision.

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. The FDA began announcing decisions on substantial equivalence reports in 2013. The FDA announced on June 25, 2013 that it approved the applications and authorized the sale of two new non-menthol Newport cigarettes that were 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. In August 2014, the FDA ordered a tobacco product manufacturer to stop selling and distributing seven dissolvable tobacco products because they were not substantially equivalent to predicate products. Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 that there remain a significant number of substantial equivalence reports for which the FDA has not announced decisions, that it is not possible to predict how long reviews of the FDA of substantial equivalence reports or new tobacco product applications will take, and a “not substantially equivalent” determination or denial of a new tobacco product application could have a material adverse impact on its business, cash flows or financial position.

As noted below, as part of the FDA’s July 2017 announcement regarding a regulatory plan for tobacco and nicotine, the FDA reported that it plans to develop foundational regulations to provide clarity and predictability to the tobacco product submission process, to include regulations outlining the information that the FDA expects to be provided in PMTAs, modified risk tobacco product applications, and substantial equivalence reports, as well as finalized guidance on PMTA reviews.

Modified Risk Products. The FSPTCA bans the use of descriptors on tobacco products such as “low tar”, “mild” and “light” when used as descriptors of modified risk unless expressly authorized by the FDA. On March 30, 2012 the FDA issued draft guidance on preparing and submitting applications for modified risk tobacco products pursuant to the FSPTCA.

On August 27, 2015, the FDA sent a warning letter to Reynolds American’s subsidiary Santa Fe Natural Tobacco Company, claiming that its use of the terms “Natural” and “Additive Free” in the product labeling and advertising for Natural American Spirit cigarettes violates the modified risk tobacco products provision of the FSPTCA. The FDA stated that in order for such terms to be used, these cigarettes must have an FDA modified-risk tobacco product order, which requires scientific evidence in order to legally make those claims. Following discussions between the parties, on January 23, 2017 the FDA and Santa Fe Natural Tobacco Company reached an agreement whereby, among other things, Santa

Fe Natural Tobacco Company committed to phasing out use of the terms “Natural” and “Additive Free” from product labeling and advertising for Natural American Spirit cigarettes on an established timeframe, but it may continue to use the term “Natural” in the Natural American Spirit brand name and trademarks.

In July 2016, the Department of Justice, on behalf of the FDA, informed Altria’s subsidiary John Middleton Co. (“**Middleton**”) that the FDA does not intend to bring an enforcement action against Middleton for the use of the term “mild” in the trademark “Black & Mild” (Middleton’s principal cigar brand), according to Altria’s Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

Product Constituents and Product Standards. On March 30, 2012 the FDA issued draft guidance on the reporting of harmful and potentially harmful constituents in tobacco products and tobacco smoke pursuant to the FSPTCA. In January 2017, the FDA proposed a product standard for N-nitrosornicotine (NNN) levels in finished smokeless tobacco products, and according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, the FDA extended the comment period in March 2017 and acknowledged what it described as a typographical error in a formula it used in documentation supporting the proposed rule.

Regulatory Plan for Tobacco and Nicotine. On July 28, 2017, the FDA announced its intent to develop a comprehensive plan for tobacco and nicotine regulation that recognizes the continuum of risk for nicotine delivery. The FDA reported that it plans to publish an Advance Notice of Proposed Rulemaking (“**ANPRM**”) to seek public input regarding the potential health benefits and possible adverse effects of lowering the level of nicotine in cigarettes. As part of the comprehensive plan, the FDA also announced its intent to issue ANPRMs requesting public stakeholder input on the impact of flavors (including menthol) in increased initiation among youth and young adults as well as assisting adult smokers to switch to potentially less harmful forms of nicotine delivery. The FDA also noted its plans to develop product standards to protect against known public health risks such as issues with electronic nicotine delivery systems batteries and concerns about children’s exposure to liquid nicotine. The FDA also reported that it plans to develop foundational regulations to provide clarity and predictability to the tobacco product submission process, to include regulations outlining the information that the FDA expects to be provided in PMTAs, Modified Risk Tobacco Product applications, and substantial equivalence reports, as well as finalized guidance on PMTA reviews (including how the FDA intends to review new product applications for e-cigarettes and other vapor products). The FDA did not provide a timeline for publication for the ANPRM documents or the commencement of regulatory activities related to the comprehensive nicotine policy.

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.

As noted above, the FSPTCA imposes “user fees” on tobacco product manufacturers and importers to pay for the cost of regulation and other matters. The quarterly fees are allocated first among tobacco product categories subject to FDA regulation and then among manufacturers and importers within certain categories based on their market share. The fees are also subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the FDA has a number of investigatory and enforcement tools available as discussed herein under “*Federal Regulation*.” Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 that compliance with the FSPTCA’s regulatory requirements has resulted and will continue to result in additional costs and that although the amount of additional compliance and related costs has not been material in any given quarter or year to date period, such compliance could become material, either individually or in the aggregate, to one or more of its tobacco subsidiaries.

FSPTCA Litigation

Tobacco manufacturers have filed suit regarding certain provisions of the FSPTCA and actions taken thereunder. In August 2009, a group of tobacco manufacturers (including Reynolds Tobacco and Lorillard) and a tobacco retailer filed a complaint against the U.S. government in the U.S. 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 U.S. 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 plaintiff manufacturers on the unconstitutionality of the FSPTCA’s restriction of tobacco advertising to black and white text. 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. On April 22, 2013, the U.S. Supreme Court denied plaintiffs’ petition for certiorari. The government had not appealed the portion of the Court of Appeals ruling that affirmed the unconstitutionality of the FSPTCA’s restriction of tobacco advertising to black and white text.

In a separate lawsuit that challenged the constitutionality of the FDA regulation that restricts tobacco manufacturers from using the trade or brand name of a non-tobacco product on cigarettes or smokeless tobacco products, the case was dismissed without prejudice pursuant to a stipulation by which the FDA agreed not to enforce the current or any amended trade name rule against plaintiffs until at least 180 days after rulemaking on the amended rule concludes. This relief only applies to plaintiffs in the case. However, in May 2010, the FDA issued guidance on the use of non-tobacco trade and brand names applicable to all cigarette and smokeless tobacco product manufacturers. This guidance indicated the FDA's intention not to commence enforcement actions under the regulation while it considers how to address the concerns raised by various manufacturers. In November 2011, the FDA proposed an amended rule, but has not yet issued a final rule, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

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 believed these members were 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 challenged 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. On July 21, 2014, the U.S. District Court for the District of Columbia 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 FDA appealed the district court's decision to the U.S. Court of Appeals for the District of Columbia in September 2014. On March 5, 2015, the FDA announced the resignation or termination of four members from the TPSAC and the addition of three members to the TPSAC, in response to the district court's order to reconstitute the committee. The FDA also announced that it would work expeditiously to fill the remaining vacancy. On January 15, 2016, the appellate court reversed the decision of the district court, finding that the plaintiffs did not have standing to challenge appointments of certain TPSAC members. Under the appellate court's order, the three former committee members can serve once again on the TPSAC and the FDA can rely on the TPSAC menthol report. On February 26, 2016, the plaintiff tobacco manufacturers filed a petition for a rehearing en banc, which was denied in May 2016.

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) 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 Administrative Procedure Act (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.” 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 a *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 and would propose a new graphic warnings rule in the future. The FDA has not provided a timeline for a new rule. In October 2016, several public health groups filed suit in federal court to force the FDA to issue final rules requiring graphic warnings on cigarette packs and advertising.

In 2015, cigarette manufacturers filed a lawsuit in the federal district court for the District of Columbia challenging the FDA’s draft guidance that had announced that certain label changes and changes to the quantity of tobacco products in a package would each require submission of substantial equivalence reports and authorization from the FDA prior to marketing tobacco products with such changes. In August 2016, the court held that a modification to an existing product’s label does not result in a “new tobacco product” and therefore such a label change does not give rise to the substantial equivalence review process, but the court upheld the guidance document’s treatment of product quantity changes as modifications that give rise to a “new tobacco product” requiring substantial equivalence review. The parties did not appeal this decision, concluding the litigation.

Surgeon General Reports

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. Furthermore, there are various Surgeon General's warnings that are required on cigarette packages and advertisements.

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." In 2012, the Surgeon General released a report on preventing tobacco use among youth and young adults, and on January 17, 2014, the Surgeon General released a report on the health consequences of smoking, contending 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.

In December 2016, the Surgeon General issued a report on e-cigarettes, raising public health concerns regarding the use of e-cigarettes by U.S. youth and young adults. The report recommended that state, local, tribal, and territorial governments implement additional laws and regulations to address e-cigarette use among youth and young adults, including: incorporating e-cigarettes into existing smoke-free policies; preventing youth access to e-cigarettes through various restrictions on sales of e-cigarettes to minors (including age verification requirements, prohibitions against self-service displays, and active enforcement of existing laws); implementing taxation and other price policies for e-cigarettes; increasing regulation of e-cigarette marketing by expanding evidence and facilitating the development of constitutionally feasible restrictions on such marketing; and targeting youth and young adults with educational initiatives on e-cigarettes and their potential for nicotine addiction and adverse health consequences. The report also calls for expanded federal funding of e-cigarette research efforts, including research on health risks and the impact of governmental policies on initiation and use patterns for e-cigarettes and other tobacco products, and recommends continued surveillance of e-cigarette marketing to assess the link between exposure to e-cigarette marketing and use of these products.

Other Federal Action

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 approximately 60,000 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 targeting 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 "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, subsequent campaigns will target young adults aged 18-24 years and people who influence teens, including parents, family members and peers. The FDA reported that the “Real Cost” campaign prevented nearly 350,000 youth aged 11 to 18 nationwide from smoking.

In March 2012, the CDC announced its first national anti-tobacco effort entitled “Tips From Former Smokers” (TIPS) which features graphic advertisements intended to shock smokers into quitting with stories of people damaged by tobacco products. The initial campaign’s goal was to convince 500,000 people to try quitting smoking and 50,000 to quit long-term, and the CDC reported that as a result of the 2012 campaign an estimated 1.6 million smokers attempted to quit smoking and more than 200,000 Americans had quit smoking immediately following the campaign, of which researchers estimated that more than 100,000 would likely quit smoking permanently, according to the CDC. The TIPS advertising campaign was subsequently renewed in March of 2013, July of 2014 and March of 2015 with new advertisements showing in stark terms the negative health effects of smoking. The CDC announced the launch of another graphic anti-smoking campaign beginning in January 2016, to run for 20 weeks on television, radio, billboards online and in magazines and newspapers. The CDC has reported that the TIPS program helped prompt millions of smokers to try to quit since it began in 2012. Annual budgets of the CDC have consistently included funds for tobacco prevention and control, including in order to continue the national tobacco education campaigns that are meant to raise awareness about the health effects of tobacco use and prompt smokers to quit.

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 making a concerted effort to reduce smoking among its members, and in June 2014 it formed an advisory committee to explore avenues for a reduction in smoking. 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. 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.

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. 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.

All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2017 ranged from \$0.17 per pack in Missouri to \$4.35 per pack in New York, according to the Campaign for Tobacco-Free Kids. Since January 1, 2002, 47 states and the District of Columbia have raised their cigarette taxes, many of them more than once, according to the American Lung Association's Tobacco Policy Project/State Legislated Actions on Tobacco Issues ("SLATI"). 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 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. During 2013, Massachusetts, Minnesota, Oregon and Puerto Rico had enacted legislation to increase their cigarette taxes. In particular, 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. New Hampshire's cigarette tax also increased by \$0.10 on August 1, 2013 due to legislation enacted in 2011. Vermont enacted a cigarette excise tax increase in 2014. During 2015, Alabama, Nevada, Kansas, Vermont, Louisiana, Ohio, Rhode Island and Connecticut enacted legislation to increase their cigarette excise taxes. During 2016, Louisiana, Pennsylvania, West Virginia and California enacted legislation to increase cigarette excise taxes. In particular, in California, a \$2.00 per pack increase in that state's cigarette excise tax (in addition to that state's then current \$0.87 per pack excise tax) was passed by voters on November 8, 2016, effective April 1, 2017. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, Rhode Island, Delaware, Oklahoma and Puerto Rico enacted cigarette excise tax increases in 2017, although in August 2017 the Oklahoma Supreme Court found that Oklahoma's tobacco tax increase, labeled as a "smoking cessation fee," was unconstitutional because the legislature failed to abide by the state's procedures for passing a tax measure.

In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold such as New York City, Philadelphia and Chicago. In November 2013, New York City passed an ordinance that set a minimum price of \$10.50 for every pack of cigarettes sold in New York City, and in August 2017 New York City raised the price of a pack of cigarettes to \$13, effective June 1, 2018. Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 that between the end of 1998 (the year in which the MSA was executed) and October 23, 2017, the weighted-average state and certain local cigarette excise taxes increased from \$0.36 to \$1.75 per pack. It is expected that states and local governments will continue to raise excise taxes on cigarettes in future years.

All 50 states and the District of Columbia subject smokeless tobacco to excise taxes. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, a majority of states currently tax smokeless tobacco products using an ad valorem method, which is calculated as a percentage of the price of the product, typically the wholesale price. As of October 23, 2017, the federal government, 23 states, Puerto Rico, Philadelphia, Pennsylvania and Cook County, Illinois have adopted a weight-based tax methodology for smokeless tobacco, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. According to SLATI, six states (Kansas, Louisiana, Minnesota, North Carolina, Pennsylvania and West Virginia) and the District of Columbia have established separate taxes on electronic cigarettes and/or vapor products—Kansas, Louisiana, North Carolina and West Virginia tax by weight of the e-cigarette liquid used in the product, while Minnesota, Pennsylvania and the District of Columbia tax by the percentage of the wholesale price of the product.

According to the Campaign for Tobacco-Free Kids, six states have special taxes or fees on brands of manufacturers not participating in the State Settlement Agreements: Alaska, Michigan, Minnesota, Mississippi, Texas and Utah. Texas's tax took effect on September 1, 2013, but 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, and enjoined Texas from collecting or assessing the tax. The State of Texas filed its petition for review with the Texas Supreme Court in October 2014, and on April 1, 2016, the Texas Supreme Court reversed the Texas Court of Appeals and ruled that the Texas equity fee legislation does not violate the Texas Constitution and remanded the case back to the Texas Court of Appeals for that court to consider the non-settling manufacturers' remaining challenges to the legislation. On March 24, 2017, the Texas Court of Appeals granted Texas' motion for summary judgment, ruling that the tax does not violate the equal protection and due process clauses of the U.S. Constitution.

In 2005, Minnesota enacted a 75-cent "health impact fee" on tobacco manufacturers for each pack of cigarettes sold, in order 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 (and in February 2007, the U.S. Supreme Court denied Philip Morris's petition for writ of certiorari). In 2013, however, the Minnesota legislature repealed the health impact fee (the bill cited the contemporaneous increase in the cigarette excise tax as offsetting the repeal of the health impact fee).

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.

Minimum Age to Possess or Purchase Tobacco Products

All states and the District of Columbia have enacted laws generally prohibiting the sale of tobacco products to individuals under the age of 18. Several jurisdictions have recently passed legislation, and other jurisdictions are considering proposals, to raise the minimum age for the purchase of tobacco products. The minimum age to purchase tobacco products rose to 21 in the State of Hawaii effective as of January 1, 2016 (the first state to do so), and subsequently, California (effective June

2016), New Jersey (July 2017 legislation, effective November 2017), Maine (August 2017 legislation, effective July 2018) and Oregon (August 2017 legislation, effective January 2018) have raised the minimum age to purchase tobacco products to 21. According to the Campaign for Tobacco-Free Kids, at least 270 localities have raised the tobacco age to 21, including New York City, Chicago, Boston, Cleveland, and both Kansas Cities. According to the Tobacco Consumption Report, proposals to raise the minimum age to 21 have been introduced in at least twenty-four states. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, the minimum age in Alabama, Alaska and Utah is 19. On March 12, 2015, the Institute of Medicine of the National Academy of Sciences released a report recommending that the minimum age of legal access to tobacco products be raised to 21. The report concluded that raising the minimum legal age to 21 would likely decrease smoking prevalence by 12% among today's teenagers when they become adults. In November 2017, U.S. Congresswoman Diana DeGette introduced the Tobacco to 21 Act (H.R. 4273), a bicameral legislation that would prohibit the sale of tobacco products to anyone under age 21.

The enactment of “minimum age” laws with respect to the sale of tobacco products is one of the factors that has led to decreasing smoking prevalence among teenagers. The CDC's Youth Risk Behavior Surveillance System found that the number of high school students who had smoked a cigarette in the previous month had dropped to 10.8% in 2015, from 15.7% in 2013, 18.1% in 2011, 21.9% in 2003 and 36.4% in 1997.

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, six states currently require some form of tobacco product disclosure information, including, for example, requiring tobacco manufacturers to disclose any added constituent of tobacco products other than tobacco, water and reconstituted tobacco sheet made wholly from tobacco (Massachusetts and Texas); requiring disclosure of the nicotine yield for each brand of cigarettes (Massachusetts, Texas and Utah); and requiring tobacco manufacturers to disclose the presence of ammonia, any compound of ammonia, arsenic, cadmium, formaldehyde or lead in their unburned or burned states (Minnesota and Utah).

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.

In July 2007, the State of Maine became the first state to enact a statute that prohibits the sale of cigarettes and cigars that have a characterizing flavor. The legislation defines characterizing flavor as “a distinguishable taste or aroma that is imparted to tobacco or tobacco smoke either prior to or during consumption, other than a taste or aroma from tobacco, menthol, clove, coffee, nuts or peppers.” In 2008 New Jersey passed similar legislation prohibiting the sale of cigarettes that have a characterizing flavor (other than the flavors of tobacco, clove or menthol). Numerous counties and municipalities have since adopted laws prohibiting or restricting the sale of certain tobacco products containing “characterizing flavors.” The scope of these laws varies from jurisdiction to jurisdiction; for example, some, but not all, of these laws exempt menthol from the definition of a “characterizing flavor,” and certain laws apply to tobacco products other than cigarettes. The “characterizing flavor” ordinances in New York City and Providence, Rhode Island were each challenged on the grounds, among others, that the FSPTCA preempts such local laws. The U.S. Courts of Appeals for the Second Circuit and First Circuit have held that the FSPTCA does not preempt the New York City and Providence, Rhode Island ordinances, respectively. In June 2017, San Francisco amended its city health code to prohibit tobacco retailers from selling flavored tobacco products, including flavored e-cigarettes and menthol cigarettes, effective April 1, 2018.

According to ANRF, as of October 2, 2017, 41 states and territories have laws that require either 100% smoke-free non-hospitality workplaces or restaurants or bars (and only 14 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, 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 October 2, 2017, 27 states and territories have laws that require 100% smoke-free non-hospitality workplaces and restaurants and bars: Arizona, California, 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. Most states without a statewide smoking ban have some local municipalities that have enacted smoking regulations. As of October 2, 2017, there were 1,415 municipalities with local laws that require 100% smoke-free non-hospitality workplaces or restaurants or bars, of which 931 municipalities (including the District of Columbia) have local laws that require 100% smoke-free non-hospitality workplaces and restaurants and bars. In addition, according to ANRF, as of October 2, 2017, there are at least 782 state-regulated gambling facilities that are required to be 100% smokefree indoors, and there are at least 619 smokefree airports. It is expected that restrictions on indoor smoking will continue to proliferate.

Smoking bans have also extended outdoors. For example, according to ANRF, as of October 2, 2017:

- Puerto Rico prohibits smoking on beaches, Maine prohibits smoking on beaches in its state parks, and 317 municipalities specified that all city beaches and/or specifically named city beaches are smoke-free;
- Oklahoma prohibits tobacco and e-cigarette use on all state lands and parks, Puerto Rico prohibits smoking in all parks, and 1,531 municipalities specified that all city parks and/or specifically named city parks are smoke-free; in addition, on March 31, 2016, New York’s highest court upheld a smoking ban in certain outdoor areas, state parks and historic sites;

- Hawaii, Maine, Michigan, Washington and Puerto Rico laws prohibit smoking in both outdoor dining areas and bar patios (while Iowa prohibits smoking only in outdoor dining areas), and 454 municipalities have enacted laws for 100% smoke-free outdoor dining, while 285 municipalities have enacted laws for 100% smoke-free outdoor dining areas and bar patios; and
- Iowa, New York, Wisconsin, Guam and the U.S. Virgin Islands prohibit smoking in outdoor public transit waiting areas, and there are 535 municipalities with smoke-free outdoor public transit waiting area laws.

Smoking bans have also been enacted for smaller governmental and private entities. According to the ANRF, as of October 2, 2017, there are at least 2,064 100% smoke-free university and college campuses, and of these, 1,736 have a 100% tobacco-free policy and 1,649 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 October 2, 2017, that four national hospitals, clinics, insurers and health service companies, and at least 4,016 local and/or state hospitals, healthcare systems and clinics have adopted 100% smokefree grounds policies; that in July 2013 New York State enacted a law requiring 100% smokefree grounds of general hospitals; in April 2016, Hawaii enacted a law requiring 100% tobacco- and e-cigarette-free grounds of state health facility properties; and that 44 municipalities have enacted laws specifically requiring 100% smokefree hospital grounds. In addition, ANRF reports as of October 2, 2017 that effective January 2015 the Federal Bureau of Prisons prohibits the smoking of tobacco in any form in and on the grounds of its institutions and offices, that correctional facilities in 21 states plus Puerto Rico are 100% smokefree indoors and outdoors, and that 28 other states ban smoking indoors in correctional facilities (but allow smoking in outdoor areas). ANRF reports that as of October 2, 2017, five states and 192 municipalities have laws requiring that all hotel and motel rooms be 100% smoke-free. Furthermore, ANRF reports as of October 2, 2017 that 61 municipalities restrict or prohibit smoking in private units of market-rate multi-unit housing (whether privately-owned or publicly-owned housing), and 530 municipalities have smokefree policies for publicly-owned multi-unit housing. The Department of Housing and Urban Development prohibits smoking in public housing residences nationwide under a federal rule effective February 3, 2017; public housing agencies have 18 months to put smoke-free policies into effect.

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 Tobacco Consumption 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 across the country and announced in 2013 a ban on smoking for all new tenants.

International Agreements

On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "FCTC"), whose objective is to establish a global agenda for tobacco regulation with the purpose of reducing

initiation of tobacco use and encouraging cessation. The FCTC entered into force in February 2005, and according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, as of October 23, 2017, 180 countries and the European Community have become party to the FCTC. The treaty recommends (and in certain instances, requires) signatory nations to enact legislation that would, among other things: establish specific actions to prevent youth tobacco product use; restrict or eliminate all tobacco product advertising, marketing, promotion and sponsorship; initiate public education campaigns to inform the public about the health consequences of tobacco consumption and exposure to tobacco smoke and the benefits of quitting; implement regulations imposing product testing, disclosure and performance standards; impose health warning requirements on packaging; adopt measures intended to combat tobacco product smuggling and counterfeit tobacco products, including tracking and tracing of tobacco products through the distribution chain; and restrict smoking in public places, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. 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, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

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 2017 Bonds payable from tobacco settlement payments made under the MSA.

Thousands of claims have been brought against the PMs in tobacco-related litigation. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, the following tobacco-related cases were pending against Altria and/or its subsidiary Philip Morris: 87 individual smoking and health cases (see “—Individual Smoking and Health Cases” below); 2,423 flight attendant cases (see “—Flight Attendant Cases” below); approximately 2,500 *Engle* Progeny cases in state court (involving approximately 3,200 state court plaintiffs) and approximately 12 *Engle* Progeny cases in federal court (see “—*Engle* Progeny Cases” below); 4 smoking and health class actions and aggregated claims cases, which number includes as one case the 600 civil actions (of which 344 were actions pending against Philip Morris) that were to be tried in West Virginia state court as a consolidated action (see “—West Virginia Individual Personal Injury Cases” below), and an additional 4 “Lights” class action cases (see “—Class Action Cases” below); and 1 health care cost recovery case (see “—Health Care Cost Recovery Cases” below). Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 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 \$490 million and interest totaling approximately \$184 million as of September 30, 2017.

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 and smoking cessation programs, among other damages.

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

Type of Case

Individual Smoking and Health Cases
Flight Attendant Cases
West Virginia Individual Personal Injury Cases
Engle Progeny Cases
Class Action Cases
Health Care Cost Recovery Cases

“Individual Smoking and Health Cases” are smoking and health cases brought by or on behalf of individual plaintiffs who allege personal injury caused by smoking cigarettes, by using smokeless tobacco products, by addiction to tobacco, or by exposure to environmental tobacco smoke (but this category of cases as described herein does not include the Flight Attendant Cases, West Virginia Cases or *Engle* Progeny Cases discussed below).

“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.

West Virginia Individual Personal Injury 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.

“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.

“Class Action Cases” are purported to be brought on behalf of large numbers of individuals for damages allegedly caused by smoking, including, among other categories, “lights” Class Action Cases.

“**Health Care Cost Recovery 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.

Individual Smoking and Health Cases

This category of cases includes smoking and health cases alleging personal injury that are brought by or on behalf of individual plaintiffs, but as described herein does not include the Flight Attendant Cases, West Virginia Cases or *Engle* Progeny Cases discussed below. An example of an Individual Smoking and Health Case pending during 2017 against Philip Morris is *Gentile*, in which, in October 2017, a jury in a Florida state court returned a verdict in favor of the plaintiff, awarding approximately \$7.1 million in compensatory damages and allocating 75% of the fault to Philip Morris (an amount of approximately \$5.3 million).

Flight Attendant Cases

The Flight Attendant Cases 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 in airplane cabins. The settlement agreement, among other things, permitted the plaintiff class members to file these individual suits. The settlement agreement bars class members from bringing aggregate claims, bars class members from obtaining punitive damages, and bars individual claims to the extent that they are based on fraud, misrepresentation, conspiracy to commit fraud or misrepresentation, RICO, suppression, concealment or any other alleged intentional or willful conduct. The defendant tobacco manufacturers agreed that, in any individual case brought by a class member, the defendant will bear the burden of proof with respect to whether environmental tobacco smoke can cause certain specifically enumerated diseases, referred to as “general causation.” With respect to all other issues relating to liability, including whether an individual plaintiff’s disease was caused by his or her exposure to environmental tobacco smoke in airplane cabins, referred to as “specific causation,” the individual plaintiff will have the burden of proof. On September 7, 1999, the Florida Supreme Court approved the settlement, and the individual Flight Attendant Cases arose out of such settlement. In October 2000, the *Broin* court entered an order applicable to all Flight Attendant Cases that the terms of the settlement agreement do not require the individual plaintiffs in the Flight Attendant Cases to prove the elements of strict liability, breach of warranty or negligence. Under the order, there is a rebuttable presumption in the plaintiffs’ favor on those elements, and the plaintiffs bear the burden of proving that their alleged adverse health effects actually were caused by exposure to environmental tobacco smoke in airplane cabins (specific causation). The period for filing Flight Attendant Cases expired in 2000 and no additional cases in this category may be filed.

West Virginia Cases

The West Virginia Cases began in 1999, in West Virginia state court, as a series of roughly 1,200 individual plaintiff cases making claims with respect to cigarettes manufactured by Philip Morris, Lorillard, Reynolds Tobacco and other manufacturers. The cases were consolidated for a Phase I trial on various defense conduct issues, to be followed in Phase II by individual trials of remaining claims to determine liability and compensatory damages. On May 15, 2013, the Phase I jury found that defendants’ cigarettes were not defectively designed; defendants’ cigarettes were not defective due to a failure to warn

before July 1, 1969; defendants were not negligent, did not breach warranties, and did not engage in conduct warranting punitive damages; and defendants' ventilated filter cigarettes manufactured and sold between 1964 and July 1, 1969 were defective for a failure to instruct. In November 2014, the West Virginia Supreme Court affirmed the verdict. On June 8, 2015, the U.S. Supreme Court denied the plaintiffs' petition for writ of certiorari. On the same date, the trial court issued an order finding that only 30 plaintiffs are alleged to have smoked ventilated filter cigarettes in the relevant period. On October 9, 2015, the trial court outlined the procedures it will follow for resolving the claims of the 30 Phase II plaintiffs, which claims will focus on whether plaintiffs blocked cigarette vents and, if so, whether blocking proximately caused their alleged injuries. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, the court intends to try the claims of these 30 plaintiffs in six consolidated trials, each with a group of five plaintiffs; the first trial is currently scheduled to begin May 1, 2018, and dates for the five remaining consolidated trials have not been scheduled. The parties have since agreed to resolve the cases for an immaterial amount and have so notified the court together with a motion that the court vacate the May trial date, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

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.

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.

In the wake of the Florida Supreme Court ruling, thousands of individuals filed separate lawsuits seeking to benefit from the *Engle* findings. According to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, as of October 23, 2017, 114 state and federal *Engle* Progeny Cases involving Philip Morris have resulted in verdicts since the Florida Supreme Court's *Engle* decision, 62 of which were returned in favor of plaintiffs, 45 of which were returned in favor of Philip Morris, 5 of which were initially returned in favor of plaintiffs but were reversed post-trial or on appeal and remain pending, and 2 of which were returned in favor of Philip Morris but were reversed for a new trial. In addition, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, as of October 23, 2017 approximately 2,500 state court cases were pending against Philip Morris or Altria asserting individual claims by or on behalf of approximately 3,200 state court plaintiffs, and approximately 12 cases were pending against Philip Morris in federal court representing the federal cases excluded from the settlement agreement discussed below.

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.

In February 2015, Philip Morris, Reynolds Tobacco and Lorillard settled virtually all of the *Engle* Progeny Cases then pending against them in federal district court. The total amount of the settlement of the federal *Engle* Progeny Cases was \$100 million, divided among Reynolds Tobacco (\$42.5 million), Philip Morris (\$42.5 million) and Lorillard (\$15 million), which shares of the settlement were paid into escrow in March 2015. The settlement, which received final approval from the court on November 6, 2015, covers more than 400 federal *Engle* Progeny Cases but does not cover certain federal *Engle* Progeny Cases previously tried to verdict and pending on post-trial motions or appeal, or filed by different lawyers from the ones who negotiated the settlement for the plaintiffs. Also, certain state court cases were removed from state to federal court, which were not part of the settlement, and were all remanded back to state court.

At the beginning of the *Engle* Progeny Cases litigation, a central issue was the proper use of the preserved *Engle* findings. The tobacco manufacturers had argued that use of the *Engle* findings to establish individual elements of progeny claims (such as defect, negligence and concealment) was a violation of federal due process, but in 2013, both the Florida Supreme Court (in the *Douglas* case) and the Eleventh Circuit (in the *Duke* and *Walker* cases) rejected that argument, and the U.S. Supreme Court denied the tobacco manufacturers' petitions for writ of certiorari in all of those cases. As noted below, the Eleventh Circuit, sitting en banc, recently heard argument on this issue again.

In addition to the global due process argument, the tobacco manufacturers raise many other factual and legal defenses as appropriate in each case, including, among other things, arguing that the plaintiff is not a proper member of the *Engle* class, that the plaintiff did not rely on any statements by any tobacco company, that the trial was conducted unfairly, that some or all claims are preempted or barred by applicable statutes of limitation, or that any injury was caused by the smoker's own conduct. In *Hess v. Philip Morris USA Inc.* and *Russo v. Philip Morris USA Inc.*, decided on April 2, 2015, the Florida Supreme Court held that, in *Engle* Progeny Cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On April 8, 2015, in *Graham v. R. J. Reynolds Tobacco Co.*, the Eleventh Circuit held that federal law impliedly preempts use of the preserved *Engle* findings to establish claims for strict liability or negligence. On January 21, 2016, the Eleventh Circuit granted the plaintiff's motion for rehearing en banc and vacated the panel decision. On May 18, 2017, the en banc Eleventh Circuit rejected Reynolds Tobacco's due process and implied preemption arguments, holding that giving preclusive effect to the findings of negligence and strict liability by the *Engle* jury in individual *Engle* Progeny Case actions against the tobacco companies is not preempted by federal tobacco laws and does not deprive the tobacco companies of due process, and the Eleventh Circuit affirmed the final judgment entered in the plaintiff's favor. In September 2017, the defendants filed a petition for writ of certiorari with the U.S. Supreme Court on due process and federal preemption grounds, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. On January 6, 2016, in *Marotta v. R. J. Reynolds Tobacco Co.*, the Florida Fourth District Court of Appeal also disagreed with the 2015 *Graham* panel decision and held that federal law does not impliedly preempt any tort claims against cigarette manufacturers, including those of plaintiffs in *Engle* Progeny Cases. The Florida Supreme Court accepted jurisdiction in *Marotta*, and on April 6, 2017 affirmed the ruling of the Florida

Fourth District Court of Appeal and found that federal law does not preempt the *Engle* Progeny Case plaintiff's claims, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

In addition, in *Searcy*, an *Engle* Progeny Case against Philip Morris and Reynolds Tobacco on appeal to the Eleventh Circuit, defendants argued that application of the *Engle* findings to the *Engle* progeny plaintiffs' concealment and conspiracy claims violated defendants' due process rights; the appeal is pending, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. In *Soffer*, an *Engle* Progeny Case against Reynolds Tobacco, the Florida First District Court of Appeal held that *Engle* progeny plaintiffs can recover punitive damages only on their intentional tort claims; the Florida Supreme Court accepted jurisdiction over plaintiff's appeal from the Florida First District Court of Appeal's decision and, in March 2016, held that *Engle* progeny plaintiffs can recover punitive damages in connection with all of their claims, and the plaintiffs now generally seek punitive damages in connection with all of their claims in *Engle* Progeny Cases, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. In *Ciccione*, an *Engle* Progeny Case against Reynolds Tobacco, the Florida Fourth District Court of Appeal held that *Engle* progeny plaintiffs could establish class membership by showing that they developed symptoms during the *Engle* class period that could, in hindsight, be attributed to their smoking-related disease. The court certified a conflict with *Castleman*, a Florida First District Court of Appeal decision, which held that manifestation requires *Engle* progeny plaintiffs to have been aware during the class period that they had a disease caused by smoking in order to establish class membership. The Florida Supreme Court accepted jurisdiction in the *Ciccione* case and, in March 2016, ruled in favor of the plaintiff, approving the Fourth District Court of Appeal's definition, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. In *Schoeff*, an *Engle* Progeny Case against Reynolds Tobacco, the Florida Fourth District Court of Appeal held that comparative fault findings should apply to reduce all compensatory damage awards, including awards based on intentional fraud claims. The Florida Supreme Court accepted jurisdiction over the plaintiff's appeal of the Florida Fourth District Court of Appeal's decision, and oral argument was held in March 2017, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

In one of the pending *Engle* Progeny Cases in which each of Philip Morris, Reynolds Tobacco and Lorillard 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. On January 6, 2016, the Florida Fourth District Court of Appeal reversed the fraudulent concealment and conspiracy claims, reversed the punitive damages award, and remanded the case for a new trial on those issues. On September 23, 2016, the Fourth District Court of Appeal, sitting en banc, reversed the judgment in its entirety and remanded the case for a new trial. In October 2016, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court, which the court denied in March 2017, and in June 2017 the plaintiff filed a petition for writ of certiorari with the United States Supreme Court seeking review of the 2016 en banc ruling by the Florida Fourth District Court of Appeal, which the court denied in October 2017, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

In another pending *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. 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. On January 6, 2016, the Fourth District Court of Appeal reversed the trial court's decision and remanded the case to the trial court to conduct a juror interview. In April 2016, Philip Morris moved for a new trial following the juror interview, which the court denied, and in May 2016, Philip Morris filed a notice of appeal to the Fourth District Court of Appeal. In April 2017, the Fourth District Court of Appeal issued a per curiam decision affirming the trial court's judgment against Philip Morris. In September 2017, Philip Morris filed a petition for writ of certiorari with the United States Supreme Court on due process and federal preemption grounds, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

In 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 \$16.9 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. The court entered partial judgment on the compensatory damages against Reynolds Tobacco in the amount of \$16.9 million on July 21, 2014. On January 27, 2015 the court denied the defendant's post-trial motions, but granted the defendant's motion for remittitur of the punitive damages award. The punitive damages award was remitted to approximately \$16.9 million. In February 2015, Reynolds Tobacco filed an objection to the remitted award of punitive damages and a demand for a new trial on damages. The court granted a new trial on the amount of punitive damages only. The new trial on punitive damages has been stayed pending Reynolds Tobacco's appeal to the First District Court of Appeal of the partial judgment of compensatory damages and of the order granting a new trial on the amount of punitive damages only. On February 24, 2017, the First District Court of Appeal reversed the judgment of the trial court and remanded the case for a new trial. On May 17, 2017, the First District Court of Appeal denied the plaintiff's motion for rehearing and the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on June 14, 2017. The Florida Supreme Court has not yet issued a ruling.

In yet another *Engle Progeny Case*, *Purdo*, a jury returned a verdict in favor of the plaintiff and against Philip Morris and Reynolds Tobacco, awarding compensatory damages of \$21 million, and awarding \$6.25 million in punitive damages against each defendant. In May 2016, Philip Morris and Reynolds Tobacco filed various post-trial motions, including motions to set aside the verdict and for a new trial, all of which the court denied and entered final judgment in favor of plaintiff with a deduction for plaintiff's comparative fault. In June 2016, the defendants filed a notice of appeal to the Florida Fourth District Court of Appeal. In August 2017, the Florida Fourth District Court of Appeal affirmed the final judgment in favor of plaintiff, and in September 2017, the defendants petitioned the Florida Fourth District Court of Appeal for panel rehearing or for rehearing en banc, which the court denied in October 2017, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. In another *Engle Progeny Case*, *Kerrivan*, a jury returned a verdict against Philip Morris and Reynolds Tobacco, awarding the plaintiff \$15.8 million in compensatory damages and \$25.3 million in

punitive damages. The trial court entered final judgment without any deduction for plaintiff's comparative fault. In December 2014, the defendants filed various post-trial motions, including a renewed motion for judgment or for a new trial. In May 2015, the trial court deferred further briefing on the post-trial motions, and in June 2017, the trial court lifted the stay on the post-trial motions, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

Various *Engle* Progeny Cases in addition to the cases described herein are discussed in detail in the SEC filings of Altria, and a number of *Engle* Progeny Cases have been placed on courts' upcoming trial calendars. Trial schedules are subject to change.

In June 2009, Florida amended its existing bond cap statute by adding a \$200 million bond cap that applied to all *Engle* Progeny Cases in the aggregate. In May 2011, Florida removed the provision that would have allowed it to expire on December 31, 2012. The bond cap for any given individual *Engle* Progeny Case varies depending on the number of judgments in effect at a given time, but never exceeds \$5 million per case for appeals within the Florida state court system. The legislation, which became effective in June 2009 and 2011, applies to judgments entered after the original 2009 effective date. 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, and in August 2012 the Florida Supreme Court dismissed the appeal as moot because the defendant had satisfied the judgment and denied the plaintiffs' rehearing petition in October 2012. In another case in August 2013, the plaintiff filed a motion in the trial court to determine the sufficiency of the bond posted by defendants on the ground that the bond cap statute was unconstitutional, which was denied. In yet another case in April 2016, the District Court of Appeal held that the bond cap applies to the period between a Florida Supreme Court ruling and completion of United States Supreme Court writ of certiorari review. No federal court has yet addressed the constitutionality of the bond cap statute or the applicability of the bond cap to *Engle* Progeny Cases tried in federal court, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. The Florida legislature is considering legislation that would repeal the 2009 appeal bond cap statute, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

Class Action Cases

In 1996, the Fifth Circuit Court of Appeals in *Castano v. American Tobacco Co.* overturned the certification of a nation-wide class of persons whose claims related to alleged addiction to tobacco products, finding that the district court failed to properly assess variations in the governing state laws and whether common issues predominated over individual issues. Since the Fifth Circuit's ruling in *Castano*, plaintiffs have filed numerous putative smoking and health class action suits in various state and federal courts; in general, these cases purport to be brought on behalf of residents of a particular state or states, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. 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. Several categories of class action cases are discussed below.

"Lights" Class Action Cases. In "lights" Class Action Cases, plaintiffs generally allege that the tobacco manufacturers made false and misleading claims that "lights" cigarettes were lower in tar and nicotine and/or were less hazardous or less mutagenic than other cigarettes. These cases typically are filed pursuant to state consumer protection laws and related statutes.

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 by the Judicial Panel on Multidistrict Litigation ("JPMDL") with other federal cases in a multidistrict litigation proceeding. In June 2011, the plaintiffs voluntarily dismissed the *Good* case without prejudice after the district court denied plaintiffs' motion for class certification, concluding the litigation. The other multidistrict cases were either voluntarily dismissed or resolved in a manner favorable to Philip Morris, according to Altria's SEC filings.

As of October 23, 2017, 21 state courts in 22 "lights" Class Action Cases have refused to certify class actions, dismissed class action allegations, reversed prior class certification decisions or entered judgment in favor of Philip Morris, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017. State trial courts have certified classes against defendant tobacco manufacturers in several jurisdictions; over time, several such cases have been dismissed by the courts at the summary judgment stage, but one certified class action remains pending on appeal against Philip Morris, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

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 April 29, 2014, the Fifth District Appellate Court reinstated the \$10.1 billion 2003 verdict. In May 2014, Philip Morris filed a petition requesting the Illinois Supreme Court to direct the Fifth Judicial District to vacate its April 2014 judgment and to order the Fifth Judicial District to affirm the trial court's denial of the plaintiff's petition for relief from the judgment, or in the alternative, grant its petition for leave to appeal. On September 24, 2014, the Illinois Supreme Court agreed to hear Philip Morris's appeal. In November 2015, the Illinois Supreme Court vacated the judgments of the lower courts and dismissed the case without prejudice to allow the plaintiffs to file a motion to recall the mandate. The plaintiffs filed a motion to recall the mandate or for other appropriate relief in the Illinois Supreme Court, which was denied on January 11, 2016. In January 2016 plaintiffs filed a petition for writ of certiorari with the United States Supreme Court on the question of whether one of the Illinois Supreme Court justices should have recused himself, and in June 2016 the U.S. Supreme Court denied plaintiffs' petition for writ of certiorari, concluding the litigation.

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.) Plaintiffs sought nearly \$2 billion in damages. 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. In January 2014, the trial court reversed its prior ruling granting partial summary judgment against plaintiffs’ “more dangerous” claim and allowed plaintiffs to pursue that claim. In October 2014, Philip Morris filed motions to decertify the class and for partial summary judgment on the plaintiffs’ “more dangerous” claim, which the court denied in June 2015. Upon retrial, in April 2016, the jury returned a verdict in favor of Philip Morris, and in May 2016, plaintiffs filed a motion for a new trial, which Philip Morris opposed in June 2016. In August 2016, the trial court denied the plaintiffs’ motion for a new trial, the plaintiffs filed a notice of appeal and Philip Morris cross-appealed, and in November 2016 the court of appeals dismissed Philip Morris’s cross-appeal without prejudice upon joint motion of the parties. Oral argument at the Missouri Court of Appeals occurred August 8, 2017, according to Altria’s Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

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. In February 2015, the Arkansas Supreme Court affirmed the trial court’s class certification order. In May 2015, Philip Morris filed a motion for partial summary judgment seeking to foreclose any recovery for cigarette purchases prior to 1999, when a private right of action was added to the consumer protection statute under which plaintiffs are suing. The trial court denied the motion in July 2015. In June 2016, the trial court granted Philip Morris’s motion for partial summary judgment to limit any damages claimed by the plaintiffs’ class to purchases made prior to May 2003. In July 2016, the parties agreed to settle all claims for \$45 million, the trial court granted final approval of the settlement in November 2016, and Philip Morris paid \$45 million to the plaintiffs’ escrow agent in December 2016, concluding the litigation, according to Altria’s Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017.

Other Class Action Cases. Other categories of class action cases include, among others, (i) medical monitoring class action cases, wherein plaintiffs seek to recover the cost for, or otherwise the implementation of, court-supervised programs for ongoing medical monitoring providing members of the purported class low dose CT scanning in order to identify and diagnose lung cancer, and other relief such as court-supervised smoking cessation programs; (ii) e-cigarette class action cases, wherein plaintiffs seek damages, alleging that defendants made false and misleading claims that e-cigarettes are less hazardous than other cigarette products or failed to disclose that e-cigarettes expose users to certain substances; and (iii) class action cases seeking damages related to Santa Fe Natural Tobacco Company’s allegedly deceptive use of the words “natural” and “additive-free” in the labeling, advertising, and promotional materials for Natural American Spirit brand cigarettes.

Health Care Cost Recovery Cases

Health Care Cost Recovery 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. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees. The claims asserted include the claim that cigarette manufacturers were “unjustly enriched” by plaintiffs’ payment of health care costs allegedly attributable to smoking, as well as claims of indemnity, negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under federal and state statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under federal and state anti-racketeering statutes.

According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017, although there have been some decisions to the contrary, most judicial decisions in the U.S. have dismissed all or most health care cost recovery claims against cigarette manufacturers; nine federal circuit courts of appeals and eight state appellate courts, relying primarily on grounds that plaintiffs’ claims were too remote, have ordered or affirmed dismissals of health care cost recovery actions, and the U.S. Supreme Court has refused to consider plaintiffs’ appeals from the cases decided by five circuit courts of appeals.

The DOJ Case. In 1999, in *United States v. Philip Morris USA Inc.*, the U.S. Department of Justice brought an action against various tobacco manufacturers in the U.S. District Court for the District of Columbia. The government initially sought to recover federal funds expended by the federal government in providing health care to smokers who developed diseases and injuries alleged to be smoking-related, based on several federal statutes. In addition, the government sought, pursuant to the civil provisions of RICO, disgorgement of profits the government contended were earned as a consequence of a RICO racketeering “enterprise.” In September 2000, the district court dismissed the government’s claims asserted under the Medical Care Recovery Act as well as those under the Medicare Secondary Payer provisions of the Social Security Act, but did not dismiss the RICO claims. In February 2005, the Circuit Court of Appeals for the District of Columbia ruled that disgorgement is not an available remedy in the case. The government’s petition for writ of certiorari with the U.S. Supreme Court was denied in October 2005. The non-jury, bench trial concluded in June 2005, and in August 2006, the U.S. District Court for the District of Columbia issued its final judgment and remedial order in favor of the government. The court determined 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 defendant tobacco manufacturers from engaging in any act of racketeering, as defined under RICO; from making any material false or deceptive statements concerning cigarettes; from making any express or implied statement about health on cigarette packaging or promotional materials (these prohibitions include a ban on using such descriptors as “low tar,” “light,” “ultra-light,” “mild” or “natural”); from making any statements that “low tar,” “light,” “ultra-light,” “mild” or “natural” or low-nicotine cigarettes may result in a reduced risk of disease; and from participating in the management or control of certain entities or their successors. The final judgment and remedial order also requires the defendants to make corrective statements on their websites, in certain media, in point-of-sale advertisements, and on cigarette package “inserts” (as described below). In addition, the final judgment and remedial order requires defendants to make disclosures of disaggregated marketing data to the government, and to make document disclosures on a website and in a physical depository, and also prohibits each defendant that manufactures cigarettes

from selling any of its cigarette brands or certain elements of its business unless certain conditions are met.

Following trial, the final judgment and remedial order was stayed because the defendants, the government and several intervenors noticed appeals to the Circuit Court of Appeals for the District of Columbia. In May 2009, a three judge panel upheld substantially all of the District Court's final judgment and remedial order. In September 2009, the Court of Appeals denied defendants' rehearing petitions as well as their motion to vacate those statements in the appellate ruling that address defendants' marketing of "low tar" or "lights" cigarettes, to vacate those parts of the trial court's judgment on that issue, and to remand the case with instructions to deny as moot the government's allegations and requested relief regarding "lights" cigarettes. In June 2010, the U.S. Supreme Court denied all of the petitions for review of the case. The case was returned to the trial court for implementation of the Court of Appeals' directions in its 2009 ruling and for entry of an amended final judgment. In March 2011, defendants filed a motion to vacate the court's factual findings and remedial order on alternative grounds, and on June 1, 2011, the trial court denied defendants' motion. Defendants filed a notice of appeal, and in July 2012 the appellate court affirmed the District Court's ruling, permitting the case to proceed. In response to the government's motion requesting clarification, the trial court held in April 2011 that the defendants must provide a broad range of data for the ten-year period beginning July 29, 2010, and that the Department of Justice may share that data with other governmental agencies, subject to the confidentiality requirements previously imposed by the trial court. The defendants noticed an appeal from this order to the U.S. Court of Appeals for the District of Columbia Circuit. In July 2012, the appellate court dismissed the appeal for lack of jurisdiction, and the defendants have not sought further review of that decision.

On November 27, 2012 the U.S. District Court for the District of Columbia issued an order specifying the text of the corrective statements that the defendants must make on their websites and through other media. The court ordered that the corrective statements include statements, among others, to the effect 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, which 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 and filed a joint motion for consent order. 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. In April 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. The consent order as revised by the parties provided 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 provided 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. In June 2014, U.S. District Court for the District of Columbia approved the April 2014 proposed consent order. However, the June 2014 consent order did not resolve outstanding issues as to whether corrective statements must be posted in retail point-of-sale displays, and this issue remains pending.

In May 2015, the U.S. Court of Appeals affirmed in part and reversed in part the consolidated appeal before it, and upheld the content of the corrective statements ordered by the district court in November 2012, but rejected the preamble to the statements (which had included a statement that the PMs deliberately deceived the American public). The Court of Appeals remanded the case to the trial court for further proceedings. In July 2015, the government filed a petition for panel rehearing, which the U.S. Court of Appeals denied in August 2015. In October 2015, the district court ordered further briefing on the content of the preamble to the statements and any implementation changes the parties propose.

On June 30, 2015, the district court held a status conference to discuss briefing and scheduling of future submissions in light of the Court of Appeals' decision on the corrective statement issue. On July 7, 2015, the U.S. Department of Justice filed a motion for rehearing with the Court of Appeals, which was denied on August 5, 2015. On August 20, 2015, the district court directed the parties to undertake mediation in order to attempt to reach agreement on the wording of the corrective-statements preamble. The parties were unable to reach agreement. On October 1, 2015, the district court held a status conference at which it ordered the parties to propose new corrective-statements preambles and brief their proposals in October and November 2015. The U.S. Department of Justice proposed a preamble that removed the reference to deliberate deception, and instead included only that a federal court has ordered the PMs to make such corrective statements. On February 8, 2016, the district court issued an order on the content of the corrective-statements preamble. In the order, the district court held that the preamble proposed by the Department of Justice remedied the concern of the Court of Appeals, and the district court adopted the corrective statements set forth in the order, with the preamble that the government had proposed. The court also ordered the parties to submit proposed changes to the consent order on the implementation details, which the parties jointly submitted and the court approved in April 2016. Also in April 2016, defendants filed a notice of appeal to the U.S. Court of Appeals for the District of Columbia Circuit on the content of the corrective communications, and in May 2016, defendants filed a notice of appeal of the consent order for the purpose of perfecting the appeal of the district court's February 2016 order on the content of the corrective communications. In April 2017, the U.S. Court of Appeals for the District of Columbia Circuit reversed in part the district court's decision on the content of the corrective communications, striking certain content (the statement "Here is the Truth") and remanding to the district court the decision on how to revise certain other content. In June 2017, the U.S. District Court for the District of Columbia issued an order adopting modified corrective statements, featuring a preamble to the effect that a federal court has ordered the OPMs to make the specified statements, and featuring statements regarding the adverse health effects of smoking, the addictiveness of smoking and nicotine, the lack of significant health benefit from smoking "low tar", "light", "ultra light", "mild" and "natural" cigarettes, the manipulation of cigarette design and composition to ensure optimum nicotine delivery, and the adverse health effects of exposure to second hand smoke.

In October 2017, the U.S. District Court for the District of Columbia approved the parties' consent order implementing the corrective statements remedy for newspapers and television. According to the October 2017 court order, beginning in November 2017, the OPMs will run court-mandated

announcements containing the agreed-upon corrective statements. Television announcements will be between 30 and 45 seconds long and will run in prime time five days a week for 52 weeks. Full-page print ads will appear in at least 45 newspapers and will run on five weekends spread over approximately four months, and will also appear on the newspapers' websites. The corrective statements will also appear on company-owned websites and in "onserts" affixed to cigarette packs, and the parties are in the process of finalizing the details for the company-owned websites and onserts. Altria stated in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2017 that in the second quarter of 2014, Altria and Philip Morris recorded provisions on each of their respective balance sheets totaling \$31 million for the estimated costs of implementing the corrective communications remedy, and that although this estimate is subject to change, Altria and Philip Morris do not expect any change to be material.

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 and electronic cigarettes, (f) ERISA claims, (g) antitrust claims and (h) employment litigation claims. Tobacco manufacturers are also subject to international litigation.

Defenses

The PMs have stated that they 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 the DOJ case, 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 type or extent of litigation that could be brought against PMs in the future cannot be predicted.

The foregoing discussion of civil litigation against the domestic tobacco industry is not exhaustive and is not based upon the examination or analysis by the Authority of the court records of the cases mentioned or of any other court records. It is based on SEC filings by Altria (as well as certain prior SEC filings of other OPMs) and on other publicly available information published by the OPMs or

others. Prospective purchasers of the Series 2017 Bonds are referred to such SEC filings and applicable court records for additional descriptions thereof.

Litigation is subject to many uncertainties, and it is not possible to predict the outcome of litigation or estimate the possible loss or range of loss to the tobacco manufacturers. Altria has stated in its SEC filings that damages claimed in some tobacco-related and other litigation are or can be significant and, in certain cases, have ranged in the billions of dollars. Altria has further stated in its SEC filings that it is possible that the consolidated results of operations, cash flows or financial position of itself or one or more of its subsidiaries could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. It can be expected that at any time and from time to time there will be developments in the litigation currently 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 2017 Bonds payable from tobacco settlement payments made by the PMs under the MSA.

SUMMARY OF THE TOBACCO CONSUMPTION REPORT

The following is a brief summary of the Tobacco Consumption Report, a copy of which is attached hereto as APPENDIX A. This summary does not purport to be complete and the Tobacco Consumption Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The Tobacco Consumption 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, the forecast 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 Tobacco Consumption 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 Tobacco Consumption Report and the variations may be material and adverse. No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2017 Bonds will be as assumed. See "RISK FACTORS" herein.

General

IHS Global Inc. ("**IHS Global**") has prepared a report dated December 20, 2017 on the consumption of cigarettes in the United States from 2017 through 2028 entitled, "*A Forecast of U.S. Cigarette Consumption (2017-2028) for the Railsplitter Tobacco Settlement Authority*" (the "**Tobacco Consumption Report**"). IHS Global provided the following description to the Authority for use in this Offering Circular: "IHS Global is an internationally recognized econometric and forecasting firm with over 600 economists located in more than 30 countries. IHS Global is a subsidiary of IHS Markit, Inc., a publicly traded company on the NASDAQ (NASDAQ: INFO). IHS Markit is a leading source of information, insight and advisory services in the areas of finance, economics, energy, chemicals, technology, transportation, healthcare, geopolitical risk, sustainability and supply chain management."

IHS Global has developed an econometric model of cigarette consumption in the United States based on historical United States data between 1965 and 2016, and what IHS Global describes as widely accepted economic principles and IHS Global's experience in building econometric forecasting models.

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 among underage youth, and qualitative variables that captured the impact of anti-smoking regulations, legislation, health warnings, and the availability of alternative tobacco and nicotine products. After determining which variables were effective in building this cigarette consumption model (including real cigarette prices, real per capita disposable personal income, the impact of workplace smoking restrictions, stricter restrictions on smoking in public places, 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 per capita cigarette consumption in the United States.

IHS Global's model, coupled with its long-term forecast of the United States economy, was then used to project total United States cigarette consumption from 2017 through 2028 (the "**Tobacco Consumption Forecast**"). The Tobacco Consumption Forecast indicates that the total consumption of cigarettes in the United States is projected to fall annually at a rate of 3.1% from 2017 through 2028, resulting in a forecast of total U.S. cigarette consumption in 2028 to be 177.3 billion cigarettes (a 31% decline from the 2016 level), as set forth in the Tobacco Consumption Report. According to IHS Global, the assumptions on which the Tobacco Consumption Forecast is based are reasonable.

Historical Cigarette Consumption

The U.S. Department of Agriculture, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco, Firearms and Explosives) grew from 2.5 billion 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, 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 MSA and the Previously Settled States Settlements. In 2000 and 2001, the rate of decline moderated, to 1.2%. Coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002 and 2003 to an average annual rate of 3.0%. The decline moderated for the next four years, through 2007, averaging 2.3%. The rate of decline accelerated dramatically in 2008 through 2010 (due to indoor smoking bans, recession and the increases in the federal and state excise taxes), before finally decelerating in 2011 and 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. In addition, some of the decline was due to a reduction in wholesale inventories late in the year, some of which was reversed in 2014. In 2015, cigarette shipment declines stopped, and manufacturers reported increased shipments for most of the year. Cigarette shipment decline resumed in 2016.

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. IHS Global's analysis includes a time trend variable in order to capture the impact of changing health trends and the effects of other such variables, which are difficult to quantify.

THE SALE AGREEMENT

The following describes certain terms of the Sale Agreement. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Sale Agreement. A copy of the Sale Agreement may be obtained upon written request to the Trustee.

Conveyance of Pledged Settlement Payments

Pursuant to the Sale Agreement, the State irrevocably sold and conveyed to the Authority, as of the date of issuance of the Series 2010 Bonds, without recourse (subject to certain continuing obligations in the Sale Agreement) in accordance with and subject to the terms of the Sale Agreement, all right, title and interest of the State on the date of issuance of the Series 2010 Bonds in and to the Pledged Settlement Payments. As consideration for such sale and conveyance of the Pledged Settlement Payments by the State to the Authority, the Authority promised to pay and otherwise conveyed to the State, without recourse, on the date of issuance of the Series 2010 Bonds, the proceeds (net of the Financing Costs) of the Series 2010 Bonds and the Residual Certificate in accordance with and subject to the terms of the Indenture and the Act.

In accordance with the Act, pursuant to the Sale Agreement, upon execution and delivery thereof, the sale and conveyance and other transfer of the right to receive the Pledged Settlement Payments shall for all purposes be a true sale and absolute conveyance of all right, title, and interest therein and not as a pledge or other security interest for any borrowing, valid, binding and enforceable in accordance with the terms of the Sale Agreement and the Indenture shall not be subject to disavowal, disaffirmance, cancellation, or avoidance by reason of insolvency of any party, lack of consideration, or any other fact, occurrence or rule of law.

Pursuant to the Sale Agreement, the right of the Authority to receive the Pledged Settlement Payments, on and after the date of issuance of the Series 2010 Bonds, is valid and enforceable, and during the period that Pledged Settlement Payments are payable to the Authority and pledged under the Indenture, the right of the Authority to receive the Pledged Settlement Payments is superior and prior to, the right and claim of the owner of the Residual Certificate to receive the Residual Revenues. Notwithstanding anything to the contrary in the Indenture or the Residual Certificate, the Trustee shall not make any deposits to the Residual Account unless and until the deposits required to be made by clauses (A)(i) through (vi) under "SECURITY FOR THE BONDS—Application of Pledged Revenues" have been paid in full.

From and after the date of issuance of the Series 2010 Bonds all Tobacco Assets required by the MSA to be made to the State shall be made to the Trustee in accordance with the provisions of the Indenture. In the event the State shall receive any payments or other funds constituting Tobacco Assets after the date of issuance of the Series 2010 Bonds, the State will promptly disburse the same to the Authority or the Trustee, as directed. Pursuant to the Sale Agreement, the State agreed to execute and deliver to the MSA Escrow Agent (and also addressed to the Independent Auditor), irrevocable instructions to make the payments constituting Tobacco Assets directly to the Authority or the Trustee. The Trustee shall immediately deposit such Tobacco Assets in the Tobacco Assets Account and, to the extent that a portion of the Tobacco Assets received by the Trustee consist of State's Unsold Assets, the Trustee shall promptly, but not later than five Business Days after receipt, transfer such State's Unsold Assets to, or at the order of, the State. Nothing in the Sale Agreement is intended to limit the rights of the

State to enforce the provisions of the Sale Agreement requiring the delivery of the Residual Certificate to the State Treasurer for deposit in the Tobacco Settlement Residual Account.

Pursuant to the Sale Agreement, the State shall cooperate with the Authority to the full extent permitted by law, including the Act and the MSA, to assure receipt by the Authority of all of the Tobacco Assets when and as due in accordance with the true intent and meaning of the Sale Agreement.

The provisions of the Sale Agreement are solely for the benefit of the State, the Authority, the owner of the Residual Certificate and other Beneficiaries and the Indenture is not intended for the benefit of and shall not be construed to create rights in any other parties. Nothing in the Sale Agreement, whether express or implied, shall be construed to give any entity any legal or equitable right, remedy or claim under or in respect of the Sale Agreement or any representations, covenants, conditions or provisions contained therein.

Representations of the State

The State, as seller, made the following representations in the Sale Agreement on which the Authority is deemed to have relied in acquiring the Pledged Settlement Payments. The representations speak as of the date of issuance of the Series 2010 Bonds, and survive the sale of the Pledged Settlement Payments to the Authority and the pledge thereof to the Trustee pursuant to the Indenture.

Power and Authority. The Governor is duly authorized by the Act to assign and sell the Pledged Settlement Payments on behalf of the State to the Authority. The State has full power and authority to execute and deliver the Sale Agreement and to carry out its terms; and the State has duly authorized such sale and assignment to the Authority by all necessary action; and the execution, delivery and performance of the Sale Agreement has been duly authorized by the State by all necessary action.

Binding Obligation. The Sale Agreement has been duly executed and delivered by the State and, assuming the due authorization, execution and delivery of the Sale Agreement by the Authority, constitutes a legal, valid and binding obligation of the State enforceable in accordance with its terms.

No Consents. No consent, approval, authorization, order, registration or qualification of or with any court or governmental agency or body is required for the consummation of the transactions contemplated by the Sale Agreement, except for those which have been obtained and are in full force and effect.

No Violation. The sale of the Pledged Settlement Payments and the consummation of the transactions contemplated by the Act and the Transaction Documents (the Sale Agreement, the Indenture and the bond purchase agreement for the Bonds) and the fulfillment of the terms thereof do not, to the State's knowledge, in any material way conflict with, result in any material breach by the State of any of the material terms and provisions of, nor constitute (with or without notice or lapse of time) a material default by the State under any indenture, agreement or other instrument to which the State is a party (including the MSA) or by which it shall be bound; nor violate any law or, to the State's knowledge, any order, rule or regulation applicable to the State of any court or of any federal or state regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the State.

No Proceedings. To the State's knowledge, except as disclosed in the offering circular for the Series 2010 Bonds or in a schedule delivered to the Authority, there are no proceedings or investigations pending against the State, before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the State: (i) asserting the invalidity of any of the Transaction Documents or the Bonds, (ii) seeking to prevent the issuance of the Bonds or the consummation of any of

the transactions contemplated by any of the Transaction Documents, or (iii) seeking any determination or ruling that would affect the validity or enforceability of any of the Transaction Documents, the Act, the Consent Decree, the MSA, the Qualifying Statute, the Complementary Legislation or the Bonds.

Title to Pledged Settlement Payments. The State is the sole owner of the Tobacco Assets. On and after the date of issuance of the Series 2010 Bonds (i) the State shall have no right, title or interest in or to the Pledged Settlement Payments and (ii) the Pledged Settlement Payments shall be the property of the Authority, and not of the State, and shall be owned, received, held and disbursed by the Authority, without appropriation, and not the State. Pursuant to the Sale Agreement, the Tobacco Assets shall be paid directly to the Trustee and the Trustee shall deposit the Tobacco Assets in the Tobacco Assets Account and shall promptly, and in no event later than five Business Days after receipt thereof, transfer the Pledged Settlement Payments in accordance with an Officer's Certificate delivered pursuant to the Indenture. State's Unsold Assets received by the Authority shall promptly, but not later than five Business Days after receipt, be transferred to, or at the order of, the State.

Absence of Liens on Pledged Settlement Payments. The State has not sold, transferred, assigned, set over or otherwise conveyed any right, title or interest of any kind whatsoever in all or any portion of the Pledged Settlement Payments, nor has the State created, or to its knowledge permitted the creation of, any Lien (as defined in the Sale Agreement) thereon. The State warranted in the Sale Agreement that the Pledged Settlement Payments are free and clear of Liens.

Assignment to Trustee. The State acknowledges in the Sale Agreement that the Authority will assign to the Trustee for the benefit of the Bondholders all of its rights and remedies with respect to the breach of any representations and warranties of the State under the Sale Agreement. Upon discovery by the State, or the Authority of a breach of any of the foregoing representations, warranties or covenants that materially and adversely affects the value of the Pledged Settlement Payments or the sale thereof to the Authority under the Sale Agreement, the party discovering such breach shall give prompt written notice to the other party and to the Trustee.

The State shall not be liable to the Trustee or the Bondholders for any loss, cost or expense resulting solely from the failure of the Trustee to promptly notify the State upon the discovery by a Responsible Officer of the Trustee of a breach of any representation, warranty or covenant contained in the Sale Agreement.

Covenants of the State

Protection of Title; Non-Impairment Covenant. Pursuant to the Act, the State pledges and agrees with the Authority under the Sale Agreement, and the Authority is authorized to include such pledge and agreement in the Indenture for the benefit of the owners of the Bonds, that the State shall (i) irrevocably direct, through the Attorney General, the Independent Auditor and the MSA Escrow Agent to transfer all Tobacco Assets directly to the Trustee as the assignee of the Authority, (ii) enforce its right to collect all moneys due from the PMs under the MSA, (iii) diligently enforce the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA against all nonparticipating manufacturers selling tobacco products in the State that are not in compliance with the Qualifying Statute, in each case in the manner and to the extent deemed necessary in the judgment of, and consistent with the discretion of, the Attorney General, provided, however, (A) that the remedies available to the Authority and the Bondholders for any breach of the pledges and agreements of the State set forth in this clause (iii) shall be limited to injunctive relief, and (B) that the State shall be deemed to have diligently enforced the Qualifying Statute so long as there has been no judicial determination by a court of competent jurisdiction in the State, in an action commenced by a PM under the MSA, that the State has failed to diligently enforce the Qualifying Statute for the purposes of section IX(d)(2)(B) of the MSA, (iv) neither amend the MSA nor the Consent Decree

or take any other action in any way that would materially adversely (A) impair the Authority's right to receive Pledged Settlement Payments, or (B) limit or alter the rights vested in the Authority to fulfill the terms of its agreements with the Bondholders, or (C) impair the rights and remedies of the Bondholders 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 proceedings by or on behalf of the Bondholders, are fully paid and discharged (provided, that nothing in the Act, the Sale Agreement or the Indenture shall be construed to preclude the State's regulation of smoking, smoking cessation activities and laws, and taxation and regulation of the sale of cigarettes or the like or to restrict the right of the State to amend, modify, repeal or otherwise alter statutes imposing or relating to the taxes), and (v) not amend, supersede or repeal the MSA or the Qualifying Statute, in any way that would materially adversely affect the amount of any payment to, or the rights to such payments of, the Authority or the Bondholders. Notwithstanding these pledges and agreements by the State, nothing in the Sale Agreement, in the Indenture, in the Bonds or in the Act shall be construed or interpreted to limit or impair the authority or discretion of the Attorney General to administer and enforce provisions of the MSA or to direct, control and settle any litigation or arbitration proceeding arising from or relating to the MSA.

Upon request of the Authority or the Trustee, the State will execute and deliver such further instruments and do such further acts as the parties reasonably agree are reasonably necessary or proper to carry out more effectively the purposes of the Sale Agreement.

Tax Covenant. The State shall at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Authority on Tax-Exempt Bonds shall be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Code; and no funds of the State shall at any time be used directly or indirectly to acquire securities, obligations or investment property the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code and any applicable regulations issued thereunder and in furtherance of such covenant shall execute and comply with the tax certificate provided by Transaction Counsel (as defined in the Sale Agreement).

MSA Escrow Agent. Simultaneously with the delivery of the Series 2010 Bonds and the purchase of the Pledged Settlement Payments, the State, acting through the Attorney General, shall notify the MSA Escrow Agent and the Independent Auditor that the Pledged Settlement Payments have been sold to the Authority and shall irrevocably instruct the MSA Escrow Agent that the Tobacco Assets are to be paid directly to the Trustee on behalf of the Authority. Should the State receive any such payments from the MSA Escrow Agent, it will immediately remit such payments to the Trustee. Additionally, the State Attorney General agrees to promptly (but in no event later than five Business Days after receipt of conclusive documentation from the Independent Auditor or the MSA Escrow Agent relating to the payment of Tobacco Assets) provide to the Authority and the Trustee a certificate which establishes what portion, if any, of Tobacco Assets received, or to be received, by the Trustee constitute State's Unsold Assets, Partial Lump Sum Payments or Lump Sum Payments and the related calculation of each such amount.

Covenants of the Authority

Further Actions. Upon request of the State or the Trustee, the Authority 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 Sale Agreement. The Authority shall, as soon as practicable, pay to the State any amounts due to the State that are received by the Authority in error.

Residual Revenues. As part of the consideration for the sale to the Authority by the State of the Pledged Settlement Payments, the Authority agreed to issue the Residual Certificate. In accordance with

the provisions of the Indenture, upon payment in full of the deposits required by clauses (A)(i) through (vi) under “SECURITY FOR THE BONDS—Application of Pledged Revenues”, the remaining balance of the Pledged Revenues shall be deposited as Residual Revenues in the Residual Account. In accordance with the Indenture, Residual Revenues on deposit in the Residual Account will be transferred promptly, (but in no event later than five Business Days after such deposit to the Residual Account) to the owner of the Residual Certificate. To the extent that the Trustee shall receive State’s Unsold Assets, the Trustee shall remit such State’s Unsold Assets to or upon the order of the State in accordance with the provisions of the Indenture.

Bonds Not Debt of State. Pursuant to the Act, neither any Bond nor any Related Contract of the Authority shall constitute an indebtedness or an obligation of the State or any subdivision thereof within the purview of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them but shall be payable solely from the Collateral. No owner of any Bond or provider of any Related Contract shall have the right to compel the exercise of the taxing power of the State to pay any principal installment of, redemption premium, if any, or interest on the Bonds or to make any payment due under any Related Contract.

Restriction on Bankruptcy. In accordance with the Act, the Authority shall have no authority to file a voluntary petition, under or become a debtor or bankrupt under, the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency, or moratorium law or statute as may, from time to time be in effect and neither any public officer nor any organization, entity, or other person shall authorize the Authority to become a debtor or bankrupt under the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency or moratorium law or statute, as may, from time to time be in effect.

Amendment

Except as otherwise provided in the Sale Agreement, after issuance of the Series 2010 Bonds, the Sale Agreement may be amended by the State and the Authority with the consent of the Trustee, but without the consent of any of the Bondholders: (a) to cure any ambiguity; (b) to correct or supplement any provisions in the Sale Agreement; (c) to correct or amplify the description of the Tobacco Assets or the Pledged Settlement Payments; (d) to add additional covenants for the benefit of the Authority; or (e) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Sale Agreement that shall not adversely affect in any material respect the Bonds.

Except as otherwise provided in the preceding paragraph, the Sale Agreement may also be amended from time to time by the State and the Authority with the consent of a Majority in Interest of the Bonds for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Sale Agreement or of modifying in any manner the rights of the Bondholders; but no such amendment shall reduce the aforesaid portion of the outstanding amount of the Bonds, the Holders of which are required to consent to any such amendment, without the consent of the Holders of all the Outstanding Bonds.

It shall not be necessary for the consent of Bondholders described above to approve the particular form of any proposed amendment or consent, but it shall be sufficient if such consent shall approve the substance thereof.

Prior to the execution of any amendment to the Sale Agreement, the holder of the Residual Certificate and the Trustee shall be entitled to receive and conclusively rely upon an Opinion of Counsel stating that the execution of such amendment is authorized or permitted by the Sale Agreement. Without the prior written consent of the holder of the Residual Certificate and the Trustee, which consent may be granted or withheld in such Person’s sole discretion, no amendment, supplement or other modification of

the Sale Agreement shall be entered into or be effective if such amendment, supplement or modification affects the holder of the Residual Certificate or the Trustee's, as applicable, own rights, duties or immunities under the Sale Agreement or otherwise.

THE RESIDUAL CERTIFICATE

The Residual Certificate represents the entitlement of the State to receive all amounts required to be distributed pursuant to the Indenture in respect of the Residual Certificate, including the Residual Revenues upon deposit in the Residual Account, which are any Pledged Settlement Payments received in any year in excess of the amounts required to pay, in accordance with the provisions of the Indenture, the Operating Expenses, debt service on Bonds, replenishment of the Debt Service Reserve Account and Junior Payments described in the Indenture.

CONTINUING DISCLOSURE UNDERTAKING

In order to assist the Underwriters in complying with the provisions of paragraph (b)(5) of Rule 15c2-12 (the "**Rule**"), promulgated by the SEC under the Securities Exchange Act of 1934, as amended (the "**1934 Act**") the Authority will execute a Continuing Disclosure Agreement for the benefit of the holders and beneficial owners of the Series 2017 Bonds (the "**Continuing Disclosure Undertaking**"), in substantially the form attached as APPENDIX E hereto. Pursuant to the Continuing Disclosure Undertaking, the Authority will provide, or cause to be provided, to the Municipal Securities Rulemaking Board (the "**MSRB**"), on its Electronic Municipal Market Access system ("**EMMA**"), certain annual financial information and operating data and, in a timely manner, notices of certain specified events (but in no event in excess of ten business days after the occurrence of the event).

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP ("**Bond Counsel**"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 2017 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "**Code**"). Bond Counsel is of the further opinion that interest on the Series 2017 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes. Bond Counsel expresses no opinion as to whether some or all interest on the Series 2017 Bonds is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel is of the further opinion that under existing statutes, interest on the Series 2017 Bonds is not exempt from State of Illinois taxes. A complete copy of the proposed form of opinion of Bond Counsel is set forth in APPENDIX C hereto.

To the extent the issue price of any maturity of the Series 2017 Bonds is less than the amount to be paid at maturity of such Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Series 2017 Bonds), the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each Beneficial Owner thereof, is treated as interest on the Series 2017 Bonds which is excluded from gross income for federal income tax purposes. For this purpose, the issue price of a particular maturity of the Series 2017 Bonds is the first price at which a substantial amount of such maturity of the Series 2017 Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the Series 2017 Bonds accrues daily over the term to maturity of such Series 2017 Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Series 2017 Bonds to determine taxable gain

or loss upon disposition (including sale, redemption, or payment on maturity) of such Series 2017 Bonds. Beneficial Owners of the Series 2017 Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Series 2017 Bonds with original issue discount, including the treatment of Beneficial Owners who do not purchase such Series 2017 Bonds in the original offering to the public at the first price at which a substantial amount of such Series 2017 Bonds is sold to the public.

Series 2017 Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) (“**Premium Bonds**”) will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner’s basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Series 2017 Bonds. The Authority has made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the Series 2017 Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Series 2017 Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Series 2017 Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel’s attention after the date of issuance of the Series 2017 Bonds may adversely affect the value of, or the tax status of interest on, the Series 2017 Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

Although Bond Counsel is of the opinion that interest on the Series 2017 Bonds is excluded from gross income for federal income tax purposes, the ownership or disposition of, or the accrual or receipt of amounts treated as interest on, the Series 2017 Bonds may otherwise affect a Beneficial Owner’s federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the Beneficial Owner or the Beneficial Owner’s other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Legislation has been passed by Congress but not yet signed by the President that repeals the corporate alternative minimum tax for taxable years beginning after December 31, 2017.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the Series 2017 Bonds to be subject, directly or indirectly, in whole or in part, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners from realizing the full current benefit of the tax status of such interest. The introduction or enactment of any such legislative proposals or clarification of the Code or court decisions may also affect, perhaps significantly, the market price for, or marketability of, the Series 2017 Bonds. Prospective purchasers of the Series 2017 Bonds should consult their own tax advisors regarding the potential impact of any pending or proposed federal or state tax legislation, regulations or litigation, as to which Bond Counsel is expected to express no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the Series 2017 Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the Authority, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Authority has covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the Series 2017 Bonds ends with the issuance of the Series 2017 Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the Authority or the Beneficial Owners regarding the tax-exempt status of the Series 2017 Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the Authority and their appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the Authority legitimately disagrees, may not be practicable. Any action of the IRS, including but not limited to selection of the Series 2017 Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the Series 2017 Bonds, and may cause the Authority or the Beneficial Owners to incur significant expense.

LITIGATION

There is no litigation pending in any court (either State or federal) to restrain or enjoin the issuance or delivery of the Series 2017 Bonds or questioning the creation, organization or existence of the Authority, the validity or enforceability of the Indenture, the sale of the Pledged Settlement Payments by the State to the Authority, the proceedings for the authorization, execution, authentication and delivery of the Series 2017 Bonds, or the validity of the Series 2017 Bonds.

RATINGS

It is expected that, upon issuance of the Series 2017 Bonds, S&P Global Ratings (together with its predecessor organizations, "S&P" or the "Rating Agency") will assign a rating of "A (sf)" to the Series 2017 Bonds maturing June 1, 2022 through June 1, 2027; and a rating of "A- (sf)" to the Series 2017 Bonds maturing June 1, 2028.

According to the S&P ratings guide, (a) the "sf" identifier shall be assigned to ratings on "structured finance instruments" when required to comply with applicable law or regulatory requirement or when S&P believes it appropriate, and (b) the addition of the "sf" identifier to a rating does not change that rating's definition or S&P's opinion about the issue's creditworthiness.

The ratings for the Series 2017 Bonds address only the likelihood that the Authority will pay the interest on and principal of the Series 2017 Bonds when due, and do not address the likelihood that principal may be paid at any faster rate. The ratings by the Rating Agency reflect only the views of such organization and any desired explanation of the significance of such ratings and any outlooks or other statements given by S&P with respect thereto should be obtained from S&P, at the following address: 55 Water Street, New York, New York 10041.

There is no assurance that the initial ratings assigned to the Series 2017 Bonds will continue for any given period of time or that any of such ratings will not be revised downward, suspended or withdrawn entirely by the Rating Agency. Any such downward revision, suspension or withdrawal of

such ratings may have an adverse effect on the availability of a market for or the market price of such Series 2017 Bonds.

LEGAL INVESTMENT

The Act provides that the State and all counties, cities, villages, incorporated towns and other municipal corporations, political subdivisions and public bodies, and public officers of any thereof, all banks, bankers, trust companies, savings banks and institutions, building and loan associations, savings and loan associations, investment companies, and other persons carrying on a banking business, all insurance companies, insurance associations, and other persons carrying on an insurance business, and all executors, administrators, guardians, trustees, and other fiduciaries may legally invest any sinking funds, moneys, or other funds belonging to them or within their control in the Series 2017 Bonds issued pursuant to the Act, it being one of the purposes of the Act to authorize the investment in such bonds issued pursuant to the Act of all sinking, insurance, retirement, compensation, pension, and trust funds, whether owned or controlled by private or public persons or officers; provided, however, that nothing contained in the Act may be construed as relieving any person, firm, or corporation from any duty of exercising reasonable care in selecting securities for purchase or investment.

UNDERWRITING

The underwriters listed on the cover page hereof (collectively, the “**Underwriters**”) have jointly and severally agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2017 Bonds from the Authority at a purchase price of \$758,027,606.24, which represents the aggregate principal amount of the Series 2017 Bonds, plus original issue premium in the amount of \$90,804,354.55, less an underwriters’ discount in the amount of \$3,741,748.31. The Underwriters will be obligated to purchase all of the Series 2017 Bonds if any are purchased.

Jefferies LLC is acting as representative on behalf of the Underwriters.

The Series 2017 Bonds may be offered and sold to certain dealers (including dealers depositing the Series 2017 Bonds into investment trusts) and institutional purchasers at prices lower than the initial public offering prices, and such public offering prices may be changed, from time to time, by the Underwriters.

Academy Securities, Inc., one of the Underwriters of the Series 2017 Bonds, has entered into distribution agreements with TD Ameritrade Inc., Stoeber, Glass & Company Inc., BNY Mellon Capital Markets LLC, Commonwealth Financial Network, R. Seelaus & Co., Lantern Investments, Inc., Ross, Sinclair & Associates, Inc., W.H. Mell Associates, Inc., Intercoastal Capital Markets, Inc., and Janney Montgomery Scott LLC for the retail distribution of certain municipal securities at the original issue prices. Pursuant to these distribution agreements (if applicable to this transaction), Academy Securities, Inc. may share a portion of its underwriting compensation with these firms.

Certain of the other Underwriters may have entered into distribution agreements with other broker-dealers (that have not been designated by the Authority as Underwriters) for the distribution of the Series 2017 Bonds at the original issue prices, pursuant to which the relevant Underwriter may share a portion of its underwriting compensation or selling concession with such broker-dealers.

The Underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage activities. Certain of the Underwriters and their respective affiliates have, from time to time, performed, and may in

the future perform, various investment banking services for the Authority for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the Underwriters and their respective affiliates may make or hold a broad array of investments and actively 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 securities and instruments of the Authority.

LEGAL MATTERS

Orrick, Herrington & Sutcliffe LLP, as Bond Counsel, will render its opinion with respect to the validity of the Series 2017 Bonds in substantially the form set forth in APPENDIX C hereto.

Certain legal matters will be passed upon for the State by Lisa Madigan, as State Attorney General, and by Chapman and Cutler LLP, Chicago, Illinois.

Certain legal matters will be passed upon for the Authority by Hawkins Delafield & Wood LLP, New York, New York, as Disclosure Counsel.

Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, as Underwriters' Counsel.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Upon delivery of the Series 2017 Bonds, the arithmetical accuracy of certain computations included in schedules provided by the Underwriters on behalf of the Authority relating to (i) the adequacy of the amounts to be applied to the refunding of the Series 2010 Bonds and (ii) the yields with respect to the Series 2017 Bonds, will be verified by Causey Demgen & Moore P.C., independent certified public accountants (the "**Verification Agent**"). Such verification shall be based solely upon information and assumptions supplied to the Verification Agent by the Underwriters. 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.

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OTHER PARTIES

IHS Global

IHS Global has been retained by the Authority as an independent econometric consultant. The Tobacco Consumption Report attached as APPENDIX A is included herein in reliance on IHS Global as experts in such matters. IHS Global's fees for acting as independent econometric consultant are not contingent upon the issuance of the Series 2017 Bonds. The Tobacco Consumption Report should be read in its entirety.

Financial Advisor

Acacia Financial Group, Inc., New York, New York, is acting as financial advisor to the Authority in connection with the issuance of the Series 2017 Bonds.

RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY

By: /s/ Scott Harry
 Chairman

Dated: December 20, 2017

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APPENDIX A

TOBACCO CONSUMPTION REPORT

**A Forecast of U.S. Cigarette Consumption (2017-2028)
for the
Railsplitter Tobacco Settlement Authority**

Submitted to:

Railsplitter Tobacco Settlement Authority

Prepared by:

IHS Global Inc.

December 20, 2017



James Diffley
Executive Director

IHS Global Inc.
1700 Market Street, Suite 3112
Philadelphia, PA 19103

(339) 223-5765

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Executive Summary

IHS Global Insight has developed a cigarette consumption model based on historical U.S. data between 1965 and 2016. 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 2017 through 2028. Our forecast indicates that total consumption in 2028 will be 177.3 billion cigarettes (or 178.4 billion including roll-your-own (“RYO”) tobacco equivalents), a 31% decline from the 2016 level. From 2017 through 2028 the average annual rate of decline is projected to be approximately 3.1%.

Our model was constructed based on widely accepted economic principles and IHS Global Insight’s considerable experience in building econometric forecasting models. A review of the economic research literature indicates that our model is consistent with the prevalent consensus among economists concerning cigarette demand. We considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking amongst underage youth, and qualitative variables that captured the impact of anti-smoking regulations, legislation, health warnings, and the availability of alternative tobacco and nicotine products. After extensive analysis, we found the following variables to be effective in building an empirical model of 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 centuries¹. 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 categories² as reported by the Bureau of Alcohol, Tobacco, Firearms, and Explosives. The USDA, which compiled data on cigarette consumption between 1900 and 2007, reports that consumption grew from 2.5 billion cigarettes in 1900 to a peak of 640 billion in 1981³. 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 2003⁴ and under 300 billion in 2011⁵. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.

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

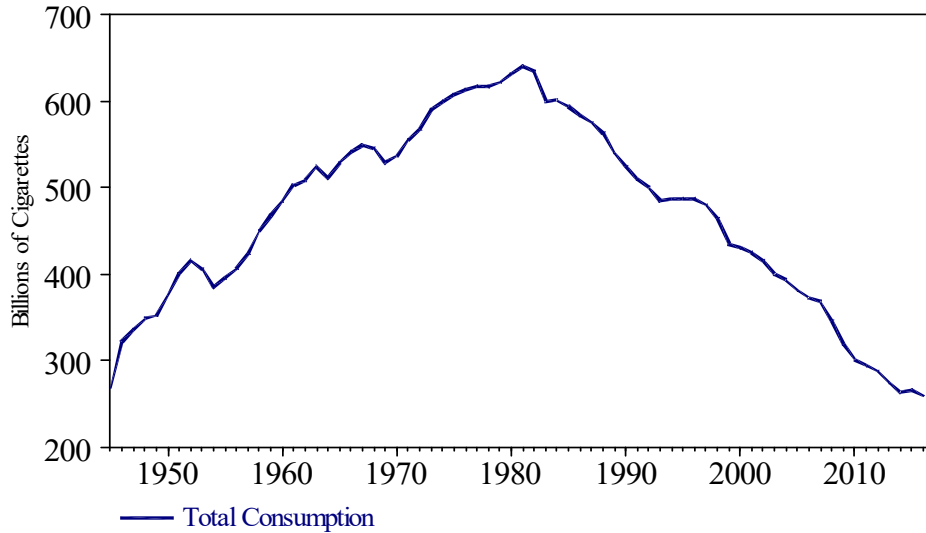
² Bureau of Alcohol, Tobacco, Firearms, and Explosives reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.

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

Historical U.S. Cigarette Consumption: 1945-2016 Number of Cigarettes (Billions)



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 and 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 RYO 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.

There was a confluence of factors which led to the dramatically reduced consumption in 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 cigarettes 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 cigarettes. 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 of state excise tax increases, prompted by the recession, similarly reduced consumption by a further 4 billion.

The consumption decline finally 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 to a weak economy, the rapid increase in usage of electronic cigarettes (“e-cigarettes”), and to an unfavorable comparison with a surprisingly strong 2012. In addition, some of the decline was due to a reduction in wholesale inventories late in the year, part of which was reversed in 2014.

Full year 2014 shipments reported by Management Science Associates, Inc. (“MSAI”) were 3.2% lower than 2013, with actual consumption net of the inventory change estimated to be down 3.4%. The National Association of Attorneys General (“NAAG”), in its report for 2015 MSA Payments, reported shipments of 264.2 billion cigarettes (part of 265.8 including RYO).

In 2015 cigarette shipment declines stopped, and indeed manufacturers reported increased shipments for most of the year. The Alcohol and Tobacco Tax and Trade Bureau (“TTB”) reported that shipments of 267.0 billion cigarettes exceeded the 2014 level by 1.7%, while NAAG ultimately certified an increase of 1.9% to 269.1 billion. But RAI, in its 2015 earnings release, indicated that MSAI estimated total industry shipments at 264.3 billion cigarettes, a 0.1% increase from 2014. In 2016 reported shipments were much less divergent, with MSAI reporting 258.0 billion and NAAG 258.6 billion, a decline of 3.96% from its higher 2015 estimate. The decline rate per MSAI was 2.4%.

The following table sets forth United States domestic cigarette consumption, with and without roll-your-own equivalents, for the nineteen years ended December 31, 2016. 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

⁶ *Source:* National Association of Attorneys General, USDA-ERS, estimates by IHS Global. 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.

at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

U.S. Cigarette Consumption

Year Ended December 31,	Consumption (Billions of Cigarettes)	Percentage Change	Consumption (Billions of Cigarettes with roll-your-own equivalents)	Percentage Change
2016	259	-3.89	260	-3.96
2015	269	1.84	271	1.91
2014	264	-3.76	266	-3.83
2013	275	-4.76	276	-4.86
2012	288	-1.79	291	-1.90
2011	294	-2.57	296	-2.75
2010	301	-5.52	305	-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		

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according to MSAI, the two leading manufacturers, Altria and Reynolds American, accounted for 76.5% of U.S. shipments in 2015. In 2014, prior to the purchase of Lorillard by Reynolds American, the three manufacturers accounted for, according to the NAAG, 84.7% of U.S. shipments in 2014. (The acquisition of Lorillard coincided with a sale of certain Lorillard and Reynolds brands to Imperial Tobacco).

On October 21, 2017, British American Tobacco (“BAT”) completed its acquisition of Reynolds American. BAT does not separately report US market share, but NAAG reports that the Original Participating Manufacturers (“OPMs”) share in 2016 was 84.4%, down from 84.5% in 2015. 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.

In 2017 NAAG determined that total shipments by the remaining OPMs, which is the basis for the computation of MSA payments, in 2016 equaled 220.8 billion, down from 226.2 billion in 2015, a 2.4% decline.

The United States government has raised revenue through tobacco taxes since the Civil War. Although the federal excise taxes have risen throughout the years, excise taxes as a percentage of total federal revenue have fallen from 3.4% in 1950 to approximately 0.4% prior to the 2009 federal excise tax increase. In fiscal year 2016, the federal government received \$14.5 billion in excise tax revenue from tobacco sales. In addition, state governments also raised significant revenues from excise taxes (\$18.0 billion in 2016). Cigarette sales constitute the majority of revenues, which also include revenues from sales of 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 40 million American adults were current smokers in 2016, representing approximately 15.8% of the population age 18 and older, a decline from 16.8% in 2014, 17.8% in 2013, and 19.4% in 2010, according to a Centers for Disease Control and Prevention (“CDC”) study released in 2017. The National Health Interview 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 accelerated between 2002 and 2004, when the incidence rate dropped from 22.5% to 20.9%, but remained as high as 20.6% in 2009. The 2014 CDC report also indicated that the percentage of smokers who smoked less than 30 cigarettes per day had declined from 12.6% in 2005 to 7.0%.

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, e-cigarettes have replaced cigarette consumption in locations subject to indoor smoking bans, to the extent that e-cigarettes are not similarly excluded (see p 13 below).

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 Surveillance System ("YRBSS") 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%.⁷ It declined to 15.7% in 2013 and 10.8% in 2015.

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, and twelfth graders was, for the fourth consecutive year, lower in 2017 than in 2016, continuing trends that began in 1996. Smoking incidence in all grades has been below 1991 levels since 2001 for eighth graders and 2002 for tenth and twelfth graders.

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

Grade	1991 (%)	2015 (%)	2016 (%)	2017 (%)	'91-'16 Change (%)
8 th	14.3	3.6	2.6	1.9	-86.7%
10 th	20.8	6.3	4.9	5.0	-76.0%
12 th	28.3	11.4	10.5	9.7	-65.7%

⁷ Source: CDC. Morbidity and Mortality Weekly Report. "Youth Risk Behavior Survey – United States, 2011". June 2012.

The Study also reports that marijuana use among teens exceeds tobacco use. A number of states have, or are considering, relaxing the legal prohibition on marijuana use. The effects of legalized marijuana on cigarettes were studied in Australia following the country's marijuana legalization. The study concluded that marijuana was, if anything, complementary to cigarette smoking, and was more likely to result in an increase in tobacco use rather than a reduction. However, a recent study published in the journal, *Addictive Behaviors*, found that one of the chemical compounds found in marijuana can decrease the craving for nicotine and hence potentially help smokers quit tobacco use.

The 2013 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 55.8 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 5.6% of youths ages 12 to 17 were current cigarette smokers in 2013, down from 8.4% in 2010 and 13.0% in 2002. In 2016 the survey indicated that the percentage of youths ages 12 to 17 who were current smokers declined to 3.4% from 4.2% in 2015.

The CDC reported on June 16, 2017 that the National Youth Tobacco Survey found that in 2016 the prevalence of tobacco product use among middle and high school students was 7.2% and 20.2%, respectively. For cigarettes the prevalence was 2.2% and 8.0%, respectively, falling from 2.3% and 9.3% in 2015. While cigarette use is substantially lower than the Survey indicated in 2011, overall tobacco use is not, as 11.3% of high school students reported using e-cigarettes in the past 30 days. Notably, e-cigarette use for middle school students declined to 4.3% from 5.3% in 2015.

In most of the nation the minimum legal age to purchase cigarettes is 18. In 2013, New York City increased that age to 21, and the Campaign for Tobacco-Free Kids now reports that at least five states and 270 localities have also raised the minimum legal age to 21. Hawaii became the first state to raise its legal age to 21 on January 1, 2016, and California's legislation to do the same went into effect on June 9, 2016. In 2017, Maine, Oregon and New Jersey did the same, while Alabama, Alaska, and Utah set the age at 19. A similar proposal to raise the smoking age to 21 has also been introduced in at least twenty-four states. In November 2017, US Congresswoman Diana DeGette introduced the Tobacco to 21 Act (H.R.4273), a bicameral legislation that would prohibit the sale of tobacco products to anyone under age 21.

Approximately 90% of smokers indicate that they began smoking before the age of 19. In March 2015 the Institute of Medicine of the National Academies published a study, "Public Health Implications of Raising the Minimum Age of Legal Access to Tobacco Products" which concluded that there would be a 3 percent decrease in prevalence of tobacco use if the minimum legal age was raised to 19, and a 12 percent decrease if raised to 21.

Price Elasticity of Cigarette Demand

The price elasticity of demand reflects the impact of changes in price on the demand for a product. Based on recent research studies, cigarette price elasticities have generally fallen between an interval of -0.3 to -0.5, meaning 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 also 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 from 1991 to 1997.⁸ The study's findings state that the decrease in cigarette prices in the early 1990's can explain 26% of the upward trend in youth smoking during that time 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.⁹ Their 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 .¹⁰ 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

⁸ 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.

⁹ 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.

¹⁰ Michael Grossman. "Individual Behaviors and Substance Use: The Role of Price". Working Paper No. W10948. National Bureau of Economic Research. December 2004.

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%.¹¹

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.¹² 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 of a 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 of a 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 the definition of initiation. In a related study, Powell et al. (2003) estimated a price elasticity of youth smoking participation of -0.46.¹³

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

Nicotine Replacement Products

In January 2017, the CDC released the results of a study on quitting smoking¹⁴. It found that, in 2015, 68.0% of smokers wanted to stop smoking, 55.4% had made a quit attempt in the past year, 7.4% had recently quit, 57.2% had been advised by a health professional to quit, and 31.2% had used counseling and/or medications when they tried to quit.

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.

A study, by Hu et al., (2000) examines the effects of nicotine replacement products on cigarette consumption in the United States.¹⁵ Among other things, the study found that, "a 0.076% reduction in cigarette consumption is associated with the availability of nicotine

¹¹ 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.

¹² Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press. Copyright 2001.

¹³ Powell et al. "Peer Effects, Tobacco Control Policies, and Youth Smoking Behavior". Impacteen. February 2003.

⁷ Source: CDC. Morbidity and Mortality Weekly Report. "Quitting Smoking Among Adults – United States, 2000-2015". January 2017.

¹⁵ Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. Summer 2000. <http://tc.bmjournals.com>.

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 to block tar and nicotine from being inhaled, is another cessation product on the market since 2003. It has been available for purchase without a prescription since October 2015, and a wholesale distribution marketing campaign is underway. Zyban is a non-nicotine cessation drug that has been available since 2000. It has been shown to be effective when combined with intensive behavioral support.¹⁶

In 2006, the FDA approved varenicline, a Pfizer product marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. Tests indicate that it is more effective as a cessation aid than Zyban. Pfizer introduced Chantix with a novel marketing program, GETQUIT, an integrated consumer support system which emphasizes personalized treatment advice with regular phone and e-mail contact. The drug debuted with strong sales in 2007, but suffered a reversal the following year due to safety concerns. It has since seen increased sales and marketing success. Free & Clear, a provider of tobacco treatment services, reported in June 2008, that Chantix has achieved higher average quit rates than Zyban, patches, gum, and lozenges. Though Pfizer reported additional positive results in 2009, the FDA required that Pfizer update the Chantix label with the most restrictive, "Black Box", safety labeling describing the risks. But the FDA does conclude: "The Agency continues to believe that the drug's benefits outweigh the risks and the current warnings in the Chantix label are appropriate." These warnings include changes in behavior, hostility, agitation, depressed mood, and suicidal thoughts or actions, as well as serious skin reactions and heart and blood vessel problems. Nevertheless, the FDA said on October 24, 2011 that it will continue to evaluate the risks 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, already suffering from depression or mood disorders to quit smoking without worsening their depression or anxiety symptoms. In September 2016 however, a preliminary review by the FDA expressed doubts about the trial. The FDA, in December 2016, announced that the Black Box labeling is no longer required, as the risk of serious side effects is lower than previously suspected. Also, in October 2013 researchers at the University of Bristol reported in the *British Medical Journal* that cessation drugs do not increase suicide risk. This was followed by a 2015 study in Sweden which reached the same conclusion. In January 2016, a study concluded that the relative effectiveness of Chantix was equal to that of nicotine patches.

In September 2011, the *New England Journal of Medicine* reported positive smoking cessation efficacy and safety tests for Cytisine, an inexpensive cessation aid long sold in Eastern Europe as Tabex.

¹⁶ Roddy, Elin. "Bupropion and Other Non-nicotine Pharmacotherapies". *British Medical Journal*. 28 February 2004.

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. The company has continued its development plans, and in 2016 the New Zealand Medical Journal recommend the low-nicotine cigarettes as a smoking reduction tool.

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 when tested in mice, though it will take several years before it can be tested in humans. More recently, in January 2015, a team from the Scripps Research Institute reported in the Journal of Medicinal Chemistry that a new vaccine design had yielded positive results and recommended its further development. In October 2015, Invion Limited completed a successful Phase 2 trial of INV102 (Nadolol), an inhaled respiratory drug for smoking cessation. The company has requested that the FDA move this drug to Phase 3 development.

Also in 2015, early phase drug development was reported by the Scripps Research Institute. They have discovered an enzyme, NicA2, which they hope will destroy nicotine in the body, serving as an alternative to other smoking cessation aids.

It is expected that products such as these will continue to be developed and that their introduction and use will contribute to the continued 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. Additionally, 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. In October 2010, Medicare coverage was expanded to provide cessation counseling to seniors without tobacco-related disease. Recent research indicates this benefits expansion increased cessation product prescriptions by 36%.¹⁷ 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. Recent research found that the Medicaid expansion may have increased smoking cessation among low-income adults.¹⁸

¹⁷ MacLean, Pesko, Hill, National Bureau of Economic Research. Working Paper No. 3450. May 2017.

¹⁸ Jonathan W. Koma, et al. Medical Care. Oct 2017

Electronic Cigarettes

E-cigarettes, which are not subject to the MSA, have also gained in popularity in recent years. 2015 sales in the US have been estimated to be over \$3 billion, though growth is slowing after years of rapid gains. The National Health Survey of the CDC reports that in 2016, 15.4% of adults had tried e-cigs and 3.2% were current users. In June 2016, the CDC released the YRBSS survey results indicating that 45% of high school students had tried e-cigarettes and only 32% in 2015, had tried cigarettes. In April 2016, it's the CDC's National Youth Tobacco Survey found that e-cigarette use among high school students had increased to 16% in 2015, from 1.5% in 2011. It was 5.3% among middle school students in 2015.

On the one hand, e-cigarettes are alternatives to cigarettes, as smokers cope with indoor and outdoor bans. On the other hand they are cessation devices whose nicotine content can be controlled. Their role in smoking, and smoking cessation, is ambiguous. When they can be used as a cessation device to wean a smoker away from cigarettes they serve as a substitute for cigarettes, and therefore result in lower cigarette consumption. Alternatively, in the presence of indoor smoking bans, they can also allow smokers to maintain a nicotine habit or addiction indoors, offsetting some of the bans' effectiveness in reducing smoking and consumption of cigarettes. In this case e-cigarettes are complements to cigarettes. Indoor smoking restrictions have reduced the consumption of cigarettes and created a demand for e-cigarettes. But e-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. Results of a trial in Italy, published by the journal Plos One in June 2013, found that 8.7% of e-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). By 2016, the scientific consensus was that e-cigarette use was associated with quit attempts by smokers.¹⁹ Others also conclude that youth use of e-cigarettes is unlikely to increase the ranks of future cigarette smokers.²⁰ In 2017 research concluded that the substantial increase in e-cigarette use among US adult smokers this decade was associated with a statistically significant increase in the smoking cessation rate at the population level.²¹

In terms of price, e-cigarettes are a less expensive alternative for the consumer, as they are not taxed as cigarettes. However, Minnesota has imposed a 95% tax on the wholesale cost, North Carolina in 2014 added a 5 cent per milliliter tax on liquid nicotine, and the District of Columbia, Kansas, and Louisiana added millimeter taxes in 2015. Though smoking habits vary, a 5 cent/mL tax is approximately equivalent to a 2.5 cent tax per

¹⁹ Zhu SH, et al, "E-cigarette use and associated changes in population smoking cessation: evidence from US current population surveys, *BMJ* 2017;358:j3262,

²⁰ L.T. Kozlowski, K.E. Warner / *Drug and Alcohol Dependence* xxx (2017) xxx-xxx

²¹ Zhu, hu-Hong et al. *BMJ* 2017;358:j3262

pack of cigarettes. A cartridge and battery for an e-cigarette would cost less than half as much as an equivalent pack of cigarettes in an average tax state.

Researchers have reported several safety concerns with the products, including concerns on the variability in delivered nicotine content. In March 2016, the U.S. Department of Transportation implemented a ban on e-cigarettes on all flights to and from the U.S., a prohibition already enacted by Amtrak on its trains. The states of California, Connecticut, Hawaii, Maine, New Jersey, North Dakota, Oregon, and Utah prohibit e-cigarette use in workplaces, restaurants, and bars. Arkansas, Colorado, Delaware, New Hampshire, and Oklahoma restrict e-cig use at state workplaces and school grounds. Based on data from the American Nonsmokers' Rights Foundation ("ANRF"), there are e-cigarette restrictions at indoor smoke-free venues in 516 localities in the US. In 2014, Chicago, New York, and San Francisco extended public places smoking bans to include e-cigarettes. In September 2013 forty state attorneys general sent a letter to the FDA urging the agency to regulate e-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.

In 2010, the U.S. Court of Appeals for the District of Columbia Circuit ruled that the FDA could not regulate e-cigarettes as a drug, rather it must regulate them as tobacco products. On May 5, 2016, the FDA released its final rule which subjects manufactures, importers and/or retailers of e-cigarettes and certain other tobacco related products to the same regulations applicable to cigarettes, cigarette tobacco, roll-your-own tobacco and smokeless tobacco, with respect to the following; (i) enforcement action against product determined to be adulterated or misbranded; (ii) required submission of ingredient listing and reporting; (iii) required registration of tobacco product manufacturing establishments and product listing; (iv) prohibition against sale and distribution of products with modified risk descriptors (e.g. "light", "low" or "mild") and claims unless authorized by the FDA; (v) placing health warnings on product packages and advertisements; (vi) prohibition on the distribution of free samples; and (vii) premarket review requirements. In addition, the final rule established additional restriction for e-cigarettes and certain other tobacco products, as follows: (i) restriction on sales to persons under the age of 18 and requiring age verification; (ii) prohibition of sales in vending machines unless in adult-only facilities; and (iii) prohibition against free samples.

On July 28, 2017, FDA Commissioner Scott Gottlieb announced that new regulations would not be imposed on e-cigarettes at this time, stating that electronic products may have a positive role to play in reducing the harmful effects of nicotine addiction.

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 e-cigarettes pose no health concern for users or bystanders. 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.

A New Product - Heat not Burn

Altria plans to market IQOS, a tobacco product as being less harmful than traditional cigarette. The product, developed by Philip Morris International (“PMI”), heats tobacco without burning, and is already on sale in over a dozen international markets, including Japan, Switzerland and Italy. In Japan, IQOS sales have expanded rapidly since launching nationwide last summer and now account for about 10% of the overall cigarette market. The product’s advantage over e-cigarettes is that, unlike the latter, it delivers a “throat-hit” sensation like combustible cigarettes. The FDA has begun the scientific review of PMI’s Modified Risk Tobacco Product Application for its IQOS device.

Different from e-cigarettes, the electronic device is used with mini tobacco sticks as opposed to a nicotine-laced liquid. These are then placed into the device before being heated, rather than burned, which is claimed to make them less harmful because they aren't burning the tobacco. The concept behind ‘Heat-not-Burn’ is that heating tobacco, rather than burning it, reduces or eliminates the formation of many of the harmful compounds that are produced at the high temperatures associated with combustion.

Similarly, BAT's Glo includes a heating device for disposable, tobacco-packed "sticks" that look and feel like ordinary cigarettes. Altria has stated that it expects the tobacco sticks to be considered as cigarettes for purposes of the MSA computations.

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.²² Their results suggest that workplace smoking bans reduce smoking prevalence by 5% and reduce consumption by smokers by 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

²² *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.

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. Based on recent conventional research studies cigarette price elasticities have generally fallen between an interval of -0.3 to -0.5. IHS Global's multivariate regression analysis using U.S. data from 1965 to 2016 shows that the long-run price elasticity of consumption for the entire population is -0.33; meaning a 1.0% increase in the price of cigarettes decreases consumption by 0.33%.

In 1998, the average nominal price of a pack of cigarettes in the U.S. was \$2.20. This increased to \$2.88 per pack in 1999, representing a nominal growth 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 excise taxes. In 2011, excise tax increases went into effect in Connecticut, again in Hawaii, and in Vermont. In 2012, Illinois and Rhode Island raised cigarette excise taxes by \$1.00 and \$0.04 per pack per pack, respectively.

In 2013, Cook County, Illinois increased its cigarette excise tax by \$1.00 per pack, and in November of that year, 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, and New Hampshire, by \$0.10 per pack. Puerto Rico also enacted plans to increase its excise taxes in 2014 and 2015. New York City now sets a minimum retail price of a pack of cigarettes at \$13.00, and prohibits the use of coupons and promotions to discount that price. In September 2014, the City of Philadelphia enacted a \$2.00 per pack tax.

The increases in New Hampshire and Oregon were the only state excise tax increases in 2014, bringing the average state cigarette excise tax rate in December 2014 to \$1.53. Eight states also raised cigarette taxes in 2015: Alabama by \$0.25 per pack, Connecticut by \$0.25, Kansas by \$0.50, Louisiana by \$0.32, Nevada by \$1.00, Ohio by \$0.35, Rhode Island by \$0.25, and Vermont by \$0.33.

In 2016, the excise tax was increased in Minnesota, by \$0.10, and Oregon, by \$0.01, on January 1, in Louisiana, by \$0.22 on April 1, and in Connecticut, by \$0.25 and in West

Virginia, by \$0.65, on July 1. The Pennsylvania budget enacted on July 14 increased its excise tax by \$1.00 per pack effective August 1. Excise tax increases are under consideration in Illinois and New Mexico. In November 2016 a ballot initiative for excise tax increases passed in California (\$2.00, effective April 2017). The average state cigarette excise tax increased from \$1.63 to \$1.89 in 2017, following increases in California, Delaware, Oklahoma, and Rhode Island.

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 an average of \$2.90 in the U.S.

Purchases of roll-your-own cigarette tobacco were discouraged by 2009 legislation that substantially raised its excise tax. However, 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, and most recently in September 2017, 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 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. In 2014, for instance, Altria raised its brands' prices by \$0.13, and in May 2015, and again in May 2016, the major manufacturers increased prices by \$0.06 per pack. In 2017, the manufacturers raised prices by \$0.08 in March, and in September, by \$0.10 per pack. In November 2017, the average price, including excise taxes, was \$8.59 per pack, a 7.5% increase over a year ago.

Over the longer term, our forecast expects price increases to continue to exceed the general rate of inflation due to increases in the manufacturers' prices as well as further increases in excise taxes.

Premium brands are typically \$1.00 to \$2.00 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 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 initially 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 cigarettes volume, but it may negatively impact MSA receipts if non-participating manufacturers gain sales.

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.²³ However, a few studies found cigarette consumption decreases as disposable income increases.²⁴ Based on our multivariate regression analysis, the income elasticity of consumption is 0.27, meaning 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,²⁵ almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.²⁶ One study examines the effects of youth smoking on future adult smoking.²⁷ The study found that between 25% and 50% of any increase or decrease in youth smoking would persist into adulthood. According to the study, several factors may alter future correlation between youth and adult smoking: there are better means for quitting smoking than in the past, and there are more workplace bans in effect that those who are currently in their teen years will face as they age.

We have compiled U.S. data from the CDC that measures the incidence of smoking in the 12-17 age group as the percentage of the population in this category that first become daily smokers. This percentage, after falling since the early 1970s, began to increase in 1990 and increased through the decade. We assume that this recent trend peaked in the late 1990s and youth smoking has resumed its long 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-

²³ Ippolito, et al.; Fuji.

²⁴ Wasserman, et al.; Townsend et al.

²⁵ Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.

²⁶ Source: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."

²⁷ 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.

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 2001, Canada began requiring cigarette labels to include large graphic depictions of adverse health consequences of smoking. Early research suggested that these warnings have some effectiveness, as one-fifth of the participants in a survey reported smoking less as a result of the labels.²⁸ 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%.²⁹ In 2015 the Rand Corporation reported results of a convenience store experiment where cigarette displays were hidden from view. The researchers found that teen smoking susceptibility was reduced by 11% by the hidden placement.

In December 2014, research was published on the effectiveness of youth-targeted anti-smoking public service announcements. It was found that a 100-ad increase in the yearly volume of ads was associated with a 0.1 percentage point drop in youth smoking rates in the following year. A 2016 study determined that smoke-free laws in workplaces are associated with a lower prevalence of youth smoking.³⁰ It estimated that youth smoking initiation declined by 34%.

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

²⁸ Hammond, Fong, McDonald, Brown, and Cameron. "Graphic Canadian Warning Labels and Adverse Outcomes: Evidence from Canadian Smokers". *American Journal of Public Health*. August 2004.

²⁹ Huang J, Chaloupka FJ, Fong GT. Cigarette graphic warning labels and smoking prevalence in Canada: a critical examination and reformulation of the FDA regulatory impact analysis. *Tobacco Control* 2013.

³⁰ Song, Dutra, Nielands, Glantz. Association of Smoke-Free Laws with Lower Percentages of New and Current Smokers Among Adolescents and Young Adults. *Journal of American Medical Association*, 2015:169.

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 of 2009 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.

The FDA has yet to implement requirements for new labels. In October 2016, eight public health groups, including the American Academy of Pediatrics, the American Cancer Society, the American Heart Association, and the American Lung Association, filed suit in federal court to force the FDA to issue final rules requiring graphic warnings on cigarette packs and advertising.

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 many 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., JP Morgan Chase, PepsiCo Inc., Northwest Airlines, Safeway, Tribune Co., and Whirlpool, are now charging smokers higher premiums.

In September 2014, CVS Caremark ceased selling cigarettes at its nationwide chain of more than 7,600 pharmacy stores. A bill was introduced in California in 2016 which would permit tobacco sales only in retail stores for which more than 60% of their revenue came from the sale of tobacco products.

Smoking Bans in Public Places. Beginning in the 1970s, numerous states passed laws banning smoking in public places as well as private workplaces. In 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 58.3% of the U.S population, according to the ANRF. In 2012 North Dakota became the most recent state to adopt these bans in public places. In 2015, smoking ban legislation was introduced in Kentucky, and New Orleans passed an ordinance banning smoking in bars and casinos.

The ANRF documents clean indoor air ordinances by local governments throughout the U.S. As of October 2, 2017, there were 4,924 municipalities with indoor smoking restrictions. Of these, 1,168 local governments required non-hospitality workplaces to be 100% smoke-free, while 1,255 governments required 100% smoke-free conditions in restaurants, and 1,119 required the same for bars. The number of such ordinances has grown rapidly in the past two decades. Ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars.³¹

Based on the regression analysis using data from 1965 to 2015, 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%. Nevertheless, the timing of the restrictions within and across states makes such statistical identification difficult. Bauer, et al. estimated that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.³² Research in Canada, by the Ontario Tobacco Research Unit, concluded that consumption drops in workplaces where smoking is banned by almost five cigarettes per person per day. Tauras, in a study based on a large survey of smokers, found that the more restrictive smoke-free air laws decrease average smoking but have little influence on prevalence.³³ The study predicted that moving from no smoking restrictions at all to the most restrictive bans reduces average smoking from 5% to 8%. In September 2015, the American Medical Association published research examining 11 years of smoke-free laws which concluded that they are associated with a lower prevalence of smoking among adolescents and young adults.³⁴

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. Nevertheless, with data available from later in the decade across a wider geography, econometric analysis reveals that the bans did have a

³¹ Source: American Nonsmokers' Rights Foundation. <http://www.no-smoke.org>. July 2013.

³² Bauer, Hyland, Li, Steger, and Cummings. "A Longitudinal Assessment of the Impact of Smoke-Free Worksite Policies on Tobacco Use". American Journal of Public Health. June 2005

³³ Tauras, John A. "Smoke-Free Air Laws, Cigarette Prices, and Adult Cigarette Demand" Economic Inquiry, April 2006.

³⁴ Song, Dutra, Neilands, and Glantz. "Association of Smoke-Free Laws with Lower Percentages of New and Current Smokers Among Adolescents and Young Adults". JAMA Pediatrics. September 2015

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, San Rafael, Santa Monica, and Walnut Creek have also established extensive outdoor restrictions, as have Boulder, Colorado, and 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. In January 2014, a smoking ban went into effect in Boston's parks, and on Hawaii's beaches. A bill was introduced in 2016 in California to ban smoking on all state beaches. It passed the legislature, but was vetoed by the Governor. According to ANRF, as of July 2016, 1,531 municipalities prohibit smoking in city parks, and 317 municipalities mandate smoke-free city beaches.

Additional restrictions are being placed in residential units as well. First, many hotels, including the Marriott, Sheraton, and Westin chains have adopted completely smoke-free room standards. And multi-family residential buildings have been increasingly subject to restrictions, beginning in 2008 in the California cities of Belmont and Calabasas, approved ordinances restricting 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 New York City, have also established smoke-free apartment policies. In 2013 Related Companies, which manages 40,000 rental units across the country, 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. The US Department of Housing and Urban Development in November 2015 announced plans to make all public housing smoke-free. The proposal would cover about 940,000 units. The plan went into effect in February 2017, and will be fully implemented by July 2018. ANRF reports that there are 530 municipalities in the US that have enacted laws prohibiting smoking in all multi-unit housing.

New Jersey has prohibited smoking in college dormitories since 2005. At least 1,736 colleges nationwide now prohibit smoking everywhere on campus. In 2013 the California and Louisiana state college and university systems 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 states have banned smoking, indoors and outdoors, at state prisons. Since February 2015, smoking has been prohibited in all federal prisons. Arkansas, California, Louisiana, Maine, Puerto Rico, Texas, Virginia, and Rockland County, NY prohibit smoking in a car where there are children present, and similar legislation has been proposed in Connecticut, Florida, 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 e-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 added smokeless products to their offerings, 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 and Reynolds American offers Camel Snus. On December 18, 2017, Reynolds American announced that the FDA accepted, and filed for substantive review, Modified Risk Tobacco Product applications covering Camel Snus, thus requesting FDA authorization to market Camel Snus as a modified risk tobacco product.

In 2014, according to SAMHSA's National Survey on Drug Use & Health, 3.3% of adults used smokeless tobacco products. Among young adults, who had been more likely to use smokeless products, 2.0% used smokeless tobacco. A Massachusetts survey in 2011 found that in snus test markets 29% of male smokers aged 18-24 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 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.³⁵ The Sweden experience is unique, even with respect to its Northern European neighbors, and it is not clear whether it could be replicated elsewhere. A May 2008 study using data from the 2000 National Health Interview Survey reported 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.³⁶ A 2009 study concluded however that young males who used smokeless tobacco products were more likely to be concurrent smokers.³⁷ Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and increased risks of oral cancer, among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General³⁸ and the American Medical Association³⁹ (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 Family Smoking Prevention and Tobacco Control Act, 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

³⁵ Foulds, Ramstrom, Burke, and Fagerstrom. "Effect of Smokeless Tobacco (Snus) on Smoking and Public Health in Sweden". Tobacco Control. Vol. 12, 2003.

³⁶ Rodu and Phillips, "Switching to Smokeless Tobacco as a Smoking Cessation Method: Evidence from the 2000 National Health Interview Survey". Harm Reduction Journal. 23 May 2008.

³⁷ 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.

³⁸ Source: Surgeon General's 1988 Report, "The Health Consequences of Smoking – Nicotine Addiction".

³⁹ Source: Council on Scientific Affairs, "Reducing the Addictiveness of Cigarettes," Report to the AMA House of Delegates, June 1998.

is especially high among minority groups, raising a call for a ban on its manufacture and sale. In an August 2016 letter, the African American Tobacco Control Leadership Council asked President Obama to direct the FDA to issue a proposed rule to remove all flavored tobacco products, including mentholated cigarettes, from the marketplace. Menthol cigarette sales represent approximately 30% of total cigarette sales. Moreover, menthol smoking rates among young adults have increased 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. 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. 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: 1) altered physiological responses to tobacco smoke, 2) increased dependence, 3) reduced success in smoking cessation, and 4) 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 FDA and in November 2013, twenty-five state attorneys general asked U.S. public health regulators to ban menthol cigarettes. No regulatory action was taken in 2014 or 2015, though in 2017 the San Francisco City Council banned the sale of menthol cigarettes beginning in 2018.

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 to do so 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. In a recent 6-week study, reduced-nicotine cigarettes versus standard-nicotine cigarettes reduced nicotine exposure, dependence, and the number of cigarettes smoked.⁴⁰ Other research has also concluded that smokers of reduced nicotine products do not increase the number of cigarettes smoked to compensate for the reduction per cigarette.⁴¹

⁴⁰ [Eric C. Donny, Ph.D., et al. N Engl J Med 2015; 373:1340-1349 October 1, 2015 DOI: 0.1056/NEJMsa1502403](#)

⁴¹ [Neal L Benowitz¹ and Jack E Henningfield² Tob Control. 2013 May; 22\(Suppl 1\): i14–i17.](#)
doi: [10.1136/tobaccocontrol-2012-050860](#)

The smaller manufacturers believe, on the other hand, that FDA regulation will strengthen the role of the major producers, as the regulation 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. Initial data, on the first wave of data collection, began to be published in 2017. 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.

Plain packaging, absent brand names has also been used as a tobacco control policy. Australia, in 2001 introduced plain-packaging requirements. A recent study concluded that a significant decline in smoking prevalence followed the introduction of plain packaging (3.7% over 2001-2013), after adjusting for the impact of other tobacco control measures.⁴²

As the prevalence of smoking declines, it is likely that the achievement of further declines will require either a greater level of spending, or more effective programs. This is the common economic principle of diminishing returns.

An Empirical Model of Cigarette Consumption

An econometric model is a set of mathematical equations which statistically best describes the available historical data. It can be applied, with assumptions on the projected path of independent explanatory variables, to predict the future path of the dependent variable being studied, in this case adult per capita cigarette consumption. After extensive analysis of available data measuring all of the above-mentioned factors which influence smoking, we found the following variables to be effective in building an empirical model of adult per capita cigarette consumption for the United States:

- 1) the real price of cigarettes
- 2) the level of real disposable income per capita
- 3) the impact of restrictions on smoking in public places

⁴² Dietheim P. Farley T. "Refuting tobacco-industry funded research: empirical data shoes a decline in smoking prevalence following the introduction of plain packaging in Australia". Tobacco Prevention & Cessation. 2015; 1 November.

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 2028. 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 is also 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 2016 on the variables described above, we developed the following regression equation.

$$\begin{aligned} \log(\text{per capita consumption}) &= 54.1 \\ &- 0.024 * \text{trend} \\ &- 0.223 * \log(\text{cigarette price}) \\ &- 0.104 * \log(\text{cigarette price last year}) \\ &+ 0.274 * \log(\text{per capita disposable income}) \\ &- 0.001 * \text{percentage of U.S. with strong indoor smoking ban} \\ &- 0.002 * \text{percentage of U.S. with strong indoor smoking ban last year.} \end{aligned}$$

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 2016 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

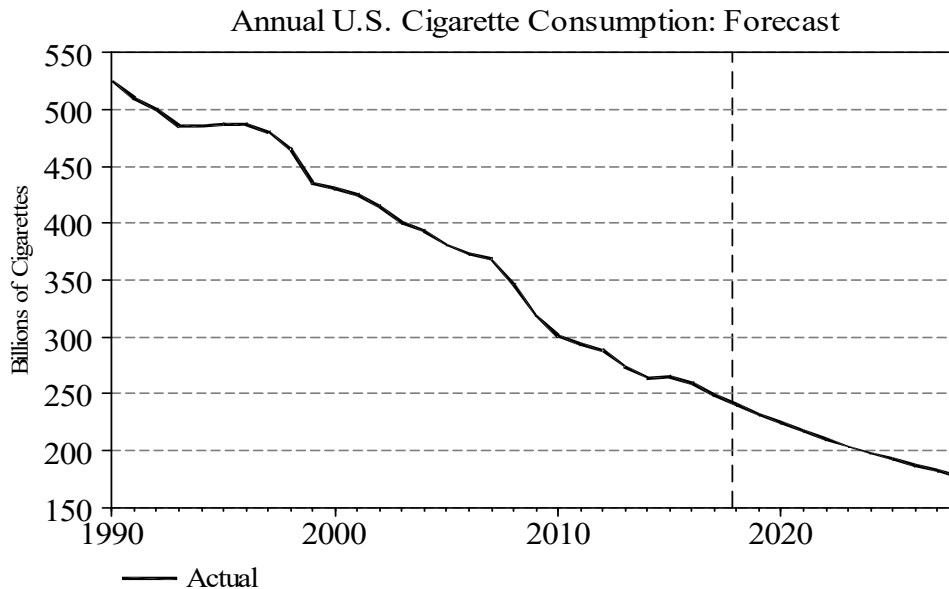
Our forecast is based on assumptions regarding the future path of the explanatory variables in the regression equation. Projections of U.S. population and real per capita personal disposable income are standard IHS Global forecasts. Annual population growth is projected to average 0.7%, and real per 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, \$7.19 in 2013, \$7.40 in 2014, \$7.60 in 2015, and \$7.89 in 2016. 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.

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 in 2012. For the full year, US Tobacco and Tax Bureau (TTB) reported shipments 4.8% lower than in 2012. Weak per capita disposable income growth was responsible for part of the decline. In addition,

the manufacturers reported that wholesale inventories declined by 1.4 billion cigarettes during the year.

In 2014, MSAI estimated shipments of 264.6 billion cigarettes, a 3.2% decline from 2013. The decline in consumption of cigarettes was somewhat greater, however, as inventories were rebuilt by 0.7 billion cigarettes to offset the 2013 decline. TTB has reported that 2014 shipments declined 4.1% compared with 2013. In its report for the 2015 MSA payments, NAAG estimated 264.2 billion cigarettes in 2014 (265.8 billion when including RYO).

For 2015, RAI reported that MSAI estimated industry shipments of 264.3 billion, a 0.1% decline from 2014. TTB reported shipments for the year to be 267.0 billion, an increase of 1.67% from 2014. The dramatic decline in oil prices, and hence gasoline prices, was coincident with higher than expected cigarette sales, most notably in convenience stores, who reported increased sales during 2015.

RAI in its 2016 fourth quarter report indicated that industry shipments declined 1.8% from 2015. After adjusting for inventory movement, TTB data for the year indicated a 3.5% decline, and NAAG certified that in 2017.

Thus far in 2017, the manufacturers, in the third quarter reports, cite a 3.3% decline from 2016. TTB reported shipments through three quarters of 191.5 billion cigarettes, a 2.4% decrease from the same period in 2016. However, its preliminary report on December 13, estimated shipments through October to be 4.9% below the same period in 2016.

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 multi-family housing.

From 2017 through 2028 the average annual rate of decline is projected to be 3.1%.

Forecast U.S. Consumption of Cigarettes

	Total Consumption	Decline Rate	Consumption including Roll- Your-Own	Decline Rate
	<i>(billions)</i>	<i>(%)</i>	<i>(billions)</i>	<i>(%)</i>
2011	293.5	-2.6%	296.2	-2.8%
2012	288.3	-1.8%	290.5	-1.9%
2013	274.5	-4.8%	276.4	-4.9%
2014	264.2	-3.8%	265.8	-3.8%
2015	269.1	1.8%	270.9	1.9%
2016	258.6	-3.9%	260.2	-4.0%
FORECAST				
2017	249.4	-3.6%	250.9	-3.6%
2018	240.5	-3.6%	241.9	-3.6%
2019	232.1	-3.5%	233.5	-3.5%
2020	224.3	-3.4%	225.6	-3.4%
2021	216.9	-3.3%	218.2	-3.3%
2022	210.1	-3.1%	211.4	-3.1%
2023	203.7	-3.0%	205.0	-3.0%
2024	197.9	-2.9%	199.1	-2.9%
2025	192.4	-2.8%	193.5	-2.8%
2026	187.2	-2.7%	188.3	-2.7%
2027	182.2	-2.7%	183.3	-2.7%
2028	177.3	-2.7%	178.4	-2.7%

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APPENDIX B

MASTER SETTLEMENT AGREEMENT

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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 affirmation 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 Manufacturer 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 20.00000000%, 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 15.00000000% (but did not exceed 20.00000000%), 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) 10.00000000% for each percentage point (or fraction thereof) of excess of such Relative Market Share over 15.00000000% (if any), or (2) 2.50000000% 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 99.05000000%, 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(c) 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(c) 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 to 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(c), subsequent payments under such subsection or subsection IX(c); in the case of offsets arising from payments under subsection VI(c), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under any of subsection IX(c)(1), IX(c)(2) or IX(e); in the case of offsets arising from payments under subsection VIII(b), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under either subsection IX(c)(1) or IX(c)(2); in the case of offsets arising from payments under subsection VIII(c), subsequent payments under either subsection IX(c)(1) or IX(c)(2); and, in the case of offsets arising from payments under subsection IX(i), subsequent payments under such subsection (consistent with the provisions of this subsection (B)(i)).

(ii) in the case of offsets to be applied against payments under subsection IX(c), the offset to be applied shall be apportioned among the Settling States pro rata in proportion to their respective shares of such payments, as such respective shares are determined pursuant to step E of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or clause "Sixth" (in the case of payments due from the Subsequent Participating Manufacturers) of subsection IX(j) (except where the offset arises from an overpayment applicable solely to a particular Settling State).

(iii) the total amount of the offset to which a Participating Manufacturer shall be entitled shall be the full amount of the overpayment it made, together with interest calculated from the time of the overpayment to the Payment Due Date of the first eligible payment against which the offset may be applied. The applicable interest rate shall be the Prime Rate (except that, where the overpayment is the result of a Settling State's withholding of information as described in subsection (d)(5)(B), the applicable interest rate shall be that described in subsection IX(h)).

(iv) an offset under this subsection (B) shall be applied up to the full amount of the Participating Manufacturer's share (in the case of payments due from Original Participating Manufacturers, determined as described in the first sentence of clause "Seventh" of subsection IX(j) (or, in the case of payments pursuant to subsection IX(c), step D of such clause)) of the eligible payment in question, as such payment has been adjusted and reduced pursuant to clauses "First" through "Sixth" of subsection IX(j), to the extent each such clause is applicable to the payment in question. In the event that the offset to which a Participating Manufacturer is entitled under this subsection (B) would exceed such Participating Manufacturer's share of the eligible payment against which it is being applied (or, in the case where such offset arises from an overpayment applicable solely to a particular Settling State, the portion of such payment that is made for the benefit of such Settling State), the offset shall be the full amount of such Participating Manufacturer's share of such payment and all amounts not offset shall carry forward and be offset against subsequent eligible payments until all such amounts have been offset.

(j) Payments After Applicable Condition. To the extent that a payment is made after the occurrence of all applicable conditions for the disbursement of such payment to the payee(s) in question, the Independent Auditor shall instruct the Escrow Agent to disburse such payment promptly following its deposit.

XII. SETTling STATES' RELEASE, DISCHARGE AND COVENANT

(a) Release.

(1) Upon the occurrence of State-Specific Finality in a Settling State, such Settling State shall absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Releasing Parties directly, indirectly, derivatively or in any other capacity ever had, now have, or hereafter can, shall or may have.

(2) Notwithstanding the foregoing, this release and discharge shall not apply to any defendant in a lawsuit settled pursuant to this Agreement (other than a Participating Manufacturer) unless and until such defendant releases the Releasing Parties (and delivers to the Attorney General of the applicable Settling State a copy of such release) from any and all Claims of such defendant relating to the prosecution of such lawsuit.

(3) Each Settling State (for itself and for the Releasing Parties) further covenants and agrees that it (and the Releasing Parties) shall not after the occurrence of State-Specific Finality sue or seek to establish civil liability against any Released Party based, in whole or in part, upon any of the Released Claims, and further agrees that such covenant and agreement shall be a complete defense to any such civil action or proceeding.

(4) (A) Each Settling State (for itself and for the Releasing Parties) further agrees that, if a Released Claim by a Releasing Party against any person or entity that is not a Released Party (a "non-Released Party") results in or in any way gives rise to a claim-over (on any theory whatever other than a claim based on an express written indemnity agreement) by such non-Released Party against any Released Party (and such Released Party gives notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), the Releasing Party: (i) shall reduce or credit against any judgment or settlement such Releasing Party may obtain against such non-Released Party the full amount of any judgment or settlement such non-Released Party may obtain against the Released Party on such claim-over; and (ii) shall, as part of any settlement with such non-Released Party, obtain from such non-Released Party for the benefit of such Released Party a satisfaction in full of such non-Released Party's judgment or settlement against the Released Party.

(B) Each Settling State further agrees that in the event that the provisions of subsection (4)(A) do not fully eliminate any and all liability of any Original Participating Manufacturer (or of any person or entity that is a Released Party by virtue of its relation to any Original Participating Manufacturer) with respect to claims-over (on any theory whatever other than a claim based on an express written indemnity agreement) by any non-Released Party to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement (to the extent that such Released Party has given notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), judgment or otherwise) of such non-Released Party to any Releasing Party arising out of any Released Claim, such Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any amounts paid by such Original Participating Manufacturer (or by any person or entity that is a Released Party by virtue of its relation to such Original Participating Manufacturer) on any such liability against such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment each year, until all such amounts paid on such liability have been offset. In the event that the offset under this subsection (4) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the offset for miscalculated or disputed payments, the Federal Tobacco Legislation Offset and the Litigating Releasing Parties Offset): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of subsection (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(C) Each Settling State further agrees that, subject to the provisions of section IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection (B) above to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on liability that would give rise to an offset under such subsection if paid by an Original Participating Manufacturer.

(5) This release and covenant shall not operate to interfere with a Settling State's ability to enforce as against any Participating Manufacturer the provisions of this Agreement, or with the Court's ability to enter the Consent Decree or to maintain continuing jurisdiction to enforce such Consent Decree pursuant to the terms thereof. Provided, however, that neither subsection III(a) or III(r) of this Agreement nor subsection V(A) or V(I) of the Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

(6) The Settling States do not purport to waive or release any claims on behalf of Indian tribes.

(7) The Settling States do not waive or release any criminal liability based on federal, state or local law.

(8) Notwithstanding the foregoing (and the definition of Released Parties), this release and covenant shall not apply to retailers, suppliers or distributors to the extent of any liability arising from the sale or distribution of Tobacco Products of, or the supply of component parts of Tobacco Products to, any non-Released Party.

(A) Each Settling State (for itself and for the Releasing Parties) agrees that, if a claim by a Releasing Party against a retailer, supplier or distributor that would be a Released Claim but for the operation of the preceding sentence results in or in any way gives rise to a claim-over (on any theory whatever) by such retailer, supplier or distributor against any Released Party (and such Released Party gives notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), the Releasing Party: (i) shall reduce or credit against any judgment or settlement such Releasing Party may obtain against such retailer, supplier or distributor the full amount of any judgment or settlement such retailer, supplier or distributor may obtain against the Released Party on such claim-over; and (ii) shall, as part of any settlement with such retailer, supplier or distributor, obtain from such retailer, supplier or distributor for the benefit of such Released Party a satisfaction in full of such retailer's, supplier's or distributor's judgment or settlement against the Released Party.

(B) Each Settling State further agrees that in the event that the provisions of subsection (8)(A) above do not fully eliminate any and all liability of any Original Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship to an Original Participating Manufacturer) with respect to claims-over (on any theory whatever) by any such retailer, supplier or distributor to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement (to the extent that such Released Party has given notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), judgment or otherwise) of such retailer, supplier or distributor to any Releasing Party arising out of any claim that would be a Released Claim but for the operation of the first sentence of this subsection (8), such Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any amounts paid by such Original Participating Manufacturer (or by any person or entity that is a Released Party by virtue of its relation to such Original Participating Manufacturer) on any such liability against such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment each year, until all such amounts paid on such liability have been offset. In the event that the offset under this subsection (8) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the offset for miscalculated or disputed payments, the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offset for claims-over under subsection XII(a)(4)(B)): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of clause (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(C) Each Settling State further agrees that, subject to the provisions of subsection IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection (B) above to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on liability that would give rise to an offset under such subsection if paid by an Original Participating Manufacturer.

(9) Notwithstanding any provision of law, statutory or otherwise, which provides that a general release does not extend to claims which the creditor does not know or suspect to exist in its favor at the time of executing the release, which if known by it must have materially affected its settlement with the debtor, the releases set forth in this section XII release all Released Claims against the Released Parties, whether known or unknown, foreseen or unforeseen, suspected or unsuspected, that the Releasing Parties may have against the Released Parties, and the Releasing Parties understand and acknowledge the significance and consequences of waiver of any such provision and hereby assume full responsibility for any injuries, damages or losses that the Releasing Parties may incur.

(b) Released Claims Against Released Parties. If a Releasing Party (or any person or entity enumerated in subsection II(pp), without regard to the power of the Attorney General to release claims of such person or entity) nonetheless attempts to maintain a Released Claim against a Released Party, such Released Party shall give written notice of such potential claim to the Attorney General of the applicable Settling State within 30 days of receiving notice of such potential claim (or within 30 days after the MSA Execution Date, whichever is later) (unless such potential claim is being maintained by such Settling State). The Released Party may offer the release and covenant as a complete defense. If it is determined at any point in such action that the release of such claim is unenforceable or invalid for any reason (including, but not limited to, lack of authority to release such claim), the following provisions shall apply:

(1) The Released Party shall take all ordinary and reasonable measures to defend the action fully. The Released Party may settle or enter into a stipulated judgment with respect to the action at any time in its sole discretion, but in such event the offset described in subsection (b)(2) or (b)(3) below shall apply only if the Released Party obtains the relevant Attorney General's consent to such settlement or stipulated judgment, which consent shall not be unreasonably withheld. The Released Party shall not be entitled to the offset described in subsection (b)(2) or (b)(3) below if such Released Party failed to take ordinary and reasonable measures to defend the action fully.

(2) The following provisions shall apply where the Released Party is an Original Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship with an Original Participating Manufacturer):

(A) In the event of a settlement or stipulated judgment, the settlement or stipulated amount shall give rise to a continuing offset as such amount is actually paid against the full amount of such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment until such time as the settlement or stipulated amount is fully credited on a dollar-for-dollar basis.

(B) Judgments (other than a default judgment) against a Released Party in such an action shall, upon payment of such judgment, give rise to an immediate and continuing offset against the full amount of such Original Participating Manufacturer's share (determined as described in subsection (A)) of the applicable Settling State's Allocated Payment, until such time as the judgment is fully credited on a dollar-for-dollar basis.

(C) Each Settling State reserves the right to intervene in such an action (unless such action was brought by the Settling State) to the extent authorized by applicable law in order to protect the Settling State's interest under this Agreement. Each Participating Manufacturer agrees not to oppose any such intervention.

(D) In the event that the offset under this subsection (b)(2) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the Federal Tobacco Legislation Offset and the offset for miscalculated or disputed payments): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection (2) in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of clause (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(3) The following provisions shall apply where the Released Party is a Subsequent Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship with a Subsequent Participating Manufacturer): Subject to the provisions of subsection IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset as described in subsections (2)(A)-(C) above against payments it otherwise would owe under section IX(i) to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on a settlement, stipulated judgment or judgment that would give rise to an offset under such subsections if paid by an Original Participating Manufacturer.

XIII. CONSENT DECREES AND DISMISSAL OF CLAIMS

(a) Within 10 days after the MSA Execution Date (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit), each Settling State and each Participating Manufacturer that is a party in any of the lawsuits identified in Exhibit D shall jointly move for a stay of all proceedings in such Settling State's lawsuit with respect to the Participating Manufacturers and all other Released Parties (except any proceeding seeking public disclosure of documents pursuant to subsection IV(b)). Such stay of a Settling State's lawsuit shall be dissolved upon the earlier of the occurrence of State-Specific Finality or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Not later than December 11, 1998 (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit):

(1) each Settling State that is a party to a lawsuit identified in Exhibit D and each Participating Manufacturer will:

(A) tender this Agreement to the Court in such Settling State for its approval; and

(B) tender to the Court in such Settling State for entry a consent decree conforming to the model consent decree attached hereto as Exhibit L (revisions or changes to such model consent decree shall be limited to the extent required by state procedural requirements to reflect accurately the factual setting of the case in question, but shall not include any substantive revision to the duties or obligations of any Settling State or Participating Manufacturer, except by agreement of all Original Participating Manufacturers); and

(2) each Settling State shall seek entry of an order of dismissal of claims dismissing with prejudice all claims against the Participating Manufacturers and any other Released Party in such Settling State's action identified in Exhibit D. Provided, however, that the Settling State is not required to seek entry of such an order in such Settling State's action against such a Released Party (other than a Participating Manufacturer) unless and until such Released Party has released the Releasing Parties (and delivered to the Attorney General of such Settling State a copy of such release) (which release shall be effective upon the occurrence of State-Specific Finality in such Settling State, and shall recite that in the event this Agreement is terminated with respect to such Settling State pursuant to subsection XVIII(u)(1) the Released Party agrees that the order of dismissal shall be null and void and of no effect) from any and all Claims of such Released Party relating to the prosecution of such action as provided in subsection XII(a)(2).

XIV. PARTICIPATING MANUFACTURERS' DISMISSAL OF RELATED LAWSUITS

(a) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will dismiss without prejudice (and without costs and fees) the lawsuit(s) listed in Exhibit M pending in such Settling State in which the Participating Manufacturer is a plaintiff. Within 10 days after the MSA Execution Date, each Participating Manufacturer and each Settling State that is a party in any of the lawsuits listed in Exhibit M shall jointly move for a stay of all proceedings in such lawsuit. Such stay of a lawsuit against a Settling State shall be dissolved upon the earlier of the occurrence of State-Specific Finality in such Settling State or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will release and discharge any and all monetary Claims against such Settling State and any of such Settling State's officers, employees, agents, administrators, representatives, officials acting in their official capacity, agencies, departments, commissions, divisions and counsel relating to or in connection with the lawsuit(s) commenced by the Attorney General of such Settling State identified in Exhibit D.

(c) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will release and discharge any and all monetary Claims against all subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts) of such Settling State, and any of their officers, employees, agents, administrators, representatives, officials acting in their official capacity, agencies, departments, commissions, divisions and counsel arising out of Claims that have been waived and released with continuing full force and effect pursuant to section XII of this Agreement.

XV. VOLUNTARY ACT OF THE PARTIES

The Settling States and the Participating Manufacturers acknowledge and agree that this Agreement is voluntarily entered into by each Settling State and each Participating Manufacturer as the result of arm's-length negotiations, and each Settling State and each Participating Manufacturer was represented by counsel in deciding to enter into this Agreement. Each Participating Manufacturer further acknowledges that it understands that certain provisions of this Agreement may require it to act or refrain from acting in a manner that could otherwise give rise to state or federal constitutional challenges and that, by voluntarily consenting to this Agreement, it (and the Tobacco-Related Organizations (or any trade associations formed or controlled by any Participating Manufacturer)) waives for purposes of performance of this Agreement any and all claims that the provisions of this Agreement violate the state or federal constitutions. Provided, however, that nothing in the foregoing shall constitute a waiver as to the entry of any court order (or any interpretation thereof) that would operate to limit the exercise of any constitutional right except to the extent of the restrictions, limitations or obligations expressly agreed to in this Agreement or the Consent Decree.

XVI. CONSTRUCTION

(a) No Settling State or Participating Manufacturer shall be considered the drafter of this Agreement or any Consent Decree, or any provision of either, for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter.

(b) Nothing in this Agreement shall be construed as approval by the Settling States of any Participating Manufacturer's business organizations, operations, acts or practices, and no Participating Manufacturer may make any representation to the contrary.

XVII. RECOVERY OF COSTS AND ATTORNEYS' FEES

(a) The Original Participating Manufacturers agree that, with respect to any Settling State in which the Court has approved this Agreement and the Consent Decree, they shall severally reimburse the following "Governmental Entities": (1) the office of the Attorney General of such Settling State; (2) the office of the governmental prosecuting authority for any political subdivision of such Settling State with a lawsuit pending against any Participating Manufacturer as of July 1, 1998 (as identified in Exhibit N) that has released such Settling State and such Participating Manufacturer(s) from any and all Released Claims (a "Litigating Political Subdivision"); and (3) other appropriate agencies of such Settling State and such Litigating Political Subdivision, for reasonable costs and expenses incurred in connection with the litigation or resolution of claims asserted by or against the Participating Manufacturers in the actions set forth in Exhibits D, M and N; provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers would reimburse their own counsel or agents (but not including costs and expenses relating to lobbying activities).

(b) The Original Participating Manufacturers further agree severally to pay the Governmental Entities in any Settling State in which State-Specific Finality has occurred an amount sufficient to compensate such Governmental Entities for time reasonably expended by attorneys and paralegals employed in such offices in connection with the litigation or resolution of claims asserted against or by the Participating Manufacturers in the actions identified in Exhibits D, M and N (but not including time relating to lobbying activities), such amount to be calculated based upon hourly rates equal to the market rate in such Settling State for private attorneys and paralegals of equivalent experience and seniority.

(c) Such Governmental Entities seeking payment pursuant to subsection (a) and/or (b) shall provide the Original Participating Manufacturers with an appropriately documented statement of all costs, expenses and attorney and paralegal time for which payment is sought, and, solely with respect to payments sought pursuant to subsection (b), shall do so no earlier than the date on which State-Specific Finality occurs in such Settling State. All amounts to be paid pursuant to

subsections (a) and (b) shall be subject to reasonable verification if requested by any Original Participating Manufacturer; provided, however, that nothing contained in this subsection (c) shall constitute, cause, or require the performance of any act that would constitute any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint prosecution privilege. All such amounts to be paid pursuant to subsections (a) and (b) shall be subject to an aggregate cap of \$150 million for all Settling States, shall be paid promptly following submission of the appropriate documentation (and the completion of any verification process), shall be paid separately and apart from any other amounts due pursuant to this Agreement, and shall be paid severally by each Original Participating Manufacturer according to its Relative Market Share. All amounts to be paid pursuant to subsection (b) shall be paid to such Governmental Entities in the order in which State-Specific Finality has occurred in such Settling States (subject to the \$150 million aggregate cap).

(d) The Original Participating Manufacturers agree that, upon the occurrence of State-Specific Finality in a Settling State, they will severally pay reasonable attorneys' fees to the private outside counsel, if any, retained by such Settling State (and each Litigating Political Subdivision, if any, within such Settling State) in connection with the respective actions identified in Exhibits D, M and N and who are designated in Exhibit S for each Settling State by the relevant Attorney General (and for each Litigating Political Subdivision, as later certified in writing to the Original Participating Manufacturers by the relevant governmental prosecuting authority of each Litigating Political Subdivision) as having been retained by and having represented such Settling State (or such Litigating Political Subdivision), in accordance with the terms described in the Model Fee Payment Agreement attached as Exhibit O.

XVIII. MISCELLANEOUS

(a) Effect of Current or Future Law. If any current or future law includes obligations or prohibitions applying to Tobacco Product Manufacturers related to any of the provisions of this Agreement, each Participating Manufacturer shall comply with this Agreement unless compliance with this Agreement would violate such law.

(b) Limited Most-Favored Nation Provision.

(1) If any Participating Manufacturer enters into any future settlement agreement of other litigation comparable to any of the actions identified in Exhibit D brought by a non-foreign governmental plaintiff other than the federal government ("Future Settlement Agreement"):

(A) before October 1, 2000, on overall terms more favorable to such governmental plaintiff than the overall terms of this Agreement (after due consideration of relevant differences in population or other appropriate factors), then, unless a majority of the Settling States determines that the overall terms of the Future Settlement Agreement are not more favorable than the overall terms of this Agreement, the overall terms of this Agreement will be revised so that the Settling States will obtain treatment with respect to such Participating Manufacturer at least as relatively favorable as the overall terms provided to any such governmental plaintiff; provided, however, that as to economic terms this Agreement shall not be revised based on any such Future Settlement Agreement if such Future Settlement Agreement is entered into after: (i) the impaneling of the jury (or, in the event of a non-jury trial, the commencement of trial) in such litigation or any severed or bifurcated portion thereof; or (ii) any court order or judicial determination relating to such litigation that (x) grants judgment (in whole or in part) against such Participating Manufacturer; or (y) grants injunctive or other relief that affects the assets or on-going business activities of such Participating Manufacturer in a manner other than as expressly provided for in this Agreement; or

(B) on or after October 1, 2000, on non-economic terms more favorable to such governmental plaintiff than the non-economic terms of this Agreement, and such Future Settlement Agreement includes terms that provide for the implementation of non-economic tobacco-related public health measures different from those contained in this Agreement, then this Agreement shall be revised with respect to such Participating Manufacturer to include terms comparable to such non-economic terms, unless a majority of the Settling States elects against such revision.

(2) If any Settling State resolves by settlement Claims against any Non-Participating Manufacturer after the MSA Execution Date comparable to any Released Claim, and such resolution includes overall terms that are more favorable to such Non-Participating Manufacturer than the terms of this Agreement (including, without limitation, any terms that relate to the marketing or distribution of Tobacco Products and any term that provides for a lower settlement cost on a per pack sold basis), then the overall terms of this Agreement will be revised so that the Original Participating Manufacturers will obtain, with respect to that Settling State, overall terms at least as relatively favorable (taking into account, among other things, all payments previously made by the Original Participating Manufacturers and the timing of any payments) as those obtained by such Non-Participating Manufacturer pursuant to such resolution of Claims. The foregoing shall include but not be limited: (a) to the treatment by any Settling State of a Future Affiliate, as that term is defined in agreements between any of the Settling States and Brooke Group Ltd., Liggett & Myers Inc. and/or Liggett Group, Inc. ("Liggett"), whether or not such Future Affiliate is merged with, or its operations combined with, Liggett or any Affiliate thereof; and (b) to any application of the terms of any such agreement (including any terms subsequently negotiated pursuant to any such agreement) to a brand of Cigarettes (or tobacco-related assets) as a result of the purchase by or sale to Liggett of such brand or assets or as a result of any combination of ownership among Liggett and any entity that manufactures Tobacco Products. Provided, however, that revision of this Agreement pursuant to this subsection (2) shall not be required by virtue of the subsequent entry into this Agreement by a Tobacco Product Manufacturer that has not become a Participating Manufacturer as of the MSA Execution Date. Notwithstanding the provisions of subsection XVIII(j), the provisions of this subsection XVIII(b)(2) may be waived by (and only by) unanimous agreement of the Original Participating Manufacturers.

(3) The parties agree that if any term of this Agreement is revised pursuant to subsection (b)(1) or (b)(2) above and the substance of such term before it was revised was also a term of the Consent Decree, each affected Settling State and each affected Participating Manufacturer shall jointly move the Court to amend the Consent Decree to conform the terms of the Consent Decree to the revised terms of the Agreement.

(4) If at any time any Settling State agrees to relieve, in any respect, any Participating Manufacturer's obligation to make the payments as provided in this Agreement, then, with respect to that Settling State, the terms of this Agreement shall be revised so that the other Participating Manufacturers receive terms as relatively favorable.

(c) Transfer of Tobacco Brands. No Original Participating Manufacturer may sell or otherwise transfer or permit the sale or transfer of any of its Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses (other than a sale or transfer of Cigarette brands or Brand Names to be sold, product formulas to be used, or Cigarette businesses to be conducted, by the acquiror or transferee exclusively outside of the States) to any person or entity unless such person or entity is an Original Participating Manufacturer or prior to the sale or acquisition agrees to assume the obligations of an Original Participating Manufacturer with respect to such Cigarette brands, Brand Names, Cigarette product formulas or businesses. No Participating Manufacturer may sell or otherwise transfer any of its Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses (other than a sale or transfer of Cigarette brands or Brand Names to be sold, Cigarette product formulas to be used, or businesses to be conducted, by the acquiror or transferee exclusively outside of the States) to any person or entity unless such person or entity is or becomes prior to the sale or acquisition a Participating Manufacturer. In the event of any such sale or transfer of a Cigarette brand, Brand Name, Cigarette product formula or Cigarette business by a Participating Manufacturer to a person or entity that within 180 days prior to such sale or transfer was a Non-Participating Manufacturer, the Participating Manufacturer shall certify to the Settling States that it has determined that such person or entity has the capability to perform the obligations under this Agreement. Such certification shall not survive beyond one year following the date of any such transfer. Each Original Participating Manufacturer certifies and represents that, except as provided in Exhibit R, it (or a wholly owned Affiliate) exclusively owns and controls in the States the Brand Names of those Cigarettes that it currently manufactures for sale (or sells) in the States and that it has the capacity to enter into an effective agreement concerning the sale or transfer of such Brand Names pursuant to this subsection XVIII(c). Nothing in this Agreement is intended to create any right for a State to obtain any Cigarette product formula that it would not otherwise have under applicable law.

(d) Payments in Settlement. All payments to be made by the Participating Manufacturers pursuant to this Agreement are in settlement of all of the Settling States' antitrust, consumer protection, common law negligence, statutory, common law and equitable claims for monetary, restitutionary, equitable and injunctive relief alleged by the Settling States with respect to the year of payment or earlier years, except that no part of any payment under this Agreement is made in settlement of an actual or potential liability for a fine, penalty (civil or criminal) or enhanced damages or is the cost of a tangible or intangible asset or other future benefit.

(e) No Determination or Admission. This Agreement is not intended to be and shall not in any event be construed or deemed to be, or represented or caused to be represented as, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Agreement; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it by the Attorneys General of the Settling States and the Litigating Political Subdivisions. Each Participating Manufacturer has entered into this Agreement solely to avoid the further expense, inconvenience, burden and risk of litigation.

(f) Non-Admissibility. The settlement negotiations resulting in this Agreement have been undertaken by the Settling States and the Participating Manufacturers in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Agreement shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Agreement nor any public discussions, public statements or public comments with respect to this Agreement by any Settling State or Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Agreement.

(g) Representations of Parties. Each Settling State and each Participating Manufacturer hereby represents that this Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of them. The signatories hereto on behalf of their respective Settling States expressly represent and warrant that they have the authority to settle and release all Released Claims of their respective Settling States and any of their respective Settling States' past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions, and that such signatories are aware of no authority to the contrary. It is recognized that the Original Participating Manufacturers are relying on the foregoing representation and warranty in making the payments required by and in otherwise performing under this Agreement. The Original Participating Manufacturers shall have the right to terminate this Agreement pursuant to subsection XVIII(u) as to any Settling State as to which the foregoing representation and warranty is breached or not effectively given.

(h) Obligations Several, Not Joint. All obligations of the Participating Manufacturers pursuant to this Agreement (including, but not limited to, all payment obligations) are intended to be, and shall remain, several and not joint.

(i) Headings. The headings of the sections and subsections of this Agreement are not binding and are for reference only and do not limit, expand or otherwise affect the contents or meaning of this Agreement.

(j) Amendment and Waiver. This Agreement may be amended by a written instrument executed by all Participating Manufacturers affected by the amendment and by all Settling States affected by the amendment. The terms of any such amendment shall not be enforceable in any Settling State that is not a signatory to such amendment. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving party or parties. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, nor shall such waiver be deemed to be or construed as a waiver by any other party.

(k) Notices. All notices or other communications to any party to this Agreement shall be in writing (including, but not limited to, facsimile, telex, telecopy or similar writing) and shall be given at the addresses specified in Exhibit P (as it may be amended to reflect any additional Participating Manufacturer that becomes a party to this Agreement after the MSA Execution Date). Any Settling State or Participating Manufacturer may change or add the name and address of the persons designated to receive notice on its behalf by notice given (effective upon the giving of such notice) as provided in this subsection.

(l) Cooperation. Each Settling State and each Participating Manufacturer agrees to use its best efforts and to cooperate with each other to cause this Agreement and the Consent Decrees to become effective, to obtain all necessary approvals, consents and authorizations, if any, and to execute all documents and to take such other action as may be appropriate in connection herewith. Consistent with the foregoing, each Settling State and each Participating Manufacturer agrees that it will not directly or indirectly assist or encourage any challenge to this Agreement or any Consent Decree by any other person, and will support the integrity and enforcement of the terms of this Agreement and the Consent Decrees. Each Settling State shall use its best efforts to cause State-Specific Finality to occur as to such Settling State.

(m) Designees to Discuss Disputes. Within 14 days after the MSA Execution Date, each Settling State's Attorney General and each Participating Manufacturer shall provide written notice of its designation of a senior representative to discuss with the other signatories to this Agreement any disputes and/or other issues that may arise with respect to this Agreement. Each Settling State's Attorney General shall provide such notice of the name, address and telephone number of the person it has so designated to each Participating Manufacturer and to NAAG. Each Participating Manufacturer shall provide such notice of the name, address and telephone number of the person it has so designated to each Settling State's Attorney General, to NAAG and to each other Participating Manufacturer.

(n) Governing Law. This Agreement (other than the Escrow Agreement) shall be governed by the laws of the relevant Settling State, without regard to the conflict of law rules of such Settling State. The Escrow Agreement shall be governed by the laws of the State in which the Escrow Court is located, without regard to the conflict of law rules of such State.

(o) Severability.

(1) Sections VI, VII, IX, X, XI, XII, XIII, XIV, XVI, XVIII(b), (c), (d), (e), (f), (g), (h), (o), (p), (r), (s), (u), (w), (z), (bb), (dd), and Exhibits A, B, and E hereof ("Nonseverable Provisions") are not severable, except to the extent that severance of section VI is permitted by Settling States pursuant to subsection VI(i) hereof. The remaining terms of this Agreement are severable, as set forth herein.

(2) If a court materially modifies, renders unenforceable, or finds to be unlawful any of the Nonseverable Provisions, the NAAG executive committee shall select a team of Attorneys General (the "Negotiating Team") to attempt to negotiate an equivalent or comparable substitute term or other appropriate credit or adjustment (a "Substitute Term") with the Original Participating Manufacturers. In the event that the court referred to in the preceding sentence is located in a Settling State, the Negotiating Team shall include the Attorney General of such Settling State. The Original Participating Manufacturers shall have no obligation to agree to any Substitute Term. If any Original Participating Manufacturer does not agree to a Substitute Term, this Agreement shall be terminated in all Settling States affected by the court's ruling. The Negotiating Team shall submit any proposed Substitute Term negotiated by the Negotiating Team and agreed to by all of the Original Participating Manufacturers to the Attorneys General of all of the affected Settling States for their approval. If any affected Settling State does not approve the proposed Substitute Term, this Agreement in such Settling State shall be terminated.

(3) If a court materially modifies, renders unenforceable, or finds to be unlawful any term of this Agreement other than a Nonseverable Provision:

(A) The remaining terms of this Agreement shall remain in full force and effect.

(B) Each Settling State whose rights or obligations under this Agreement are affected by the court's decision in question (the "Affected Settling State") and the Participating Manufacturers agree to negotiate in good faith a Substitute Term. Any agreement on a Substitute Term reached between the Participating Manufacturers and the Affected Settling State shall not modify or amend the terms of this Agreement with regard to any other Settling State.

(C) If the Affected Settling State and the Participating Manufacturers are unable to agree on a Substitute Term, then they will submit the issue to non-binding mediation. If mediation fails to produce agreement to a Substitute Term, then that term shall be severed and the remainder of this Agreement shall remain in full force and effect.

(4) If a court materially modifies, renders unenforceable, or finds to be unlawful any portion of any provision of this Agreement, the remaining portions of such provision shall be unenforceable with respect to the affected Settling State unless a Substitute Term is arrived at pursuant to subsection (o)(2) or (o)(3) hereof, whichever is applicable.

(p) Intended Beneficiaries. No portion of this Agreement shall provide any rights to, or be enforceable by, any person or entity that is not a Settling State or a Released Party. No Settling State may assign or otherwise convey any right to enforce any provision of this Agreement.

(q) Counterparts. This Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered as valid signatures as of the date affixed, although the original signature pages shall thereafter be appended.

(r) Applicability. The obligations and duties of each Participating Manufacturer set forth herein are applicable only to actions taken (or omitted to be taken) within the States. This subsection (r) shall not be construed as extending the territorial scope of any obligation or duty set forth herein whose scope is otherwise limited by the terms hereof.

(s) Preservation of Privilege. Nothing contained in this Agreement or any Consent Decree, and no act required to be performed pursuant to this Agreement or any Consent Decree, is intended to constitute, cause or effect any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint defense privilege, and each Settling State and each Participating Manufacturer agrees that it shall not make or cause to be made in any forum any assertion to the contrary.

(t) Non-Release. Except as otherwise specifically provided in this Agreement, nothing in this Agreement shall limit, prejudice or otherwise interfere with the rights of any Settling State or any Participating Manufacturer to pursue any and all rights and remedies it may have against any Non-Participating Manufacturer or other non-Released Party.

(u) Termination.

(1) Unless otherwise agreed to by each of the Original Participating Manufacturers and the Settling State in question, in the event that (A) State-Specific Finality in a Settling State does not occur in such Settling State on or before December 31, 2001; or (B) this Agreement or the Consent Decree has been disapproved by the Court (or, in the event of an appeal from or review of a decision of the Court to approve this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review), and the time to Appeal from such disapproval has expired, or, in the event of an Appeal from such disapproval, the Appeal has been dismissed or the disapproval has been affirmed by the court of last resort to which such Appeal has been taken and such dismissal or disapproval has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court); or (C) this Agreement is terminated in a Settling State for whatever reason (including, but not limited to, pursuant to subsection XVIII(o) of this Agreement), then this Agreement and all of its terms (except for the non-admissibility provisions hereof, which shall continue in full force and effect) shall be canceled and terminated with respect to such Settling State, and it and all orders issued by the courts in such Settling State pursuant hereto shall become null and void and of no effect.

(2) If this Agreement is terminated with respect to a Settling State for whatever reason, then (A) the applicable statute of limitation or any similar time requirement shall be tolled from the date such Settling State signed this Agreement until the later of the time permitted by applicable law or for one year from the date of such termination, with the effect that the parties shall be in the same position with respect to the statute of limitation as they were at the time such Settling State filed its action, and (B) the parties shall jointly move the Court for an order reinstating the actions and claims dismissed pursuant to sections XIII and XIV hereof, with the effect that the parties shall be in the same position with respect to those actions and claims as they were at the time the action or claim was stayed or dismissed.

(v) Freedom of Information Requests. Upon the occurrence of State-Specific Finality in a Settling State, each Participating Manufacturer will withdraw in writing any and all requests for information, administrative applications, and proceedings brought or caused to be brought by such Participating Manufacturer pursuant to such Settling State's freedom of information law relating to the subject matter of the lawsuits identified in Exhibit D.

(w) Bankruptcy. The following provisions shall apply if a Participating Manufacturer both enters Bankruptcy and at any time thereafter is not timely performing its financial obligations as required under this Agreement:

(1) In the event that both a number of Settling States equal to at least 75% of the total number of Settling States and Settling States having aggregate Allocable Shares equal to at least 75% of the total aggregate Allocable Shares assigned to all Settling States deem (by written notice to the Participating Manufacturers other than the bankrupt Participating Manufacturer) that the financial obligations of this Agreement have been terminated and rendered null and void as to such bankrupt Participating Manufacturer (except as provided in subsection (A) below) due to a material breach by such Participating Manufacturer, whereupon, with respect to all Settling States:

(A) all agreements, all concessions, all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall be null and void as to such Participating Manufacturer. Provided, however, that (i) all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall remain in full force and effect as to all persons or entities (other than the bankrupt Participating Manufacturer itself or any person or entity that, as a result of the Bankruptcy, obtains domestic tobacco assets of such

Participating Manufacturer (unless such person or entity is itself a Participating Manufacturer)) who (but for the first sentence of this subsection (A)) would otherwise be Released Parties by virtue of their relationship with the bankrupt Participating Manufacturer; and (ii) in the event a Settling State asserts any Released Claim against a bankrupt Participating Manufacturer after the termination of this Agreement with respect to such Participating Manufacturer as described in this subsection (1) and receives a judgment, settlement or distribution arising from such Released Claim, then the amount of any payments such Settling State has previously received from such Participating Manufacturer under this Agreement shall be applied against the amount of any such judgment, settlement or distribution (provided that in no event shall such Settling State be required to refund any payments previously received from such Participating Manufacturer pursuant to this Agreement);

(B) the Settling States shall have the right to assert any and all claims against such Participating Manufacturer in the Bankruptcy or otherwise without regard to any limits otherwise provided in this Agreement (subject to any and all defenses against such claims);

(C) the Settling States may exercise all rights provided under the federal Bankruptcy Code (or other applicable bankruptcy law) with respect to their Claims against such Participating Manufacturer, including the right to initiate and complete police and regulatory actions against such Participating Manufacturer pursuant to the exceptions to the automatic stay set forth in section 362(b) of the Bankruptcy Code (provided, however, that such Participating Manufacturer may contest whether the Settling State's action constitutes a police and regulatory action); and

(D) to the extent that any Settling State is pursuing a police and regulatory action against such Participating Manufacturer as described in subsection (1)(C), such Participating Manufacturer shall not request or support a request that the Bankruptcy court utilize the authority provided under section 105 of the Bankruptcy Code to impose a discretionary stay on the Settling State's action. The Participating Manufacturers further agree that they will not request, seek or support relief from the terms of this Agreement in any proceeding before any court of law (including the federal bankruptcy courts) or an administrative agency or through legislative action, including (without limitation) by way of joinder in or consent to or acquiescence in any such pleading or instrument filed by another.

(2) Whether or not the Settling States exercise the option set forth in subsection (1) (and whether or not such option, if exercised, is valid and enforceable):

(A) In the event that the bankrupt Participating Manufacturer is an Original Participating Manufacturer, such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer for all purposes under this Agreement except (i) such Participating Manufacturer shall be treated as a Non-Participating Manufacturer (and not as an Original Participating Manufacturer or Participating Manufacturer) for all purposes with respect to subsections IX(d)(1), IX(d)(2) and IX(d)(3) (including, but not limited to, that the Market Share of such Participating Manufacturer shall not be included in Base Aggregate Participating Manufacturer Market Share or Actual Aggregate Participating Manufacturer Market Share, and that such Participating Manufacturer's volume shall not be included for any purpose under subsection IX(d)(1)(D)); (ii) such Participating Manufacturer's Market Share shall not be included as that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(e) has been achieved (provided that such Participating Manufacturer shall be treated as an Original Participating Manufacturer for all other purposes with respect to such subsection); (iii) for purposes of subsection (B)(iii) of Exhibit E, such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer, but its operating income shall be recalculated by the Independent Auditor to reflect what such income would have been had such Participating Manufacturer made the payments that would have been due under this Agreement but for the Bankruptcy; (iv) for purposes of subsection XVIII(c), such Participating Manufacturer shall not be treated as an Original Participating Manufacturer or as a Participating Manufacturer to the extent that after entry into Bankruptcy it becomes the acquiror or transferee of Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection); and (v) as to any action that by the express terms of this Agreement requires the unanimous agreement of all Original Participating Manufacturers.

(B) In the event that the bankrupt Participating Manufacturer is a Subsequent Participating Manufacturer, such Participating Manufacturer shall continue to be treated as a Subsequent Participating Manufacturer for all purposes under this Agreement except (i) such Participating Manufacturer shall be treated as a Non-Participating Manufacturer (and not as a Subsequent Participating Manufacturer or Participating Manufacturer) for all purposes with respect to subsections IX(d)(1), (d)(2) and (d)(4) (including, but not limited to, that the Market Share of such Participating Manufacturer shall not be included in Base Aggregate Participating Manufacturer Market Share or Actual Aggregate Participating Manufacturer Market Share, and that such Participating Manufacturer's volume shall not be included for any purpose under subsection IX(d)(1)(D)); (ii) such Participating Manufacturer's Market Share shall not be included as that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(e) has been achieved (provided that such Participating Manufacturer shall be treated as a Subsequent Participating Manufacturer for all other purposes with respect to such subsection); and (iii) for purposes of subsection XVIII(c), such Participating Manufacturer shall not be treated as a Subsequent Participating Manufacturer or as a Participating Manufacturer to the extent that after entry into Bankruptcy it becomes the acquiror or transferee of Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall

continue to be treated as a Subsequent Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection).

(C) Revision of this Agreement pursuant to subsection XVIII(b)(2) shall not be required by virtue of any resolution on an involuntary basis in the Bankruptcy of Claims against the bankrupt Participating Manufacturer.

(x) Notice of Material Transfers. Each Participating Manufacturer shall provide notice to each Settling State at least 20 days before consummating a sale, transfer of title or other disposition, in one transaction or series of related transactions, of assets having a fair market value equal to five percent or more (determined in accordance with United States generally accepted accounting principles) of the consolidated assets of such Participating Manufacturer.

(y) Entire Agreement. This Agreement (together with any agreements expressly contemplated hereby and any other contemporaneous written agreements) embodies the entire agreement and understanding between and among the Settling States and the Participating Manufacturers relating to the subject matter hereof and supersedes (1) all prior agreements and understandings relating to such subject matter, whether written or oral, and (2) all purportedly contemporaneous oral agreements and understandings relating to such subject matter.

(z) Business Days. Any obligation hereunder that, under the terms of this Agreement, is to be performed on a day that is not a Business Day shall be performed on the first Business Day thereafter.

(aa) Subsequent Signatories. With respect to a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, the timing of obligations under this Agreement (other than payment obligations, which shall be governed by subsection II(jj)) shall be negotiated to provide for the institution of such obligations on a schedule not more favorable to such subsequent signatory than that applicable to the Original Participating Manufacturers.

(bb) Decimal Places. Any figure or percentage referred to in this Agreement shall be carried to seven decimal places.

(cc) Regulatory Authority. Nothing in section III of this Agreement is intended to affect the legislative or regulatory authority of any local or State government.

(dd) Successors. In the event that a Participating Manufacturer ceases selling a brand of Tobacco Products in the States that such Participating Manufacturer owned in the States prior to July 1, 1998, and an Affiliate of such Participating Manufacturer thereafter and after the MSA Execution Date intentionally sells such brand in the States, such Affiliate shall be considered to be the successor of such Participating Manufacturer with respect to such brand. Performance by any such successor of the obligations under this Agreement with respect to the sales of such brand shall be subject to court-ordered specific performance.

(ee) Export Packaging. Each Participating Manufacturer shall place a visible indication on each pack of Cigarettes it manufactures for sale outside of the fifty United States and the District of Columbia that distinguishes such pack from packs of Cigarettes it manufactures for sale in the fifty United States and the District of Columbia.

(ff) Actions Within Geographic Boundaries of Settling States. To the extent that any provision of this Agreement expressly prohibits, restricts, or requires any action to be taken "within" any Settling State or the Settling States, the relevant prohibition, restriction, or requirement applies within the geographic boundaries of the applicable Settling State or Settling States, including, but not limited to, Indian country or Indian trust land within such geographic boundaries.

(gg) Notice to Affiliates. Each Participating Manufacturer shall give notice of this Agreement to each of its Affiliates.

IN WITNESS WHEREOF, each Settling State and each Participating Manufacturer, through their fully authorized representatives, have agreed to this Agreement.

[Signatures Intentionally Omitted]

**EXHIBIT A
STATE ALLOCATION PERCENTAGES**

State	Percentage
Alabama	1.6161308%
Alaska	0.3414187%
Arizona	1.4738845%
Arkansas	0.8280661%
California	12.7639554%
Colorado	1.3708614%
Connecticut	1.8565373%
Delaware	0.3954695%
D.C.	0.6071183%
Florida	0.0000000%
Georgia	2.4544575%
Hawaii	0.6018650%
Idaho	0.3632632%
Illinois	4.6542472%
Indiana	2.0398033%
Iowa	0.8696670%
Kansas	0.8336712%
Kentucky	1.7611586%
Louisiana	2.2553531%
Maine	0.7693505%
Maryland	2.2604570%
Massachusetts	4.0389790%
Michigan	4.3519476%
Minnesota	0.0000000%
Mississippi	0.0000000%
Missouri	2.2746011%
Montana	0.4247591%
Nebraska	0.5949833%
Nevada	0.6099351%
New Hampshire	0.6659340%
New Jersey	3.8669963%
New Mexico	0.5963897%
New York	12.7620310%
North Carolina	2.3322850%
North Dakota	0.3660138%
Ohio	5.0375098%
Oklahoma	1.0361370%
Oregon	1.1476582%
Pennsylvania	5.7468588%
Rhode Island	0.7189054%
South Carolina	1.1763519%
South Dakota	0.3489458%
Tennessee	2.4408945%
Texas	0.0000000%
Utah	0.4448869%
Vermont	0.4111851%
Virginia	2.0447451%
Washington	2.0532582%
West Virginia	0.8864604%
Wisconsin	2.0720390%
Wyoming	0.2483449%
American Samoa	0.0152170%
N. Mariana Isl.	0.0084376%
Guam	0.0219371%
U.S. Virgin Isl.	0.0173593%
Puerto Rico	1.1212774%
Total	100.0000000%

**EXHIBIT B
FORM OF ESCROW AGREEMENT**

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

WITNESSETH:

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

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

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1. Appointment of Escrow Agent.

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

SECTION 2. Definitions.

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

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

SECTION 3. Escrow and Accounts.

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

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

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

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

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

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

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

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

SECTION 4. Failure of Escrow Agent to Receive Instructions.

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

SECTION 5. Investment of Funds by Escrow Agent.

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

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

Each signatory to this Escrow Agreement shall provide the Escrow Agent with a correct taxpayer identification number on a substitute Form W-9 or if it does not have such a number, a statement evidencing its status as an entity exempt from back-up withholding, within 30 days of the date hereof (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). The escrow established pursuant to this Escrow Agreement is intended to be treated as a Qualified Settlement Fund for federal tax purposes pursuant to Treas. Reg. § 1.468B-1. The Escrow Agent shall comply with all applicable tax filing, payment and reporting requirements, including, without limitation, those imposed under Treas. Reg. § 1.468B, and if requested to do so shall join in the making of the relation-back election under such regulation.

SECTION 7. Duties and Liabilities of Escrow Agent.

The Escrow Agent shall have no duty or obligation hereunder other than to take such specific actions as are required of it from time to time under the provisions of this Escrow Agreement, and it shall incur no liability hereunder or in connection herewith for anything whatsoever other than any liability resulting from its own gross negligence or willful misconduct. The Escrow Agent shall not be bound in any way by any agreement or contract between the Participating Manufacturers and the Settling States (whether or not the Escrow Agent has knowledge thereof) other than this Escrow Agreement, and the only duties and responsibilities of the Escrow Agent shall be the duties and obligations specifically set forth in this Escrow Agreement.

SECTION 8. Indemnification of Escrow Agent.

The Participating Manufacturers shall indemnify, hold harmless and defend the Escrow Agent from and against any and all losses, claims, liabilities and reasonable expenses, including the reasonable fees of its counsel, which it may suffer or incur in connection with the performance of its duties and obligations under this Escrow Agreement, except for those losses, claims, liabilities and expenses resulting solely and directly from its own gross negligence or willful misconduct.

SECTION 9. Resignation of Escrow Agent.

The Escrow Agent may resign at any time by giving written notice thereof to the other parties hereto, but such resignation shall not become effective until a successor Escrow Agent, selected by the Original Participating Manufacturers and the Settling States, shall have been appointed and shall have accepted such appointment in writing. If an instrument of acceptance by a successor Escrow Agent shall not have been delivered to the resigning Escrow Agent within 90 days after the giving of such notice of resignation, the resigning Escrow Agent may, at the expense of the Participating Manufacturers (to

be shared according to their pro rata Market Shares), petition the Escrow Court for the appointment of a successor Escrow Agent.

SECTION 10. Escrow Agent Fees and Expenses.

The Participating Manufacturers shall pay to the Escrow Agent its fees as set forth in Appendix A hereto as amended from time to time by agreement of the Original Participating Manufacturers and the Escrow Agent. The Participating Manufacturers shall pay to the Escrow Agent its reasonable fees and expenses, including all reasonable expenses, charges, counsel fees, and other disbursements incurred by it or by its attorneys, agents and employees in the performance of its duties and obligations under this Escrow Agreement. Such fees and expenses shall be shared by the Participating Manufacturers according to their pro rata Market Shares.

SECTION 11. Notices.

All notices, written instructions or other communications to any party or other person hereunder shall be given in the same manner as, shall be given to the same person as, and shall be effective at the same time as provided in subsection XVIII(k) of the Agreement.

SECTION 12. Setoff; Reimbursement.

The Escrow Agent acknowledges that it shall not be entitled to set off against any funds in, or payable from, any Account to satisfy any liability of any Participating Manufacturer. Each Participating Manufacturer that pays more than its pro rata Market Share of any payment that is made by the Participating Manufacturers to the Escrow Agent pursuant to Section 8, 9 or 10 hereof shall be entitled to reimbursement of such excess from the other Participating Manufacturers according to their pro rata Market Shares of such excess.

SECTION 13. Intended Beneficiaries; Successors.

No persons or entities other than the Settling States, the Participating Manufacturers and the Escrow Agent are intended beneficiaries of this Escrow Agreement, and only the Settling States, the Participating Manufacturers and the Escrow Agent shall be entitled to enforce the terms of this Escrow Agreement. Pursuant to the Agreement, the Settling States have designated NAAG and the Foundation as recipients of certain payments; for all purposes of this Escrow Agreement, the Settling States shall be the beneficiaries of such payments entitled to enforce payment thereof. The provisions of this Escrow Agreement shall be binding upon and inure to the benefit of the parties hereto and, in the case of the Escrow Agent and Participating Manufacturers, their respective successors. Each reference herein to the Escrow Agent or to a Participating Manufacturer shall be construed as a reference to its successor, where applicable.

SECTION 14. Governing Law.

This Escrow Agreement shall be construed in accordance with and governed by the laws of the State in which the Escrow Court is located, without regard to the conflicts of law rules of such state.

SECTION 15. Jurisdiction and Venue.

The parties hereto irrevocably and unconditionally submit to the continuing exclusive jurisdiction of the Escrow Court for purposes of any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, this Escrow Agreement, and the parties hereto agree not to commence any such suit, action or proceeding except in the Escrow Court. The parties hereto hereby irrevocably and unconditionally waive any objection to the laying of venue of any such suit, action or proceeding in the Escrow Court and hereby further irrevocably waive and agree not to plead or claim in the Escrow Court that any such suit, action or proceeding has been brought in an inconvenient forum.

SECTION 16. Amendments.

This Escrow Agreement may be amended only by written instrument executed by all of the parties hereto that would be affected by the amendment. The waiver of any rights conferred hereunder shall be effective only if made in a written instrument executed by the waiving party. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this Escrow Agreement, nor shall such waiver be deemed to be or construed as a waiver by any other party.

SECTION 17. Counterparts.

This Agreement may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. Delivery by facsimile of a signed counterpart shall be deemed delivery for purposes of acknowledging acceptance hereof; however, an original executed Escrow Agreement must promptly thereafter be delivered to each party.

SECTION 18. Captions.

The captions herein are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 19. Conditions to Effectiveness.

This Escrow Agreement shall become effective when each party hereto shall have signed a counterpart hereof. The parties hereto agree to use their best efforts to seek an order of the Escrow Court approving, and retaining continuing jurisdiction over, the Escrow Agreement as soon as possible, and agree that such order shall relate back to, and be deemed effective as of, the date this Escrow Agreement became effective.

SECTION 20. *Address for Payments.*

Whenever funds are under the terms of this Escrow Agreement required to be disbursed to a Settling State, a Participating Manufacturer, NAAG or the Foundation, the Escrow Agent shall disburse such funds by wire transfer to the account specified by such payee by written notice delivered to all Notice Parties in accordance with Section 11 hereof at least five Business Days prior to the date of payment. Whenever funds are under the terms of this Escrow Agreement required to be disbursed to any other person or entity, the Escrow Agent shall disburse such funds to such account as shall have been specified in writing by the Independent Auditor for such payment at least five Business Days prior to the date of payment.

SECTION 21. *Reporting.*

The Escrow Agent shall provide such information and reporting with respect to the escrow as the Independent Auditor may from time to time request.

IN WITNESS WHEREOF, the parties have executed this Escrow Agreement as of the day and year first hereinabove written.

[Signature Blocks]

Appendix A
Schedule Of Fees And Expenses

EXHIBIT C
FORMULA FOR CALCULATING
INFLATION ADJUSTMENTS

- (1) Any amount that, in any given year, is to be adjusted for inflation pursuant to this Exhibit (the "Base Amount") shall be adjusted upward by adding to such Base Amount the Inflation Adjustment.
- (2) The Inflation Adjustment shall be calculated by multiplying the Base Amount by the Inflation Adjustment Percentage applicable in that year.
- (3) The Inflation Adjustment Percentage applicable to payments due in the year 2000 shall be equal to the greater of 3% or the CPI%. For example, if the Consumer Price Index for December 1999 (as released in January 2000) is 2% higher than the Consumer Price Index for December 1998 (as released in January 1999), then the CPI% with respect to a payment due in 2000 would be 2%. The Inflation Adjustment Percentage applicable in the year 2000 would thus be 3%.
- (4) The Inflation Adjustment Percentage applicable to payments due in any year after 2000 shall be calculated by applying each year the greater of 3% or the CPI% on the Inflation Adjustment Percentage applicable to payments due in the prior year. Continuing the example in subsection (3) above, if the CPI% with respect to a payment due in 2001 is 6%, then the Inflation Adjustment Percentage applicable in 2001 would be 9.1800000% (an additional 6% applied on the 3% Inflation Adjustment Percentage applicable in 2000), and if the CPI% with respect to a payment due in 2002 is 4%, then the Inflation Adjustment Percentage applicable in 2002 would be 13.5472000% (an additional 4% applied on the 9.1800000% Inflation Adjustment Percentage applicable in 2001).
- (5) "Consumer Price Index" means the Consumer Price Index for All Urban Consumers as published by the Bureau of Labor Statistics of the U.S. Department of Labor (or other similar measures agreed to by the Settling States and the Participating Manufacturers).
- (6) The "CPI%" means the actual total percent change in the Consumer Price Index during the calendar year immediately preceding the year in which the payment in question is due.
- (7) Additional Examples.

(A) Calculating the Inflation Adjustment Percentages:

Payment Year	Hypothetical CPI%	Percentage to be applied on the Inflation Adjustment Percentage for the prior year (i.e., the greater of 3% or the CPI%)	Inflation Adjustment Percentage
2000	2.4%	3.0%	3.0000000%
2001	2.1%	3.0%	6.0900000%
2002	3.5%	3.5%	9.8031500%
2003	3.5%	3.5%	13.6462603%
2004	4.0%	4.0%	18.1921107%
2005	2.2%	3.0%	21.7378740%
2006	1.6%	3.0%	25.3900102%

(B) Applying the Inflation Adjustment:

- Using the hypothetical Inflation Adjustment Percentages set forth in section (7)(A):
- the subsection IX(c)(1) base payment amount for 2002 of \$6,500,000,000 as adjusted for inflation would equal \$7,137,204,750;
- the subsection IX(c)(1) base payment amount for 2004 of \$8,000,000,000 as adjusted for inflation would equal \$9,455,368,856;
- the subsection IX(c)(1) base payment amount for 2006 of \$8,000,000,000 as adjusted for inflation would equal \$10,031,200,816.

EXHIBIT D
LIST OF LAWSUITS

1. Alabama
Baylock et al. v. American Tobacco Co. et al., Circuit Court, Montgomery County, No. CV-96-1508-PR
2. Alaska
State of Alaska v. Philip Morris, Inc., et al., Superior Court, First Judicial District of Juneau, No. IJU-97915 CI (Alaska)
3. Arizona
State of Arizona v. American Tobacco Co., Inc., et al., Superior Court, Maricopa County, No. CV-96-14769 (Ariz.)
4. Arkansas
State of Arkansas v. The American Tobacco Co., Inc., et al., Chancery Court, 6th Division, Pulaski County, No. IJ 97-2982 (Ark.)
5. California
People of the State of California et al. v. Philip Morris, Inc., et al., Superior Court, Sacramento County, No. 97-AS-30301
6. Colorado
State of Colorado et al., v. R.J. Reynolds Tobacco Co., et al., District Court, City and County of Denver, No. 97CV3432 (Colo.)
7. Connecticut
State of Connecticut v. Philip Morris, et al., Superior Court, Judicial District of Waterbury No. X02 CV96-0148414S (Conn.)
8. Georgia
State of Georgia et al. v. Philip Morris, Inc., et al., Superior Court, Fulton County, No. CA E-61692 (Ga.)
9. Hawaii
State of Hawaii v. Brown & Williamson Tobacco Corp., et al., Circuit Court, First Circuit, No. 97-0441-01 (Haw.)
10. Idaho
State of Idaho v. Philip Morris, Inc., et al., Fourth Judicial District, Ada County, No. CVOC 9703239D (Idaho)
11. Illinois
People of the State of Illinois v. Philip Morris et al., Circuit Court of Cook County, No. 96-L13146 (Ill.)
12. Indiana
State of Indiana v. Philip Morris, Inc., et al., Marion County Superior Court, No. 49D 07-9702-CT-000236 (Ind.)
13. Iowa
State of Iowa v. R.J. Reynolds Tobacco Company et al., Iowa District Court, Fifth Judicial District, Polk County, No. CL71048 (Iowa)
14. Kansas
State of Kansas v. R.J. Reynolds Tobacco Company, et al., District Court of Shawnee County, Division 2, No. 96-CV-919 (Kan.)
15. Louisiana
Ieyoub v. The American Tobacco Company, et al., 14th Judicial District Court, Calcasieu Parish, No. 96-1209 (La.)
16. Maine
State of Maine v. Philip Morris, Inc., et al., Superior Court, Kennebec County, No. CV 97-134 (Me.)
17. Maryland
Maryland v. Philip Morris Incorporated, et al., Baltimore City Circuit Court, No. 96-122017-CL211487 (Md.)
18. Massachusetts
Commonwealth of Massachusetts v. Philip Morris Inc., et al., Middlesex Superior Court, No. 95-7378 (Mass.)
19. Michigan
Kelley v. Philip Morris Incorporated, et al., Ingham County Circuit Court, 30th Judicial Circuit, No. 96-84281-CZ (Mich.)
20. Missouri
State of Missouri v. American Tobacco Co., Inc. et al., Circuit Court, City of St. Louis, No. 972-1465 (Mo.)
21. Montana
State of Montana v. Philip Morris, Inc., et al., First Judicial Court, Lewis and Clark County, No. CDV 9700306-14 (Mont.)
22. Nebraska
State of Nebraska v. R.J. Reynolds Tobacco Co., et al., District Court, Lancaster County, No. 573277 (Neb.)

23. Nevada
Nevada v. Philip Morris, Incorporated, et al., Second Judicial Court, Washoe County, No. CV97-03279 (Nev.)
24. New Hampshire
New Hampshire v. R.J. Reynolds Tobacco Co., et al., New Hampshire Superior Court, Merrimack County, No. 97-E-165 (N.H.)
25. New Jersey
State of New Jersey v. R.J. Reynolds Tobacco Company, et al., Superior Court, Chancery Division, Middlesex County, No. C-254-96 (N.J.)
26. New Mexico
State of New Mexico v. The American Tobacco Co., et al., First Judicial District Court, County of Santa Fe, No. SF-1235 c (N.M.)
27. New York State
State of New York et al. v. Philip Morris, Inc., et al., Supreme Court of the State of New York, County of New York, No. 400361/97 (N.Y.)
28. Ohio
State of Ohio v. Philip Morris, Inc., et al., Court of Common Pleas, Franklin County, No. 97CVH055114 (Ohio)
29. Oklahoma
State of Oklahoma, et al. v. R.J. Reynolds Tobacco Company, et al., District Court, Cleveland County, No. CJ-96-1499-L (Okla.)
30. Oregon
State of Oregon v. The American Tobacco Co., et al., Circuit Court, Multnomah County, No. 9706-04457 (Or.)
31. Pennsylvania
Commonwealth of Pennsylvania v. Philip Morris, Inc., et al., Court of Common Pleas, Philadelphia County, April Term 1997, No. 2443
32. Puerto Rico
Rossello, et al. v. Brown & Williamson Tobacco Corporation, et al., U.S. District Court, Puerto Rico, No. 97-1910JAF
33. Rhode Island
State of Rhode Island v. American Tobacco Co., et al., Rhode Island Superior Court, Providence, No. 97-3058 (R.I.)
34. South Carolina
State of South Carolina v. Brown & Williamson Tobacco Corporation, et al., Court of Common Pleas, Fifth Judicial Circuit, Richland County, No. 97-CP-40-1686 (S.C.)
35. South Dakota
State of South Dakota, et al. v. Philip Morris, Inc., et al., Circuit Court, Hughes County, Sixth Judicial Circuit, No. 98-65 (S.D.)
36. Utah
State of Utah v. R.J. Reynolds Tobacco Company, et al., U.S. District Court, Central Division, No. 96 CV 0829W (Utah)
37. Vermont
State of Vermont v. Philip Morris, Inc., et al., Chittenden Superior Court, Chittenden County, No. 744-97 (Vt.) and 5816-98 (Vt.)
38. Washington
State of Washington v. American Tobacco Co. Inc., et al., Superior Court of Washington, King County, No. 96-2-1505608SEA (Wash.)
39. West Virginia
McGraw, et al. v. The American Tobacco Company, et al., Kanawha County Circuit Court, No. 94-1707 (W. Va.)
40. Wisconsin
State of Wisconsin v. Philip Morris Inc., et al., Circuit Court, Branch 11, Dane County, No. 97-CV-328 (Wis.)
- Additional States

For each Settling State not listed above, the lawsuit or other legal action filed by the Attorney General or Governor of such Settling State against *Participating Manufacturers* in the Court in such Settling State prior to 30 days after the MSA Execution Date asserting Released Claims.

EXHIBIT E
FORMULA FOR CALCULATING
VOLUME ADJUSTMENTS

Any amount that by the terms of the Master Settlement Agreement is to be adjusted pursuant to this Exhibit E (the "Applicable Base Payment") shall be adjusted in the following manner:

(A) In the event the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico by the Original Participating Manufacturers in the Applicable Year (as defined hereinbelow) (the "Actual Volume") is greater than 475,656,000,000 Cigarettes (the "Base Volume"), the Applicable Base Payment shall be multiplied by the ratio of the Actual Volume to the Base Volume.

(B) In the event the Actual Volume is less than the Base Volume,

i. The Applicable Base Payment shall be reduced by subtracting from it the amount equal to such Applicable Base Payment multiplied both by 0.98 and by the result of (i) 1(one) minus (ii) the ratio of the Actual Volume to the Base Volume.

ii. Solely for purposes of calculating volume adjustments to the payments required under subsection IX(c)(1), if a reduction of the Base Payment due under such subsection results from the application of subparagraph (B)(i) of this Exhibit E, but the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes for the Applicable Year in the fifty United States, the District of Columbia, and Puerto Rico (the "Actual Operating Income") is greater than \$7,195,340,000 (the "Base Operating Income") (such Base Operating Income being adjusted upward in accordance with the formula for inflation adjustments set forth in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996) then the amount by which such Base Payment is reduced by the application of subsection (B)(i) shall be reduced (but not below zero) by the amount calculated by multiplying (i) a percentage equal to the aggregate Allocable Shares of the Settling States in which State-Specific Finality has occurred by (ii) 25% of such increase in such operating income. For purposes of this Exhibit E, "operating income from sales of Cigarettes" shall mean operating income from sales of Cigarettes in the fifty United States, the District of Columbia, and Puerto Rico: (a) before goodwill amortization, trademark amortization, restructuring charges and restructuring related charges, minority interest, net interest expense, non-operating income and expense, general corporate expenses and income taxes; and (b) excluding extraordinary items, cumulative effect of changes in method of accounting and discontinued operations -- all as such income is reported to the United States Securities and Exchange Commission ("SEC") for the Applicable Year (either independently by the Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of such Participating Manufacturer) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with U.S. generally accepted accounting principles and audited by a nationally recognized accounting firm. For years subsequent to 1998, the determination of the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes shall not exclude any charges or expenses incurred or accrued in connection with this Agreement or any prior settlement of a tobacco and health case and shall otherwise be derived using the same principles as were employed in deriving such Original Participating Manufacturers' aggregate operating income from sales of Cigarettes in 1996.

iii. Any increase in a Base Payment pursuant to subsection (B)(ii) above shall be allocated among the Original Participating Manufacturers in the following manner:

(1) only to those Original Participating Manufacturers whose operating income from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico for the year for which the Base Payment is being adjusted is greater than their respective operating income from such sales of Cigarettes (including operating income from such sales of any of their Affiliates that do not continue to have such sales after the MSA Execution Date) in 1996 (as increased for inflation as provided in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996); and

(2) among the Original Participating Manufacturers described in paragraph (1) above in proportion to the ratio of (x) the increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of the Original Participating Manufacturer in question, to (y) the aggregate increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of those Original Participating Manufacturers described in paragraph (1) above.

(C) "Applicable Year" means the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

(D) For purposes of this Exhibit, shipments shall be measured as provided in subsection II(mm).

EXHIBIT F
POTENTIAL LEGISLATION NOT TO BE OPPOSED

1. Limitations on Youth access to vending machines.
2. Inclusion of cigars within the definition of tobacco products.
3. Enhancement of enforcement efforts to identify and prosecute violations of laws prohibiting retail sales to Youth.
4. Encouraging or supporting use of technology to increase effectiveness of age-of-purchase laws, such as, without limitation, the use of programmable scanners, scanners to read drivers' licenses, or use of other age/ID data banks.
5. Limitations on promotional programs for non-tobacco goods using tobacco products as prizes or give-aways.
6. Enforcement of access restrictions through penalties on Youth for possession or use.
7. Limitations on tobacco product advertising in or on school facilities, or wearing of tobacco logo merchandise in or on school property.
8. Limitations on non-tobacco products which are designed to look like tobacco products, such as bubble gum cigars, candy cigarettes, etc.

EXHIBIT G
OBLIGATIONS OF THE TOBACCO INSTITUTE
UNDER THE MASTER SETTLEMENT AGREEMENT

(a) Upon court approval of a plan of dissolution The Tobacco Institute ("TI") will:

(1) Employees. Promptly notify and arrange for the termination of the employment of all employees; provided, however, that TI may continue to engage any employee who is (A) essential to the wind-down function as set forth in section (g) herein; (B) reasonably needed for the sole purpose of directing and supporting TI's defense of ongoing litigation; or (C) reasonably needed for the sole purpose of performing the Tobacco Institute Testing Laboratory's (the "TITL") industry-wide cigarette testing pursuant to the Federal Trade Commission (the "FTC") method or any other testing prescribed by state or federal law as set forth in section (h) herein.

(2) Employee Benefits. Fund all employee benefit and pension programs; provided, however, that unless ERISA or other federal or state law prohibits it, such funding will be accomplished through periodic contributions by the Original Participating Manufacturers, according to their Relative Market Shares, into a trust or a like mechanism, which trust or like mechanism will be established within 90 days of court approval of the plan of dissolution. An opinion letter will be appended to the dissolution plan to certify that the trust plan is not inconsistent with ERISA or employee benefit pension contracts.

(3) Leases. Terminate all leaseholds at the earliest possible date pursuant to the leases; provided, however, that TI may retain or lease anew such space (or lease other space) as needed for its wind-down activities, for TITL testing as described herein, and for subsequent litigation defense activities. Immediately upon execution of this Agreement, TI will provide notice to each of its landlords of its desire to terminate its lease with such landlord, and will request that the landlord take all steps to re-lease the premises at the earliest possible date consistent with TI's performance of its obligations hereunder. TI will vacate such leasehold premises as soon as they are re-leased or on the last day of wind-down, whichever occurs first.

(b) Assets/Debts. Within 60 days after court approval of a plan of dissolution, TI will provide to the Attorney General of New York and append to the dissolution plan a description of all of its assets, its debts, tax claims against it, claims of state and federal governments against it, creditor claims against it, pending litigation in which it is a party and notices of claims against it.

(c) Documents. Subject to the privacy protections provided by New York Public Officers Law §§ 91-99, TI will provide a copy of or otherwise make available to the State of New York all documents in its possession, excluding those that TI continues to claim to be subject to any attorney-client privilege, attorney work product protection, common interest/joint defense privilege or any other applicable privilege (collectively, "privilege") after the re-examination of privilege claims pursuant to court order in *State of Oklahoma v. R.J. Reynolds Tobacco Company, et al.*, CJ-96-2499-L (Dist. Ct., Cleveland County) (the "Oklahoma action"):

(1) TI will deliver to the Attorney General of the State of New York a copy of the privilege log served by it in the Oklahoma action. Upon a written request by the Attorney General, TI will deliver an updated version of its privilege log, if any such updated version exists.

(2) The disclosure of any document or documents claimed to be privileged will be governed by section IV of this Agreement.

(3) At the conclusion of the document production and privilege logging process, TI will provide a sworn affidavit that all documents in its possession have been made available to the Attorney General of New York except for documents claimed to be privileged, and that any privilege logs that already exist have been made available to the Attorney General.

(d) Remaining Assets. On mutual agreement between TI and the Attorney General of New York, a not-for-profit health or child welfare organization will be named as the beneficiary of any TI assets that remain after lawful transfers of assets and satisfaction of TI's employee benefit obligations and any other debts, liabilities or claims.

(e) Defense of Litigation. Pursuant to Section 1006 of the New York Not-for-Profit Corporations Law, TI will have the right to continue to defend its litigation interests with respect to any claims against it that are pending or threatened now or that are brought or threatened in the future. TI will retain sole discretion over all litigation decisions, including, without limitation, decisions with respect to asserting any privileges or defenses, having privileged communications and creating privileged documents, filing pleadings, responding to discovery requests, making motions, filing affidavits and briefs, conducting party and non-party discovery, retaining expert witnesses and consultants, preparing for and defending itself at trial, settling any claims asserted against it, intervening or otherwise participating in litigation to protect interests that it deems significant to its defense, and otherwise directing or conducting its defense. Pursuant to existing joint defense agreements, TI may continue to assist its current or former members in defense of any litigation brought or threatened against them. TI also may enter into any new joint defense agreement or agreements that it deems significant to its defense of pending or threatened claims. TI may continue to engage such employees as reasonably needed for the sole purpose of directing and supporting its defense of ongoing litigation. As soon as TI has no litigation pending against it, it will dissolve completely and will cease all functions consistent with the requirements of law.

(f) No public statement. Except as necessary in the course of litigation defense as set forth in section (e) above, upon court approval of a plan of dissolution, neither TI nor any of its employees or agents acting in their official capacity on behalf of TI will issue any statements, press releases, or other public statement concerning tobacco.

(g) Wind-down. After court approval of a plan of dissolution, TI will effectuate wind-down of all activities (other than its defense of litigation as described in section (e) above) expeditiously, and in no event later than 180 days after the date of court approval of the plan of dissolution. TI will provide monthly status reports to the Attorney General of New York regarding the progress of wind-down efforts and work remaining to be done with respect to such efforts.

(h) TITL. Notwithstanding any other provision of this Exhibit G or the dissolution plan, TI may perform TITL industry-wide cigarette testing pursuant to the FTC method or any other testing prescribed by state or federal law until such function is transferred to another entity, which transfer will be accomplished as soon as practicable but in no event more than 180 days after court approval of the dissolution plan.

(i) Jurisdiction. After the filing of a Certificate of Dissolution, pursuant to Section 1004 of the New York Not-for-Profit Corporation Law, the Supreme Court for the State of New York will have continuing jurisdiction over the dissolution of TI and the winding-down of TI's activities, including any litigation-related activities described in subsection (e) herein.

(j) No Determination or Admission. The dissolution of TI and any proceedings taken hereunder are not intended to be and shall not in any event be construed as, deemed to be, or represented or caused to be represented by any Settling State as, an admission or concession or evidence of any liability or any wrongdoing whatsoever on the part of TI, any of its current or former members or anyone acting on their behalf. TI specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it by the Attorneys General of the Settling States.

(k) Court Approval. The Attorney General of the State of New York and the Original Participating Manufacturers will prepare a joint plan of dissolution for submission to the Supreme Court of the State of New York, all of the terms of which will be agreed on and consented to by the Attorney General and the Original Participating Manufacturers consistent with this schedule. The Original Participating Manufacturers and their employees, as officers and directors of TI, will take whatever steps are necessary to execute all documents needed to develop such a plan of dissolution and to submit it to the court for approval. If any court makes any material change to any term or provision of the plan of dissolution agreed upon and consented to by the Attorney General and the Original Participating Manufacturers, then:

(1) the Original Participating Manufacturers may, at their election, nevertheless proceed with the dissolution plan as modified by the court; or

(2) if the Original Participating Manufacturers elect not to proceed with the court-modified dissolution plan, the Original Participating Manufacturers will be released from any obligations or undertakings under this Agreement or this schedule with respect to TI; provided, however, that the Original Participating Manufacturers will engage in good faith negotiations with the New York Attorney General to agree upon the term or terms of the dissolution plan that the court may have modified in an effort to agree upon a dissolution plan that may be resubmitted for the court's consideration.

EXHIBIT H DOCUMENT PRODUCTION

Section 1.

- (a) Philip Morris Companies, Inc., et al., v. American Broadcasting Companies, Inc., et al., At Law No. 760CL94X00816-00 (Cir. Ct., City of Richmond)
- (b) Harley-Davidson v. Lorillard Tobacco Co., No. 93-947 (S.D.N.Y.)
- (c) Lorillard Tobacco Co. v. Harley-Davidson, No. 93-6098 (E.D. Wis.)
- (d) Brown & Williamson v. Jacobson and CBS, Inc., No. 82-648 (N.D. Ill.)
- (e) The FTC investigations of tobacco industry advertising and promotion as embodied in the following cites:
- 46 FTC 706
 - 48 FTC 82
 - 46 FTC 735
 - 47 FTC 1393
 - 108 F. Supp. 573
 - 55 FTC 354
 - 56 FTC 96
 - 79 FTC 255
 - 80 FTC 455
 - Investigation #8023069
 - Investigation #8323222

Each Original Participating Manufacturer and Tobacco-Related Organization will conduct its own reasonable inquiry to determine what documents or deposition testimony, if any, it produced or provided in the above-listed matters.

Section 2.

- (a) State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King)
- (b) In re Mike Moore, Attorney General, ex rel. State of Mississippi Tobacco Litigation, No. 94-1429 (Chancery Ct., Jackson, Miss.)
- (c) State of Florida v. American Tobacco Co., et al., No. CL 95-1466 AH (Fla. Cir. Ct., 15th Judicial Cir., Palm Beach Co.)
- (d) State of Texas v. American Tobacco Co., et al., No. 5-96CV-91 (E.D. Tex.)
- (e) Minnesota v. Philip Morris et al., No. C-94-8565 (Minn. Dist. Ct., County of Ramsey)
- (f) Broin v. R.J. Reynolds, No. 91-49738 CA (22) (11th Judicial Ct., Dade County, Florida)

EXHIBIT I
INDEX AND SEARCH FEATURES FOR DOCUMENT WEBSITE

(a) Each Original Participating Manufacturer and Tobacco-Related Organization will create and maintain on its website, at its expense, an enhanced, searchable index, as described below, using Alta-Vista or functionally comparable software, for all of the documents currently on its website and all documents being placed on its website pursuant to section IV of this Agreement.

(b) The searchable indices of documents on these websites will include:

(1) all of the information contained in the 4(b) indices produced to the State Attorneys General (excluding fields specific only to the Minnesota action other than "request number");

(2) the following additional fields of information (or their substantial equivalent) to the extent such information already exists in an electronic format that can be incorporated into such an index:

Document ID	Master ID
Other Number	Document Date
Primary Type	Other Type
Person Attending	Person Noted
Person Author	Person Recipient
Person Copied	Person Mentioned
Organization Author	Organization Recipient
Organization Copied	Organization Mentioned
Organization Attending	Organization Noted
Physical Attachment 1	Physical Attachment 2
Characteristics	File Name
Site	Area
Verbatim Title	Old Brand
Primary Brand	Mentioned Brand
Page Count	

(c) Each Original Participating Manufacturer and Tobacco-Related Organization will add, if not already available, a user-friendly document retrieval feature on the Website consisting of a "view all pages" function with enhanced image viewer capability that will enable users to choose to view and/or print either "all pages" for a specific document or "page-by-page".

(d) Each Original Participating Manufacturer and Tobacco-Related Organizations will provide at its own expense to NAAG a copy set in electronic form of its website document images and its accompanying subsection IV(h) index in ASCII-delimited form for all of the documents currently on its website and all of the documents described in subsection IV(d) of this Agreement. The Original Participating Manufacturers and Tobacco-Related Organizations will not object to any subsequent distribution and/or reproduction of these copy sets.

EXHIBIT J
TOBACCO ENFORCEMENT FUND PROTOCOL

The States' Antitrust/Consumer Protection Tobacco Enforcement Fund ("Fund") is established by the Attorneys General of the Settling States, acting through NAAG, pursuant to section VIII(c) of the Agreement. The following shall be the primary and mandatory protocol for the administration of the Fund.

Section A
Fund Purpose

Section 1

The monies to be paid pursuant to section VIII(c) of the Agreement shall be placed by NAAG in a new and separate interest bearing account, denominated the States' Antitrust/ Consumer Protection Tobacco Enforcement Fund, which shall not then or thereafter be commingled with any other funds or accounts. However, nothing herein shall prevent deposits into the account so long as monies so deposited are then lawfully committed for the purpose of the Fund as set forth herein.

Section 2

A committee of three Attorneys General ("Special Committee") shall be established to determine disbursements from the account, using the process described herein. The three shall be the Attorney General of the State of Washington, the Chair of NAAG's antitrust committee, and the Chair of NAAG's consumer protection committee. In the event that an Attorney General shall hold either two or three of the above stated positions, that Attorney General may serve only in a single capacity, and shall be replaced in the remaining positions by first, the President of NAAG, next by the President-Elect of NAAG and if necessary the Vice-President of NAAG.

Section 3

The purpose of the Fund is: (1) to enforce and implement the terms of the Agreement, in particular, by partial payment of the monetary costs of the Independent Auditor as contemplated by the Agreement; and (2) to provide monetary assistance to the various states' attorneys general: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute ("Qualifying Actions"). The Special Committee shall entertain requests only from Settling States for disbursement from the fund associated with a Qualifying Action ("Grant Application").

Section B
Administration Standards Relative to Grant Applications

Section 1

The Special Committee shall not entertain any Grant Application to pay salaries or ordinary expenses of regular employees of any Attorney General's office.

Section 2

The affirmative vote of two or more of the members of the Special Committee shall be required to approve any Grant Application.

Section 3

The decision of the Special Committee shall be final and non-appealable.

Section 4

The Attorney General of the State of Washington shall be chair of the Special Committee and shall annually report to the Attorneys General on the requests for funds from the Fund and the actions of the Special Committee upon the requests.

Section 5

When a Grant Application to the Fund is made by an Attorney General who is then a member of the Special Committee, such member will be temporarily replaced on the Committee, but only for the determination of such Grant Application. The remaining members of the Special Committee shall designate an Attorney General to replace the Attorney General so disqualified, in order to consider the application.

Section 6

The Fund shall be maintained in a federally insured depository institution located in Washington, D.C. Funds may be invested in federal government-backed vehicles. The Fund shall be regularly reported on NAAG financial statements and subject to annual audit.

Section 7

Withdrawals from and checks drawn on the Fund will require at least two of three authorized signatures. The three persons so authorized shall be the executive director, the deputy director, and controller of NAAG.

Section 8

The Special Committee shall meet in person or telephonically as necessary to determine whether a grant is sought for assistance with a Qualifying Action and whether and to what extent the Grant Application is accepted. The chair of the

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

Section 9

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

Section 10

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

Section 11

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

Section 12

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

Section 13

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

**Section C
Grant Application Procedures**

Section 1

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

Section 2

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

Section 3

Grant Applications must include the following:

- (A) A description of the contemplated/pending action, including the scope of the alleged violation and the area (state/regional/multi-state) likely to be affected by the suspected offending conduct.
- (B) A statement whether the action is actively and currently pursued by any other Attorney General or other prosecuting authority.
- (C) A description of the purposes for which the monies sought will be used.
- (D) The amount requested.
- (E) A directive as to how disbursements from the Fund should be made, e.g., either directly to a supplier of services (consultants, experts, witnesses, and the like), to the Attorney General's office directly, or in the case of multi-state action, to one or more Attorneys General's offices designated as a recipient of the monies.

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

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

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

Section 4

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

Section 5

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

**Section D
Other Disbursements from the Fund**

Section 1

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

**Section E
Administrative Costs**

Section 1

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

EXHIBIT K
MARKET CAPITALIZATION PERCENTAGES

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

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 [XXXXXXXXXXXXX],
Plaintiff,
v. CONSENT DECREE AND FINAL JUDGMENT
[XXXXXX XXXXX XXXX], et al.,
Defendants.
----- x

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

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

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

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

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

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

I. JURISDICTION AND VENUE

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

II. DEFINITIONS

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

III. APPLICABILITY

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

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

IV. VOLUNTARY ACT OF THE PARTIES

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

V. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

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

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

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

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

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

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

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

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

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

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

VI. MISCELLANEOUS PROVISIONS

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

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

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

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

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

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

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

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

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

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

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

VII. FINAL DISPOSITION

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

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

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this ____ day of _____, 1998.

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

1. Philip Morris, Inc., et al. v. Margery Bronster, Attorney General of the State of Hawaii, In Her Official Capacity, Civ. No. 96-00722HG, United States District Court for the District of Hawaii
2. Philip Morris, Inc., et al. v. Bruce Botelho, Attorney General of the State of Alaska, In His Official Capacity, Civ. No. A97-0003CV, United States District Court for the District of Alaska
3. Philip Morris, Inc., et al. v. Scott Harshbarger, Attorney General of the Commonwealth of Massachusetts, In His Official Capacity, Civ. No. 95-12574-GAO, United States District Court for the District of Massachusetts
4. Philip Morris, Inc., et al. v. Richard Blumenthal, Attorney General of the State of Connecticut, In His Official Capacity, Civ. No. 396CV01221 (PCD), United States District Court for the District of Connecticut
5. Philip Morris, et al. v. William H. Sorrell, et al., No. 1:98-ev-132, United States District Court for the District of Vermont

EXHIBIT N
LITIGATING POLITICAL SUBDIVISIONS

1. City of New York, et al. v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of New York, Index No. 406225/96
2. County of Erie v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of Erie, Index No. 1 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 became 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]

[Intentionally Omitted]

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 Q
1996 AND 1997 DATA

(1) 1996 Operating Income

<u>Original Participating Manufacturer</u>	<u>Operating Income</u>
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)

<u>Original Participating Manufacturer</u>	<u>Number of Cigarettes</u>
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)

<u>Original Participating Manufacturer</u>	<u>Number of Cigarettes</u>
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]

B-42

S-1

EXHIBIT T
MODEL STATUTE

Section __. Findings and Purpose.¹

(a) Cigarette smoking presents serious public health concerns to the State and to the citizens of the State. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the State. Under certain health-care programs, the State may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the State pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

(d) It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts.

(e) On _____, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the State. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the State (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

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

Section __. Definitions.

(a) "Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

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

(c) "Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

(d) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

(e) "Master Settlement Agreement" means the settlement agreement (and related documents) entered into on _____, 1998 by the State and leading United States tobacco product manufacturers.

(f) "Qualified escrow fund" means an escrow arrangement with a federally or State chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least \$1,000,000,000 where such arrangement requires that such financial institution hold the escrowed funds' principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing or directing the use of the funds' principal except as consistent with section __ (b)-(c) of this Act.

(g) "Released claims" means Released Claims as that term is defined in the Master Settlement Agreement.

(h) "Releasing parties" means Releasing Parties as that term is defined in the Master Settlement Agreement.

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

T-1

(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

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).]

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.]

EXHIBIT U
STRATEGIC CONTRIBUTION FUND PROTOCOL

The payments made by the Participating Manufacturers pursuant to section IX(c)(2) of the Agreement ("Strategic Contribution Fund") shall be allocated among the Settling States pursuant to the process set forth in this Exhibit U.

Section 1

A panel committee of three former Attorneys General or former Article III judges ("Allocation Committee") shall be established to determine allocations of the Strategic Contribution Fund, using the process described herein. Two of the three members of the Allocation Committee shall be selected by the NAAG executive committee. Those two members shall choose the third Allocation Committee member. The Allocation Committee shall be geographically and politically diverse.

Section 2

Within 60 days after the MSA Execution Date, each Settling State will submit an itemized request for funds from the Strategic Contribution Fund, based on the criteria set forth in Section 4 of this Exhibit U.

Section 3

The Allocation Committee will determine the appropriate allocation for each Settling State based on the criteria set forth in Section 4 below. The Allocation Committee shall make its determination based upon written documentation.

Section 4

The criteria to be considered by the Allocation Committee in its allocation decision include each Settling State's contribution to the litigation or resolution of state tobacco litigation, including, but not limited to, litigation and/or settlement with tobacco product manufacturers, including Liggett and Myers and its affiliated entities.

Section 5

Within 45 days after receiving the itemized requests for funds from the Settling States, the Allocation Committee will prepare a preliminary decision allocating the Strategic Contribution Fund payments among the Settling States who submitted itemized requests for funds. All Allocation Committee decisions must be by majority vote. Each Settling State will have 30 days to submit comments on or objections to the draft decision. The Allocation Committee will issue a final decision allocating the Strategic Contribution Fund payments within 45 days.

Section 6

The decision of the Allocation Committee shall be final and non-appealable.

Section 7

The expenses of the Allocation Committee, in an amount not to exceed \$100,000, will be paid from disbursements from the Subsection VIII(c) Account.

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APPENDIX C

PROPOSED FORM OF OPINION OF BOND COUNSEL

December 27, 2017

Railsplitter Tobacco Settlement Authority
c/o Governor's Office of Management and Budget
Chicago, Illinois 60601

Re: Railsplitter Tobacco Settlement Authority
\$670,965,000 Tobacco Settlement Revenue Bonds, Series 2017

Ladies and Gentlemen:

We have acted as bond counsel to the Railsplitter Tobacco Settlement Authority (the "Issuer") in connection with the issuance of \$670,965,000 aggregate principal amount of Railsplitter Tobacco Settlement Authority Tobacco Settlement Revenue Bonds, Series 2017 (the "Bonds"), issued pursuant to the Indenture, dated as of December 1, 2010 (as supplemented and amended, the "2010 Indenture"), between the Issuer and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee") and the Series 2017 Supplement relating to the Bonds, dated as of December 1, 2017 (the "Series 2017 Supplement", and together with the 2010 Indenture, the "Indenture"), between the Issuer and the Trustee. The Bonds are being issued to refund \$682,375,000 outstanding principal amount of the Railsplitter Tobacco Settlement Authority Tobacco Settlement Revenue Bonds, Series 2010 (the "2010 Bonds"). Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Indenture.

In such connection, we have reviewed the Indenture; the Purchase and Sale Agreement, dated as of December 1, 2010 (the "Sale Agreement"), between the Issuer and the State of Illinois (the "State"); opinions of counsel to the State and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee"); the opinion of the Attorney General of the State of Illinois (the "State"); the Tax Certificate of the Issuer and the Tax Certificate of the State, each dated the date hereof (collectively, the "Tax Certificates"); certificates of the Issuer, the State and others; and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon or otherwise used in connection with any such actions, events or matters. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Issuer. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second and third paragraphs hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Sale Agreement and the Tax Certificates, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest

on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Indenture, the Sale Agreement and the Tax Certificates and their enforceability may be subject to bankruptcy, insolvency, receivership, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles and to the exercise of judicial discretion in appropriate cases. We express no opinion with respect to any indemnification, contribution, liquidated damages, penalty (including any remedy deemed to constitute a penalty), right of set-off, arbitration, choice of law, choice of forum, non-exclusivity of remedies, choice of venue, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the remedies available to enforce liens on any such assets. Our services did not include financial or other non-legal advice. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Offering Circular or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Bonds constitute the valid and binding limited obligations of the Issuer payable solely and only out of the Collateral.

2. The Indenture has been duly authorized, executed and delivered by, and constitutes the valid and binding obligation of, the Issuer, and is in full force and effect. The Indenture creates a valid pledge of the Collateral to secure the payment of the principal of and interest on the Bonds, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture.

3. The issuance of the Bonds will not, in and of itself, adversely affect the exclusion of interest on the 2010 Bonds from gross income for federal income tax purposes.

4. Interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. Interest on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes. We express no opinion as to whether some or all interest on the Bonds is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Interest on the Bonds is not exempt from State of Illinois taxes. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Bonds.

Faithfully yours,

APPENDIX D

DEFINITIONS AND SUMMARY OF THE INDENTURE

The following summary describes certain terms of the Indenture. 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. Copies of the Indenture may be obtained upon written request to the Trustee at Two North LaSalle Street, Suite 1020, Chicago, Illinois 60602. See “SECURITY FOR THE BONDS” and “THE SERIES 2017 BONDS” for further descriptions of certain terms and provisions of the Series 2017 Bonds.

Amendment to the Indenture

The Series 2017 Supplement dated as of December 1, 2017 pursuant to which the Series 2017 Bonds are to be issued includes an amendment to the definition of “Debt Service Reserve Requirement”. As a result of their purchase of the Series 2017 Bonds, owners thereof will be deemed as of the date of issuance of the Series 2017 Bonds to have irrevocably consented to (and to have waived notice, if any, required to be given under the Indenture, regarding) such amendment to the Indenture. The amendment is described in this Appendix D under “Definitions.” Deletions are shown as ~~striktthrough~~ and additions underlined.

Definitions

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

“*Accounts*” means the Tobacco Assets Account, the Pledged Revenues Account, the Operating Account, the Debt Service Account, the Debt Service Reserve Account, the Lump Sum Account, the Costs of Issuance Account, the Rebate Account, the Residual Account, any subaccounts within such accounts and any accounts established by Series Supplement, all of which shall be established and held by the Trustee.

“*Act*” means the State’s Railsplitter Tobacco Settlement Authority Act, codified as 30 ILCS §171/3-1 et seq., as the same may be amended from time to time.

“*Authority Operating Subaccount*” means the subaccount within the Operating Account so designated and established pursuant to the Indenture.

“*Authorized Denomination*” shall have the meaning set forth therefor in the applicable Series Supplement.

“*Authorized Officer*” means: (i) in the case of the Authority, the Chairman and his successors in office or any other officer as may be designated as an “authorized officer” by the members of the Authority; (ii) in the case of the Trustee, any officer assigned to the Corporate Trust Office, including any managing director, director, vice president, assistant vice president, associate, assistant secretary, authorized signer or any other officer of the Trustee customarily performing functions similar to those performed by any of the above designated officers and having direct responsibility for the administration of the Indenture, and also, with respect to a particular matter, any other officer, to whom such matter is referred because of such officer’s knowledge of and familiarity with the particular subject; (iii) in the case of the State, the Director of the Governor’s Office of Management and Budget, or his or her designee; and (iv) in the case of the State Attorney General, any person authorized by the State Attorney General to deliver the Officer’s Certificate for enforcement expenses.

“*Beneficiaries*” means Bondholders, the owner of the Residual Certificate and, to the extent specified in the related Series Supplement or other Supplemental Indenture, the party or parties to Related Contracts.

“*Bondholders*” or “*Holder*s” or similar terms mean the registered owners of the Bonds registered as to principal and interest or as to principal only, as shown on the books of the Trustee.

“*Bonds*” means all obligations issued pursuant to the Indenture.

“*Business Day*” means any day other than (i) a Saturday or a Sunday or a legal holiday or (ii) a day on which banking institutions in Chicago, Illinois or New York, New York, are required or authorized by law, regulation or executive order to be closed.

“*Closing Date*” means the date of issuance by the Authority of the Series 2010 Bonds.

“*Code*” or “*Tax Code*” means the Internal Revenue Code of 1986, as amended.

“*Collateral*” has the meaning set forth under the heading “Security and Pledge” below.

“*Complementary Legislation*” means 30 ILCS §167/1 et seq.

“*Consent Decree*” means the Consent Decree and Final Judgment of the Circuit Court of Cook County, Illinois, dated December 8, 1998, as the same has been and may be corrected, amended or modified, in the action entitled People of the State of Illinois v. Philip Morris Incorporated, et al.

“*Corporate Trust Office*” means the office of the Trustee at which the corporate trust business of the Trustee related hereto shall, at any particular time, be principally administered, which office is, at the date of the Indenture, located as follows: Two North LaSalle Street, Suite 1020, Chicago, Illinois 60602.

“*Costs of Issuance*” means those costs related to the authorization, sale or issuance of Bonds, including but not limited to all fees, costs, expenses and governmental charges for: underwriting and transaction structuring, auditors or accountants, printing, reproducing documents, filing and recording of documents, fiduciaries, legal services, financial advisory and professional consultants’ services, credit ratings, credit and liquidity enhancements, execution, and transportation and safekeeping of Bonds; and also includes costs incurred by the State to the extent the same are to be paid by the Authority in accordance with the Sale Agreement.

“*Costs of Issuance Account*” means the Account so designated and established pursuant to the Indenture.

“*Debt Service*” means interest, redemption premium, principal and Sinking Fund Installments due on Outstanding Bonds.

“*Debt Service Account*” means the Account so designated and established pursuant to the Indenture.

“*Debt Service Reserve Account*” means the Account so designated and established pursuant to the Indenture.

“*Debt Service Reserve Requirement*” means ~~for each Series of Bonds, the amount specified in the Series Supplement authorizing the issuance of such Series~~ for all Outstanding Bonds, \$140,461,875.

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

“*Defeasance Collateral*” means money and, to the extent permitted by the Public Funds Investment Act, (a) direct obligations of, or obligations the principal of and the interest on which are unconditionally guaranteed by, the United States of America and which are entitled to the full faith and credit thereof, and (b) obligations issued by United States of America government agencies or instrumentalities, as to which

the full and timely payment of the principal of, premium, if any, and the interest on which is fully and unconditionally guaranteed as a full faith and credit obligation of the United States of America (including any securities described in (a) or (b) issued or held in book entry form on the books of the Department of the Treasury of the United States of America).

“*Defeased Beneficiaries*” means, when there is held by or for the account of the Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities as will provide sufficient funds to pay or redeem all or any portion of Outstanding Bonds in accordance with their terms and all or any portion of obligations to Beneficiaries (including parties to Related Contracts), the holders of such Bonds and such Beneficiaries.

“*Defeased Bonds*” means Bonds that remain in the hands of their Holders, but are deemed no longer Outstanding as specified under the Indenture.

“*Distribution Date*” means (1) each June 1 and December 1, commencing June 1, 2011, or if such date is not a Business Day, the following Business Day, (2) each additional Distribution Date selected by the Authority or the Trustee following an Event of Default, and (3) each Distribution Date, to the extent so characterized in a Supplemental Indenture.

“*DTC*” means The Depository Trust Company, a limited-purpose trust company organized under the laws of the State of New York, and includes any nominee of DTC in whose name any Bonds are then registered.

“*Eligible Investments*” means and includes any of the following securities, to the extent permitted under the Public Funds Investment Act:

(i) Direct obligations of, or obligations the principal of and the interest on which are unconditionally guaranteed by, the United States of America and which are entitled to the full faith and credit thereof;

(ii) Bonds, notes, debentures, or other obligations or securities issued by a federal government agency that is rated “AAA” (or equivalent) by Standard & Poor’s and Fitch, respectively, or if not rated by both of them, so rated by one of them and in the equivalent category by another nationally recognized rating agency;

(iii) Prime commercial paper of a corporation incorporated under the laws of any state of the United States of America with assets exceeding \$500,000,000 if (i) such obligations are rated at the time of purchase rated “A-1” and “F1” by Standard & Poor’s and Fitch, respectively, or if not rated by both of them, so rated by one of them and in the equivalent category by another nationally recognized rating agency and which mature not later than 180 days from the date of purchase, (ii) such purchases do not exceed 10% of the corporation’s outstanding obligations and (iii) no more than one-third of the public agency’s funds may be invested in short term obligations of corporations;

(iv) Banker’s acceptances issued by a domestic bank or a federally chartered domestic office of a foreign bank, which are eligible for purchase by the Federal Reserve System, rated “A-1” and “F1” by Standard & Poor’s and Fitch, respectively or, if not rated by either of them, rated in the equivalent category by another nationally recognized rating agency;

(v) Demand deposits, including interest bearing money market accounts, time deposits, trust funds, trust accounts, overnight bank deposits and interest-bearing deposits of depository institutions, including the Trustee or any of its affiliates, rated in the “AA” long-term rating category or higher by

Standard & Poor's and Fitch or, if not rated by either of them, rated in the equivalent category by another nationally recognized rating agency or which are fully FDIC-insured;

(vi) Shares in diversified open end, no load investment funds, provided such funds are registered under the Investment Company Act of 1940, which is a money market mutual fund, which has been rated "AAAm" and "AAAm-G" or the equivalent by Standard & Poor's and Fitch or, if not rated by either of them, rated in the equivalent category by another nationally recognized rating agency, and such fund is limited to obligations described in (i) or (ii) above and to agreements to repurchase such obligations, including those for which the Trustee or an affiliate performs services for a fee, whether as a custodian, transfer agent, investment advisor or otherwise;

(vii) Federally insured or collateralized certificates of deposit issued by banks (which may include the Trustee) which are state chartered banks, federally chartered banks or foreign banks with domestic offices. Collateralized certificates of deposit shall be collateralized by obligations described in clause (i) or (ii) above, which such obligations at all times have a market value (exclusive of accrued interest) at least equal to a minimum of one hundred and two percent (102%) of such bank deposits so secured, including interest;

(viii) Repurchase agreements relating to securities of the type specified in clauses (i) and (ii) above; provided that such securities in an amount at least equal to a market value at all times of at least one hundred and two percent (102%) of the amount of the agreements shall be delivered as security for such agreements to the account of the Trustee to be held therein during the term of the agreements; and

(ix) Any other obligations conforming to the requirements of the Public Funds Investment Act, so long as such obligations are rated at least in the two highest rating categories of each of Standard & Poor's and Fitch, or if not rated by both of them, so rated by one of them and in the equivalent category by another nationally recognized rating agency.

"*Event of Default*" means any one of the following:

(a) principal or Sinking Fund Installments of or interest on any Bond has not been paid, when due;

(b) the Authority fails to observe or perform any other provision of the Indenture, which failure is not remedied within 60 days after written notice thereof is given to the Authority by the Trustee or to the Authority and the Trustee by the Holders of at least 25% in principal amount of the Bonds then Outstanding. In the case of a Default under this subsection (b), if the Default cannot be corrected within the said 60-day period and is diligently pursued until the Default is corrected, it shall not constitute an Event of Default if corrective action is instituted by the Authority within said 60-day period and diligently pursued until the Default is corrected;

(c) the State fails to observe or perform its covenants which are included in Section 5.07 of the Indenture or in Article IV of the Sale Agreement, which failure is not remedied within 60 days after written notice thereof is given to the Authority and the State by the Trustee or to the Authority and the Trustee by the Holders of at least 25% in principal amount of the Bonds then Outstanding; or

(d) 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 Authority and, if instituted against the Authority, are not dismissed within 60 days after such institution.

“*Extraordinary Prepayment*” means the payment of Bonds as provided in the Indenture upon the occurrence of a Payment Default.

“*Federal Bankruptcy Code*” means the Bankruptcy Reform Act of 1978, as amended, codified as Title 11, United States Code, as it has been and will be amended from time to time and any successor federal statute.

“*Fiduciary*” means the Trustee, any representative of the Holders of Bonds appointed by Series Supplement, and each Paying Agent, if any.

“*Financing Costs*” means (1) Costs of Issuance, (2) the capitalization of initial Operating Expenses of the Authority, (3) the funding of the Debt Service Reserve Account and any other debt service reserves, (4) fees and costs for Related Contracts, and (5) any other fees, discounts, expenses and costs of any kind whatsoever related to issuing, securing and marketing the Bonds, including, without limitation, any net original issue discount.

“*Fiscal Year*” means the twelve (12) month period commencing July 1 of each year and ending on June 30 of the succeeding year.

“*Fitch*” means Fitch Ratings, Inc.; references to Fitch under the Indenture are effective so long as Fitch is a Rating Agency.

“*Funds*” means funds or accounts established under the Indenture and by Series Supplement.

“*Indenture*” means the Indenture, dated as of December 1, 2010, by and between Railsplitter Tobacco Settlement Authority and The Bank of New York Mellon Trust Company, N.A., as trustee, as may be amended or supplemented.

“*Junior Payments*” means (i) termination payments and loss amounts on Related Contracts, (ii) amounts due under Related Contracts and not payable as Debt Service, (iii) operating expenses, including litigation expenses, if any, incurred by the Authority, incurred in the previous Fiscal Year in excess of the applicable Operating Cap or reasonably expected to be incurred in the current or next succeeding Fiscal Years in excess of the applicable Operating Cap for such Fiscal Years and (iv) any other Junior Payments so identified in or by reference to the Indenture or any Supplemental Indenture.

“*Lump Sum Account*” means the Account so designated and established pursuant to the Indenture.

“*Lump Sum Payment*” means a lump sum payment received by the Trustee as a payment from a PM which results in, or is due to, a release of that PM from all of its obligations due on or after the Closing Date under the MSA.

“*Majority in Interest*” means as of any particular date of calculation the Holders of a majority of the Outstanding Bonds eligible to act on a matter, measured by Outstanding principal amount, payable at maturity.

“*Master Settlement Agreement*” or “*MSA*” means the MSA identified in the Consent Decree, including the related Escrow Agreement (as defined in the MSA).

“*Maturity Date*” means the stated maturity date of each Serial Bond and Term Bond.

“*MSA Escrow Agent*” means Citibank, N.A. or any other firm serving as escrow agent under the MSA.

“*Officer’s Certificate*” means a certificate signed by an Authorized Officer of the Authority in accordance with the Act.

“*Operating Account*” means the Account so designated and established pursuant to the Indenture.

“*Operating Cap*” means \$250,000.00 in the Fiscal Year ending June 30, 2011 inflated annually in each following Fiscal Year by the greater of (x) 3% and (y) the percentage increase in the Consumer Price Index for all Urban Consumers as published by the Bureau of Labor Statistics for December of the prior year.

“*Operating Expenses*” means (a) all operating and administrative expenses incurred by the Authority, and all operating and administrative expenses incurred by the Governor’s Office of Management and Budget and related (as set forth in a certificate of an Authorized Officer of the Authority) to such Office’s activities on behalf of or in assistance to the Authority, including but not limited to, the cost of preparation of accounting and other reports, costs of maintenance of ratings on the Bonds, arbitrage rebate and penalties, salaries, administrative expenses, insurance premiums, auditing and legal expenses, fees and expenses incurred by or for the Trustee, any Paying Agents, professional consultants and fiduciaries, costs incurred to preserve the tax-exempt status of any Tax-Exempt Bonds, costs of the Authority and the Governor’s Office of Management and Budget related to the enforcement rights with respect to the Indenture, the Sale Agreement or the Bonds or other contracts or agreements in which the Authority has an interest or enforcement right and all other Operating Expenses of the Authority or the Governor’s Office of Management and Budget so identified in the Indenture; and (b) any expenses incurred by the State Attorney General relating to the enforcement of the MSA, the Qualifying Statute and the Complementary Legislation (provided, however, that in no event will the amount of such enforcement expenses paid as an Operating Expense exceed \$2,500,000 in any Fiscal Year.

“*OPM*” means an Original Participating Manufacturer, as defined in the MSA.

“*Other Series*” means a Series of Refunding Bonds.

“*Outstanding*” means, with respect to bonds, all Bonds issued under the Indenture, excluding: (i) Bonds that have been exchanged or replaced, or delivered to the Trustee for credit against a principal payment; (ii) Bonds that have been paid; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Bonds for which (A) there has been irrevocably set aside sufficient Defeasance Collateral timely maturing and bearing interest, to pay or redeem them and (B) any required notice of redemption shall have been duly given in accordance with the Indenture or irrevocable instructions to give notice shall have been given to the Trustee; (v) Bonds the payment of which shall have been provided for pursuant to the Indenture; and (vi) for purposes of any consent or other action to be taken by the Holders of a Majority in Interest or specified percentage of Bonds under the Indenture, Bonds held by or for the account of the Authority, the State or any person controlling, controlled by or under common control with either of them. For the purposes of this definition, “control”, when used with respect to any specified person, means the power to direct the management and policies of such person, directly or indirectly, whether through the ownership of voting securities, by law or contract or otherwise, and the terms “controlling” and “controlled” have meanings correlative to the foregoing.

“*Partial Lump Sum Payment*” means a lump sum payment received by the Trustee as a payment from a PM which results in, or is due to, a release of that PM from a portion of its obligations due on or after the Closing Date under the MSA.

“*Paying Agent*” means each Paying Agent designated from time to time pursuant to the Indenture.

“*Payment Default*” means the occurrence of an Event Default where principal or Sinking Fund Installments of or interest on any Bond has not been paid, when due.

“*Pledged Accounts*” means the Tobacco Assets Account (except to the extent that State’s Unsold Assets are deposited therein), the Pledged Revenues Account, the Debt Service Account, the Debt Service Reserve Account and the Lump Sum Account, all of which shall be established and held by the Trustee as segregated trust accounts, and any additional Accounts designated in a Supplemental Indenture as a Pledged Account.

“*Pledged Revenues*” means (i) the Pledged Settlement Payments, (ii) to the extent set forth in the applicable Series Supplement or other Supplemental Indenture, payments made to the Authority or Trustee under Related Contracts, and (iii) all fees, charges, payments, investment earnings and other income and receipts (including Bond proceeds, but only to the extent deposited in the Debt Service Reserve Account) paid or payable to the Authority or the Trustee for the account of the Authority or the Beneficiaries.

“*Pledged Revenues Account*” means the Account so designated and established pursuant to the Indenture.

“*Pledged Settlement Payments*” means the “pledged tobacco revenues”, as defined in the Act, which for purposes of the Sale Agreement and the Indenture consist of the Tobacco Assets less the State’s Unsold Assets.

“*PM*” means a Participating Manufacturer, as defined in the MSA.

“*Pro Rata*” means, for an allocation of available amounts to any payments of interest or principal to be made pursuant to the Indenture, the application of a fraction of such available amounts (a) the numerator of which is equal to the amount due to each respective Holder to whom such payment is owing and (b) the denominator of which is equal to the total amount due to all Holders to which such payment is owing.

“*Public Funds Investment Act*” means the State’s Public Funds Investment Act, codified as 30 ILCS §235/0.01 et seq., as the same may be amended from time to time.

“*Qualifying Statute*” means 30 ILCS §168/1 et seq.

“*Rating Agency*” means each nationally recognized statistical rating organization that has, at the request of the Authority, a rating in effect for any of the Bonds.

“*Rebate Account*” means the Account so designated and established pursuant to the Indenture.

“*Record Date*” means the last Business Day of the calendar month preceding a Distribution Date; and the Authority or the 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 Trustee.

“*Refunding Bonds*” means Bonds issued to renew or refund any Bonds, by exchange, purchase, redemption or payment.

“*Related Contracts*” means the “related bond facilities”, as defined in the Act, which for purposes of the Indenture consists of contracts entered into by the Authority pursuant to the provisions of the related Series Supplement or other Supplemental Indenture, for its benefit or the benefit of any of the Beneficiaries, to facilitate the issuance, sale, resale, purchase, repurchase or payment of Bonds, interest

rate savings or market diversification, including any bond insurance, letters of credit and liquidity facilities, investment agreements and forward delivery agreements with respect to Eligible Investments.

“*Residual Account*” means the account so designated and established pursuant to the Indenture.

“*Residual Certificate*” means an instrument in the form of an exhibit to the Indenture.

“*Residual Revenues*” means all Pledged Revenues that are in excess of the deposit requirements set forth in Section 4.04(a)(1) - (6) of the Indenture (as described under clauses (1) - (6) of the heading “Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues”).

“*Sale Agreement*” means the Purchase and Sale Agreement, dated as of December 1, 2010, by and between the Authority and the State, as amended, supplemented and in effect from time to time.

“*S&P*” means Standard & Poor’s Ratings Services, a Division of the McGraw-Hill Companies, Inc.; references to S&P under the Indenture are effective so long as S&P is a Rating Agency.

“*Securities Depository*” means DTC or another securities depository specified by a Series Supplement, or if the incumbent Securities Depository resigns from its functions as depository of the Bonds or the Authority discontinues use of the incumbent Securities Depository, then any other securities depository designated in an Officer’s Certificate of the Authority.

“*Serial Bonds*” means the Bonds so specified in a Series Supplement.

“*Series*” means all Bonds so identified in a Series Supplement, regardless of variations in class, maturity, interest rate or other provisions, and any Bonds thereafter delivered in exchange or replacement therefor.

“*Series 2010 Bonds*” means the Authority’s \$1,503,460,000 Tobacco Settlement Revenue Bonds, Series 2010, initially dated their date of delivery, including any Bonds issued in exchange or replacement therefor.

“*Series Supplement*” means a Supplemental Indenture, or a supplement thereto, executed pursuant to the Indenture.

“*Sinking Fund Installment*” means a scheduled amount set forth in the applicable Series Supplement for required amortization prior to maturity of a Term Bond.

“*Sinking Fund Installment Date*” means the date scheduled for the payment of a particular Sinking Fund Installment.

“*Special Conditions*” means, with respect to a consolidation or merger by the Authority with or into any other person, or a conveyance or transfer of all or substantially all of its properties or assets, the following conditions:

(i) an entity shall survive such event, and such entity shall be organized and existing under the laws of the United States, the State or any state and shall expressly assume the due and punctual payment of all obligations owing to Beneficiaries and the performance or observance of every agreement and covenant of the Authority in the Indenture;

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

(iii) the Authority has received an opinion of Transaction Counsel to the effect that such transaction will not adversely affect the exclusion of interest on any Tax-Exempt Bond from gross income for federal income tax purposes;

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

(v) the Authority has delivered to the Trustee an Officer's Certificate and an opinion of Counsel to the effect that such transaction complies with the Indenture and that all conditions precedent to such transaction have been complied with.

“*State*” means the State of Illinois.

“*State Attorney General Operating Subaccount*” means the subaccount within the Operating Account so designated and established pursuant to the Indenture.

“*State's Unsold Assets*” means (i) any payments made with respect to liability to make those payments under the MSA for calendar years completed prior to calendar year 2010, and (ii) those amounts otherwise to be received by the State which were deposited by PMs into the Disputed Payments Account (as defined in the MSA) or withheld by PMs in accordance with Section XI(f)(2) of the MSA prior to the Closing Date.

“*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.

“*Tax Certificate*” means the Tax Certificate executed by the Authority and the State at the time of issuance of each Series of Tax-Exempt Bonds, each as originally executed and as each may be amended or supplemented from time to time with the term thereof.

“*Tax-Exempt Bonds*” means all Bonds so identified in the Series Supplement relating to such Bonds.

“*Term Bonds*” means the Bonds so specified in a Series Supplement.

“*Tobacco Assets*” means all tobacco settlement payments paid or payable to the State on and after the Closing Date and required to be made, pursuant to the terms of the MSA, by PMs to the State, and the State's rights to receive such tobacco settlement payments, consisting of (i) the annual payments and strategic contribution fund payments (as such terms are defined in the MSA) payable to the State under the MSA (and all adjustments thereto) and (ii) any Partial Lump Sum Payments and Lump Sum Payments.

“*Tobacco Assets Account*” means the Account so designated and established pursuant to the Indenture.

“*Tobacco Settlement Bond Proceeds Account*” means the Account so designated and established within the Tobacco Settlement Recovery Fund.

“*Tobacco Settlement Recovery Fund*” means the Fund so designated and established in the State Treasury in accordance with 30 ILCS §105/57-43.

“*Tobacco Settlement Residual Account*” means the Account so designated and established within the Tobacco Settlement Recovery Fund.

“*Transaction Counsel*” means a nationally recognized bond counsel as may be selected by the Authority for a specific purpose under the Indenture.

“*Transaction Documents*” means, collectively, the Sale Agreement, the MSA, the Consent Decree and the escrow instructions to the MSA Escrow Agent.

“*Trustee*” means The Bank of New York Mellon Trust Company, N.A., until a successor shall become such pursuant to the applicable provisions of the Indenture and, thereafter, “Trustee” shall mean the successor Trustee.

“*Written Notice*”, “*written notice*” or “*notice in writing*” means notice in writing which may be delivered by hand or first class mail and also means facsimile transmission and electronic mail transmission.

Directors and Officers Not Liable on Bonds

Neither the members, directors or officers of the Authority nor any person executing Bonds, the Residual Certificate, the Related Contracts or other obligations of the Authority nor any officer, member, employee or agent of the Authority will be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance or execution and delivery thereof.

PURSUANT TO THE ACT, NEITHER ANY BOND NOR ANY RELATED CONTRACT OF THE AUTHORITY WILL CONSTITUTE AN INDEBTEDNESS OR AN OBLIGATION OF THE STATE OR ANY SUBDIVISION THEREOF WITHIN THE PURVIEW OF ANY CONSTITUTIONAL OR STATUTORY LIMITATION OR PROVISION OR A CHARGE AGAINST THE GENERAL CREDIT OR TAXING POWERS, IF ANY, OF ANY OF THEM BUT WILL BE PAYABLE SOLELY FROM THE COLLATERAL. NO OWNER OF ANY BOND OR PROVIDER OF ANY RELATED CONTRACT WILL HAVE THE RIGHT TO COMPEL THE EXERCISE OF THE TAXING POWER OF THE STATE TO PAY ANY PRINCIPAL INSTALLMENT OF, REDEMPTION PREMIUM, IF ANY, OR INTEREST ON THE BONDS OR TO MAKE ANY PAYMENT DUE UNDER ANY RELATED CONTRACT. (Section 1.03)

Separate Accounts and Records

The parties to the Indenture represent and covenant, each for itself, that: (a) the Authority and the Trustee each will maintain its respective books, financial records and accounts (including, without limitation, inter entity transaction accounts) in a manner so as to identify separately the assets and liabilities of each such entity; each has observed and will observe all applicable corporate or trust procedures and formalities, including, where applicable, the holding of regular periodic and special meetings of governing bodies, the recording and maintenance of minutes of such meetings and the recording and maintenance of resolutions, if any, adopted at such meetings; and all transactions and agreements between the Authority and the Trustee have reflected and will reflect the separate legal existence of each entity and have been and will be formally documented in writing; and (b) the Authority has paid and will pay its liabilities and losses from its separate assets. In furtherance of the foregoing, the Authority has compensated and will compensate all consultants, independent contractors and agents from its own funds for services provided to it by such consultants, independent contractors and agents. (Section 1.04)

Security and Pledge

Pursuant to the Indenture, the Authority will assign and pledge to the Trustee and, pursuant to the Act, will grant a first lien on and a first priority security interest in, in trust upon the terms of the Indenture, all of the Authority’s right, title and interest, whether then owned or thereafter acquired, in, to and under all of the following property constituting the “Collateral”: (a) the Pledged Revenues (including all Pledged

Settlement Payments), (b) all rights to receive the Pledged Revenues and the proceeds of such rights, (c) the Pledged Accounts (excluding any State's Unsold Assets deposited in the Tobacco Assets Account) and assets thereof (including Related Contracts), including money, contract rights, general intangibles or other personal property, held by the Trustee under the Indenture, (d) subject to the following sentence, all rights and interest of the Authority under the Sale Agreement, including the representations, warranties and covenants of the State in the Sale Agreement, and (e) any and all other property of every kind and nature from time to time hereafter, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture. Except as specifically provided in the Indenture, this assignment and pledge does not include: (i) the Residual Revenues, (ii) the State's Unsold Assets, (iii) the rights of the Authority pursuant to provisions for consent or other action by the Authority, notice to the Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Beneficiaries, (iv) any right or power reserved to the Authority pursuant to the Act or other law, (v) any Defeasance Collateral held by the Trustee for the benefit of Defeased Beneficiaries in accordance with the Defeasance provisions of the Indenture, and (vi) as to any Series of Bonds, any other property or interest explicitly excluded from Collateral pursuant to the terms of the related Series Supplement, nor is precluded the Authority's enforcement of its rights under and pursuant to the Sale Agreement for the benefit of the Beneficiaries as provided in the Indenture. The Residual Revenues, the State's Unsold Assets and the proceeds of the Bonds, other than the amounts deposited in the Debt Service Reserve Account, do not constitute any portion of the Pledged Revenues, are not pledged to the holders of the Bonds and are not subject to the lien of the Indenture. In accordance with the Indenture, the Trustee will promptly, but not more than five Business Days after receipt of Tobacco Assets, transfer any portion thereof representing State's Unsold Assets to, or at the order of, the State and, after fully funding the deposits required by the Indenture as described in clauses (1) - (6) of the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues", any portion thereof representing Residual Revenues to the Residual Account. The foregoing Collateral is to be pledged and a security interest is therein granted by the Authority to secure the payment of Bonds and Related Contracts, all with the respective priorities specified in the Indenture. The pledge and assignment made by the Indenture and the covenants and agreements to be performed by or on behalf of the Authority will be for the equal and ratable benefit, protection and security of the Holders of any and all of the Outstanding Bonds and all other Beneficiaries, all of which, regardless of the time or times of their issue or maturity, will be of equal rank without preference, priority or distinction of such Bonds and all other Beneficiaries over any other Bonds or Beneficiaries except as expressly provided in the Indenture or permitted thereby. The lien of such pledge and the obligation to perform the contractual provisions in the Indenture made will have priority over any or all other obligations and liabilities of the Authority secured by the Pledged Revenues. The Authority will not incur any obligations, except as authorized in the Indenture, secured by a lien on the Pledged Revenues, or the Pledged Accounts equal or prior to the lien in the Indenture. Notwithstanding anything to the contrary in the Indenture or the Residual Certificate, the Trustee will not make any transfers to the Residual Account unless and until the deposits required by the Indenture as described in clauses (1) - (6) of the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues", have been made in full. The Authority will implement, protect and defend the assignment and pledge by all appropriate legal action, the cost thereof to be an Operating Expense. (Section 2.01).

Defeasance

When (a) there is held by or for the account of the Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities as will provide sufficient funds to pay or redeem all or any portion of Outstanding Bonds in accordance with their terms and all or any portion of obligations to Beneficiaries (including parties to Related Contracts) (the holders of said Bonds and such Beneficiaries called the "Defeased Beneficiaries") (to be verified by a nationally recognized firm of independent certified public accountants or other professionals expert in verifying bond

defeasance escrows), (b) any required notice of redemption shall have been duly given in accordance with the Indenture or irrevocable written instructions to give notice shall have been given to the Trustee, and (c) all the rights under the Indenture of the Fiduciaries have been provided for, then upon written notice from the Authority to the Trustee, such Defeased Beneficiaries will cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien under the Indenture, the security interests created by the Indenture with respect to such Defeased Beneficiaries (except in such funds and investments) will terminate, and the Authority and the Trustee will execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created under the Indenture with respect to such Defeased Beneficiaries. Upon such defeasance, the funds and investments required to pay or redeem such Bonds and other obligations to such Defeased Beneficiaries will be irrevocably set aside for that purpose, subject to certain provisions of the Indenture, and money held for defeasance will be invested only in Defeasance Collateral and applied by the Trustee and other Paying Agents, if any, to the retirement of such Bonds and such other obligations. When provision for payment or redemption is made in accordance under the "Defeasance" provisions of the Indenture for less than all the Bonds of a Series and maturity, the Trustee will choose by lot the particular Bond or Bonds of such Series and maturity to be so paid or redeemed. Upon defeasance of all Outstanding Bonds and Beneficiaries, the lien of the Indenture shall be extinguished, the Indenture shall be deemed terminated and any funds or property held by the Trustee and not required for payment or redemption of such Bonds and such other obligations to Defeased Beneficiaries and Fiduciaries in full will be distributed to, or upon the order of, the owner of the Residual Certificate.

The Trustee will, if so directed by the Authority, apply any moneys or Defeasance Collateral that are held by an escrow agent pursuant to an escrow agreement to the open market purchase of Bonds that have previously been defeased but remain unpaid; provided, however, that if Bonds have been defeased to a date prior to their applicable Maturity Date, the open market purchase may only occur prior to the publication of a notice of redemption for such Bonds. It will be a condition to any such open market purchase that the Trustee receive (i) a certificate of a nationally recognized firm of independent certified public accountants or other professionals expert in verifying bond defeasance escrows showing that the moneys and Defeasance Collateral remaining on deposit in the applicable escrow account after the purchase of such Bonds will be sufficient to pay or redeem in accordance with their terms all of the remaining defeased Bonds and (ii) a Transaction Counsel's opinion to the effect that (x) any redemption or sale of Defeasance Collateral will not adversely affect the exclusion of the interest on the remaining defeased Bonds from the gross income of the holders thereof for federal income tax purposes and (y) that such redemption or sale otherwise complies with the terms of the Indenture. Upon completion of any open market purchase, the Trustee will immediately thereafter cancel all Bonds so purchased. (Section 2.02)

Bonds of the Authority

By Series Supplement complying procedurally and in substance with the Indenture, and including with any consent of the Authority Representative required by the terms of the related Series Supplement, the Authority may authorize, issue, sell and deliver (1) the Series 2010 Bonds and (2) other Series of Bonds, but solely as Refunding Bonds, from time to time in such principal amounts as the Authority may determine, and establish such escrows therefor as it may determine.

Subsequent to the issuance of the Series 2010 Bonds, only Refunding Bonds may be issued to refund Outstanding Bonds, by exchange, purchase, redemption or payment, and the Authority may establish such escrows therefor as the Authority may determine; provided that such Refunding Bonds mature on or prior to the final Maturity Date of the Series 2010 Bonds. (Section 3.01)

Accounts

There are established pursuant to the Indenture the following accounts and subaccounts, to be held and maintained by the Trustee: the Tobacco Assets Account, the Pledged Revenues Account, Operating Account, the Authority Operating Subaccount, the State Attorney General Operating Subaccount, the Debt Service Account, the Debt Service Reserve Account, the Costs of Issuance Account, the Lump Sum Account, the Residual Account and the Rebate Account. The Authority may also by Supplemental Indenture create additional Accounts and sub-accounts within any Account. Amounts in the foregoing Accounts may be invested by the Trustee in Eligible Investments pursuant to the Indenture. (Section 4.01)

Application of Tobacco Assets

Effective on the Closing Date, the Attorney General of the State will direct the MSA Escrow Agent to pay all Tobacco Assets to the Trustee on behalf of the Authority. All Tobacco Assets received by the Trustee will immediately be deposited in the Tobacco Assets Account and will be transferred, as set forth in paragraph (b) below, in accordance with the instructions set forth in an Officer's Certificate of the Authority. Such Officer's Certificate will be delivered within two Business Days of the receipt by the Authority of documentation from the State Attorney General as provided in Section 4.03 of the Sale Agreement and will identify (i) the total amount of the Tobacco Assets received, (ii) the amount thereof representing State's Unsold Assets, (iii) the amount thereof representing Pledged Settlement Payments (including Partial Lump Sum Payments and Lump Sum Payments) and (iv) the amount thereof that represents Residual Revenues; provided, however, that if by the earlier of (i) the Business Day prior to a Distribution Date and (ii) the tenth Business Day after receipt of any Tobacco Assets (1) the Authority has not received the documentation from the State Attorney General as provided in Section 4.03 of the Sale Agreement or (2) the Authority has not delivered the Officer's Certificate required by this paragraph, then on such Business Day, the Trustee will apply such amounts to fund the deposits described under clauses (1)-(5) under the heading "Application of Pledged Settlement Payments and Residual Revenues-Deposit of Pledged Revenues" below.

Within five Business Days after receipt of the Officer's Certificate of the Authority referenced in the previous paragraph, the Trustee will make the following transfers (but only to the extent that funds were not previously applied in accordance with the provisions described under the heading "Application of Pledged Settlement Payments and Residual Revenues-Deposit of Pledged Revenues" in accordance with the proviso contained in the previous paragraph):

- (1) Pledged Settlement Payments (other than Partial Lump Sum Payments and Lump Sum Payments) to Pledged Revenues Account for application in accordance with the provisions described under the heading "Application of Pledged Settlement Payments and Residual Revenues" below;
- (2) Partial Lump Sum Payments and Lump Sum Payments to the Lump Sum Account for application in accordance with the provisions described under the heading "Lump Sum Account" below; and
- (3) State's Unsold Assets to, or upon the order of, the State.

Any Tobacco Assets received by the Authority will be promptly (and no event later than two Business Days after receipt) transferred to the Trustee. (Section 4.03)

Application of Pledged Settlement Payments and Residual Revenues

Deposit of Pledged Revenues. Unless otherwise specified in the Indenture, the Trustee will deposit all Pledged Revenues received by it in the Pledged Revenues Account.

No later than five Business Days following each deposit of Pledged Revenues to the Pledged Revenues Account (but in no event later than the next Distribution Date), the Trustee will withdraw Pledged Revenues on deposit in the Pledged Revenues Account and transfer such amounts as follows and in the following order of priority; provided, however, that investment earnings on amounts in the Funds and Accounts (other than the Debt Service Reserve Account, investment earnings on which will be retained therein until the amounts on deposit therein are at least equal to the Debt Service Reserve Requirement, and on the fifth Business Day preceding each Distribution Date amounts on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement may, at the direction of the Authority, be deposited directly to the Debt Service Account) will be deposited directly to the Debt Service Account; and provided, further, that upon the occurrence of a Payment Default, Pledged Revenues will be transferred as set forth in clauses (1), (2) and (4) below and then all remaining Pledged Revenues will be applied to make Extraordinary Prepayments in accordance with the Indenture (as described under the heading “Extraordinary Prepayment” below):

(1) (a) to the Authority Operating Subaccount, the amount required to pay (i) Trustee fees and expenses (including reasonable attorney’s fees, if applicable) reasonably expected to be due during the next Fiscal Year and (ii) an amount specified by an Officer’s Certificate for Operating Expenses of the Authority for the next Fiscal Year (provided that such amounts paid pursuant to this clause (a) will not exceed the Operating Cap and Operating Expenses will not include any termination payments or loss amounts on Related Contracts) and (b) to the State Attorney General Operating Subaccount, the amount required to be deposited therein to fund such subaccount in an amount not to exceed \$2,500,000 for the next Fiscal Year;

(2) to the Debt Service Account an amount sufficient to cause the amount therein (together with interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next Distribution Date) to equal interest (including interest at the stated rate on the principal of Outstanding Bonds and on overdue interest, if any) due on the next succeeding Distribution Date;

(3) to the Debt Service Account, exclusive of the amount on deposit therein under clause (2) above, an amount sufficient to cause the amount therein (together with any Partial Lump Sum Payment to be applied to the payment of principal or Sinking Fund Installments on the next succeeding June 1 and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next succeeding June 1 to the extent not counted for purposes of clause (2) above), to equal the principal and Sinking Fund Installments due on the next succeeding June 1;

(4) to the Debt Service Account, exclusive of the amounts deposited therein pursuant to clauses (2) and (3) above, an amount sufficient to cause the amount on deposit therein (together with interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the second succeeding Distribution Date to the extent not counted for purposes of clause (2) or (3) above) to equal interest (including interest at the stated rate on the principal of Outstanding Bonds and on overdue interest, if any) due on the second succeeding Distribution Date;

(5) to replenish the Debt Service Reserve Account until the amount on deposit therein equals the Debt Service Reserve Requirement;

(6) in the amounts and to the Funds and Accounts established by Series Supplement for Junior Payments; and

(7) to the Residual Account, the remaining Pledged Revenues.

On the first (1st) Business Day of the calendar month preceding a month in which a Distribution Date occurs, the Trustee will compare (i) the liquidation value of the aggregate amount on deposit in the Pledged Accounts (other than State's Unsold Assets in the Tobacco Assets Account and amounts set aside for the payment of Bonds) to (ii) the principal amount of and accrued interest (if any) on Bonds that will remain Outstanding after the application of amounts described below on such Distribution Date, and if the amount in clause (i) is greater than the amount described in clause (ii) as of such Distribution Date, then the Trustee will, at the direction of the Authority, liquidate the investments in the Pledged Accounts and will withdraw from the Pledged Accounts an amount sufficient to, and will, retire the Bonds in full on such Distribution Date.

Application of Pledged Revenues. Unless a Payment Default shall have occurred, on each Distribution Date (except with respect to clause (1) below), the Trustee will apply amounts in the various Accounts in the following order of priority:

- (1) at any time, from (A) the Authority Operating Subaccount, to the parties entitled thereto, to pay the expenses of Authority described in clause (a) of the definition of Operating Expenses, in the amount specified in an Officer's Certificate of the Authority and (B) the State Attorney General Operating Subaccount, to pay the expenses of the State Attorney General described in clause (b) of the definition of the Operating Expenses, in the amount specified in a certificate delivered by an Authorized Officer of the State Attorney General;
- (2) from the Debt Service Account (and, to the extent that amounts in the Debt Service Account are insufficient therefor, from amounts that will be transferred on such Distribution Date to the Debt Service Account from the Debt Service Reserve Account), to pay interest on the Outstanding Bonds (including interest on overdue interest, if any) due on such Distribution Date, plus any unpaid interest due on prior Distribution Dates;
- (3) from the Debt Service Account (and, to the extent that amounts in the Debt Service Account are insufficient therefor, from amounts that will be transferred on such Distribution Date to the Debt Service Account from the Debt Service Reserve Account), to pay in order of Maturity Dates and Sinking Fund Installment Dates, the principal and Sinking Fund Installments due on such Distribution Date; and
- (4) From the Funds and Accounts therefor, to make Junior Payments.

If a Payment Default has occurred, the Trustee will apply the Pledged Revenues in accordance with the priorities and purposes set forth in clauses (1), (2) and (4) under the subheading "Deposit of Pledged Revenues" above and then to make Extraordinary Prepayments in accordance with the Indenture, as described under the heading "Extraordinary Prepayment" below.

Deposit and Application of Residual Revenues. In accordance with the Indenture, as described in clause (7) under the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues", after making the required deposits described by clauses (1)-(6), the Trustee will deposit the balance of the Pledged Revenues, representing the Residual Revenues, in the Residual Account. Promptly, and in no event more than five Business Days after the deposit of such funds in the Residual Account, the Residual Revenues will be transferred to the registered owner of the Residual Certificate.

Whenever the moneys on deposit in the Debt Service Reserve Account exceed the applicable Debt Service Reserve Requirement, such excess may be, in the discretion of the Authority, transferred by the Trustee to the Debt Service Account or, if approved by an opinion of Transaction Counsel as not in violation of the terms of the Indenture or adversely affecting the federal tax exemption applicable to Tax-

Exempt Bonds, to any Fund or Account specified by the Authority in an Officer's Certificate. (Section 4.04)

Lump Sum Account

In accordance with the Indenture, the Trustee will transfer all Pledged Revenues that constitute Partial Lump Sum Payments and Lump Sum Payments to the Lump Sum Account. To the extent that amounts represent a Lump Sum Payment, the Trustee will invest such amount in Defeasance Collateral, pursuant to the Indenture, to pay or redeem a Pro Rata portion of each maturity of Outstanding Bonds in accordance with their terms. To the extent that the amounts represent a Partial Lump Sum Payment, such amounts will be held by the Trustee in the Lump Sum Account and transferred to the Debt Service Account at the times and in the amounts necessary to pay the principal or Sinking Fund Installments of the Bonds on the respective Distribution Dates covered by such Partial Lump Sum Payment. Upon the occurrence of a Payment Default, any Partial Lump Sum Payment will be applied to make Extraordinary Prepayments in accordance with the Indenture, as described under the heading "Extraordinary Prepayment" below. All amounts on deposit in the Lump Sum Account will be held in trust and invested in accordance with the provisions of the Indenture. (Section 4.06)

Related Contracts

The Authority may enter into, amend or terminate, as it determines to be necessary or appropriate, Related Contracts, and may by Series Supplement or other Supplemental Indenture provide for the receipt of payments thereunder as Pledged Revenues, and provide for the payment of amounts due from the Authority thereunder as Junior Payments. (Section 4.07)

Redemption of the Bonds

The Authority may redeem Bonds at its option in accordance with their terms and the terms of the applicable Series Supplement. When Bonds are called for redemption, the accrued interest thereon will become due on the redemption date. To the extent not otherwise provided, the Authority will deposit with the Trustee on or prior to the redemption date a sufficient sum to pay principal or Sinking Fund Installments, redemption premium, if any, and accrued interest.

Unless otherwise specified by Series Supplement, there will, at the option of the Authority, be applied to or credited against any sinking fund requirement the principal amount of any Bonds subject to redemption therefrom that have been defeased, purchased or redeemed and not previously so applied or credited.

When a Bond is to be redeemed prior to its Maturity Date, the Trustee will give notice in the name of the Authority, which notice will identify the Bonds to be redeemed, state the date fixed for redemption and state that such Bonds will be redeemed at the Corporate Trust Office of the Trustee or a Paying Agent. The notice will further state that on such date there will become due and payable upon each Bond to be redeemed the redemption price thereof, together with interest accrued to the redemption date, and that money therefor having been deposited with the Trustee or Paying Agent on or prior to the redemption date, from and after such date, interest thereon will cease to accrue. The Trustee will give 20 days' notice (or such shorter period permitted by DTC so long as DTC remains the registered owner of the Bonds) by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions under the Indenture, to the registered owners of any Bonds which are to be redeemed, at their addresses shown on the registration books of the Authority. Such notice may be waived by any Holder of Bonds to be redeemed. Failure by a particular Holder to receive notice, or any defect in the notice to such Holder, will not affect the redemption of any other Bond. Any notice of redemption given pursuant to the Indenture may be rescinded by Written Notice by the Authority to the Trustee no later than five days prior to the date specified for redemption. The Trustee will give notice of such rescission as soon thereafter as

practicable in the same manner and to the same persons, as notice of such redemption was given as described above.

Unless otherwise in the Indenture or by a Series Supplement, if less than all the Outstanding Bonds of like Series and Maturity Date are to be redeemed, the particular Bonds to be redeemed will be selected by the Trustee by such method as it will deem fair and appropriate, and the Trustee may provide for the selection for redemption of portions (equal to any authorized denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination.

To the extent set forth in the applicable Series Supplement, the Bonds will be subject to redemption from Sinking Fund Installments. (Section 4.08)

Investments

Pending its application under the Indenture, money in the Funds and Accounts may be invested by the Trustee pursuant to written direction of the Authority 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 amounts on deposit in the Tobacco Assets Account and the Residual Account will be held in Eligible Investments which mature overnight until released from such accounts in accordance with the subheadings “Deposit of Pledged Revenues” and “Deposit and Application of Residual Revenues”, respectively. Specifically, Eligible Investments will mature or be redeemable at the option of the Authority in an amount and at such times sufficient to make the payments under the Indenture described in clauses (1)-(6) under the heading “Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues” and described under “Extraordinary Prepayment” on the applicable Distribution Dates. Investments will be held by the Trustee in the respective Funds and Accounts and will be sold or redeemed to the extent necessary to make payments or transfers from each Fund or Account. The Trustee will not be liable for any losses on investments made at the direction of the Authority. The Trustee may conclusively rely upon the Authority’s written instructions as to both the suitability and legality of the directed investments. Ratings of Eligible Investments will be determined at the time of purchase of such Eligible Investments and without regard to ratings subcategories. The Trustee may make any and all such investments through its own investment department or that of its affiliates or subsidiaries, and may charge its ordinary and customary fees for such trades, including cash sweep account fees. In the absence of investment instructions from the Authority, the Trustee will not be responsible or liable for keeping the moneys held by it under the Indenture fully invested in Eligible Investments.

Although the Authority recognizes that it may obtain a broker confirmation or written statement containing comparable information at no additional cost, the Authority agrees under the Indenture that confirmations of Eligible Investments are not required to be issued by the Trustee for each month in which a monthly statement is rendered. No statement need be rendered for any fund or account if no activity occurred in such fund or account during such month.

On the tenth Business Day immediately preceding each Distribution Date, the Trustee will value the money and investments in the Debt Service Reserve Account according to the methods set forth under the Investments provisions of the Indenture. Any amounts in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement will be applied as provided under the Indenture.

In computing the amount in any Fund or Account, the value of Eligible Investments will be determined by the Trustee at least as frequently as the third Business Day preceding each Distribution Date and will be calculated as follows:

(i) As to investments the bid and asked prices of which are published on a regular basis in The Wall Street Journal, the average of the bid and asked prices for such investments so published on or most recently prior to such time of determination;

(ii) As to investments the bid and asked prices of which are not published on a regular basis in The Wall Street Journal, the average bid price at such time of determination for such investments by any two nationally recognized government securities dealers (selected by the Trustee in its absolute discretion) at the time making a market in such investments or the bid price published by a nationally recognized pricing service;

(iii) As to certificates of deposit and bankers acceptances, the face amount thereof, plus accrued interest; and

(iv) As to any investment not specified above: the value thereof established by prior agreement between the Authority and the Trustee.

The Trustee may hold undivided interests in Eligible Investments for more than one Fund or Account (for which they are eligible) and may make interfund transfers in kind.

In respect of Defeasance Collateral held for Defeased Bonds, the provisions of the Indenture summarized under the caption "Investments" will be effective only to the extent it is consistent with other applicable provisions of the Indenture or any separate escrow agreement. (Section 4.09)

Rebate

(a) The Trustee will establish and maintain an account separate from any other account established and maintained under the Indenture designated as the Rebate Account. Subject to the transfer provisions provided in paragraph (e) below, all money at any time deposited in the Rebate Account will be held by the Trustee in trust, to the extent required to satisfy the Rebate Requirement (as defined, computed and provided to the Trustee in accordance with the Tax Certificate), for payment to the United States Treasury. Neither the Authority nor any Bondholder will have any rights in or claim to such money in the Rebate Account. All amounts deposited into or on deposit in the Rebate Account will be governed by the rebate provisions and the tax covenants contained in the Indenture and by the Tax Certificate. The Trustee will be deemed conclusively to have complied with such provisions if it follows such directions of the Authority, and will have no liability or responsibility to enforce compliance by the Authority with the terms of the Tax Certificate.

(b) Upon the Authority's written direction, an amount will be deposited to the Rebate Account by the Trustee from amounts on deposit in the Operating Account so that the balance in the Rebate Account will equal the Rebate Requirement. Computations of the Rebate Requirement will be furnished by or on behalf of the Authority in accordance with the Tax Certificate. The Trustee will supply to the Authority all information required to be provided in the Tax Certificate to the extent such information is reasonably available to the Trustee.

(c) The Trustee will have no obligation to rebate any amounts required to be rebated pursuant to the rebate provisions of the Indenture, other than from money held in the Operating Account or the Rebate Account created under the Indenture.

(d) At the written direction of the Authority, the Trustee will invest all amounts held in the Rebate Account in Eligible Investments, subject to the restrictions set forth in the Tax Certificate. Money will not be transferred from the Rebate Account except as provided in paragraph (e) below. The Trustee will not be liable for any consequences arising from such investment.

(e) Upon receipt of the Authority's written directions, the Trustee will remit part or all of the balances in the Rebate Account to the United States, as directed in writing by the Authority. In addition, if the Authority so directs, the Trustee will deposit money into or transfer money out of the Rebate Account from or into such Accounts or Funds as directed by the Authority's written directions; provided, however, that only money in excess of the Rebate Requirement may, at the written direction of the Authority, be transferred out of the Rebate Account to such other Accounts or Funds or to anyone other than the United States in satisfaction of the arbitrage rebate obligation. Any funds remaining in the Rebate Account after each five year remittance to the United States, redemption and payment of all of the bonds and payment and satisfaction of any Rebate Requirement, or after provision has been made therefor satisfactory to the Trustee, will be withdrawn and deposited in the Pledged Revenues Account.

(f) Notwithstanding any other provision of the Indenture, the obligation to remit the Rebate Requirement to the United States and to comply with all other requirements of the Tax Covenants provisions of the Indenture and the Tax Certificate will survive the defeasance or payment in full of the Tax-Exempt Bonds. (Section 4.11)

Contract; Obligations to Beneficiaries

In consideration of the purchase and acceptance of any or all of the Bonds and Related 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 the Authority with the Beneficiaries. The pledge made in the Indenture and the covenants set forth in the Indenture to be performed by the Authority will be for the equal benefit, protection and security of the Beneficiaries of the same priority. All of the Bonds or Related Contracts of the same priority, regardless of the time or times of their issuance, payment or maturity, will be of equal rank without preference, priority or distinction of any thereof over any other except as expressly provided in the Indenture.

Under the Indenture, the Authority covenants to pay when due all sums payable on the Bonds, but only from the Pledged Revenues and money designated in the Indenture, subject only to (i) the Indenture, and (ii) to the extent permitted by the Indenture, (x) agreements with Holders of Bonds pledging particular collateral for the payment thereof and (y) the rights of Beneficiaries under Related Contracts. The obligation of the Authority to pay principal or Sinking Fund Installments, 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. The Authority will pay its Operating Expenses.

In addition, the Authority represents 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 Pledged Revenues and other collateral purported to be pledged in the manner and to the extent provided in the Indenture. The Pledged Revenues and other collateral so pledged are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Indenture, and all corporate action on the part of the Authority to that end has been duly and validly taken. The Bonds and the provisions of the Indenture are and will be the valid and binding obligations of the Authority in accordance with their terms. (Section 5.01)

Enforcement

Subject to the provisions of the Indenture, the Trustee will enforce, by appropriate legal proceedings, each covenant, pledge or agreement made by the State in the Sale Agreement for the benefit of any of the Beneficiaries. (Section 5.02)

Tax Covenants

The Authority will covenant under the Indenture that:

- (a) the Authority will at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Authority on Tax-Exempt Bonds will be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Code; and
- (b) No funds of the Authority will at any time be used directly or indirectly to acquire securities, obligations or other investment property the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code.

If and to the extent required by the Code, the Authority 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. Without limiting the foregoing, the Authority agrees that it will comply with the provisions of the Tax Certificate which are incorporated in the Indenture. The Authority's tax covenants will, notwithstanding any other provisions of the Indenture, survive the defeasance or other payment of the Tax-Exempt Bonds. (Section 5.03)

Accounts and Reports

The Authority will make the following covenants under the Indenture:

- (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 and at the expense of the Authority be subject to inspection by the Trustee and, at the written request of the Holders of an aggregate of not less than 25% in principal amount of Bonds then Outstanding, the Holders of the Outstanding Bonds or their representatives duly authorized in writing; and
- (b) annually, within 30 days after release by the State Comptroller of the State's Comprehensive Audited Financial Report, deliver to the Trustee and each Rating Agency, a copy of its financial statements for such Fiscal Year, as audited by an independent certified public accountant or accountants. (Section 5.04)

Ratings

Unless otherwise specified by Series Supplement, the Authority will pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect ratings on all the Bonds from at least one Rating Agency. (Section 5.05)

Affirmative Covenants

The Authority will covenant and agree under the Indenture as follows:

Punctual Payment. The Authority will duly and punctually pay the principal or Sinking Fund Installments of and premium, if any, and interest on the Bonds in accordance with the terms of the Bonds and the Indenture.

Maintenance of Existence. Unless the Special Conditions described under "Limitations on Consolidation, Merger, Sale of Assets, etc." below are met, the Authority will keep in full effect its existence, rights and franchises as a special purpose corporation of the State under the laws of the State.

Protection of Collateral. The Authority will from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (i) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (ii) perfect, publish notice of or protect the validity of any grant made or to be made by the Indenture; (iii) preserve and defend title to the Pledged Revenues and other collateral pledged under the Indenture and the rights of the Trustee and the Bondholders and Beneficiaries in such collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of the Consent Decree, the Indenture, the Sale Agreement or the Act or the performance by any party thereunder; (iv) cause the Trustee to enforce the Sale Agreement; (v) pay any and all taxes levied or assessed upon all or any part of the collateral; or (vi) carry out more effectively the purposes of the Indenture.

Performance of Obligations. The Authority (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 Sale Agreement or the Consent Decree.

Notice of Events of Default. The Authority will give the Trustee and Rating Agencies prompt written notice of each Event of Default under the Indenture. (Section 5.06)

Agreement with the State

Pursuant to the Act, the State pledges and agrees with the Authority, and the owners of the Bonds by reason of the inclusion in the Indenture by the Authority, as agent of the State, of the following pledge and agreement, that the State will (i) irrevocably direct, through the Attorney General, the Independent Auditor and the Escrow Agent (as such terms are defined in the MSA) to transfer all Pledged Settlement Payments directly to the Trustee as the assignee of the Authority, (ii) enforce its right to collect all money due from the PMs under the MSA, (iii) diligently enforce the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA against all nonparticipating manufacturers selling tobacco products in the State that are not in compliance with the Qualifying Statute, in each case in the manner and to the extent deemed necessary in the judgment of, and consistent with the discretion of, the Attorney General, provided, however, (a) that the remedies available to the Authority and the Beneficiaries for any breach of the pledges and agreements of the State set forth in this clause (iii) will be limited to injunctive relief, and (b) that the State will be deemed to have diligently enforced the Qualifying Statute so long as there has been no judicial determination by a court of competent jurisdiction in the State, in an action commenced by a PM under the MSA, that the State has failed to diligently enforce the Qualifying Statute for the purposes of section IX(d)(2)(B) of the MSA, (iv) neither amend the MSA nor the Consent Decree or take any other action in any way that would materially adversely (a) impair the Authority's right to receive Pledged Settlement Payments, or (b) limit or alter the rights vested in the Authority to fulfill the terms of its agreements with the Beneficiaries, or (c) impair the rights and remedies of the Beneficiaries 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 proceedings by or on behalf of the Beneficiaries, are fully paid and discharged (provided that nothing in the Act, the Sale Agreement or the Indenture will be construed to preclude the State's regulation of smoking, smoking cessation activities and laws, and taxation and regulation of the sale of cigarettes or the like or to restrict the right of the State to amend, modify, repeal or otherwise alter statutes imposing or relating to the taxes), and (v) not amend, supersede or repeal the MSA or the Qualifying Statute, in any way that would materially adversely affect the amount of any payment to, or the rights to such payments of, the Authority or the Beneficiaries. Notwithstanding these pledges and agreements by the State, nothing in the Indenture, in the Sale Agreement, in the Bonds or in the Act will be construed or interpreted to limit or impair the authority or discretion of the Attorney

General to administer and enforce provisions of the MSA or to direct, control and settle any litigation or arbitration proceeding arising from or relating to the MSA. (Section 5.07)

Negative Covenants

The Authority will covenant and agree as follows under the Indenture:

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

No Setoff. The Authority will not claim any credit on, or make any deduction from the principal or premium, if any, or interest due in respect of, the Bonds or payments due to other Beneficiaries or assert any claim against any present or former Bondholder or Beneficiary by reason of the payment of taxes levied or assessed upon any part of the collateral.

Liquidation. Unless the Special Conditions described under “Limitations on Consolidation, Merger, Sales of Assets, etc.” below are met, the Authority will not terminate its existence or dissolve or liquidate in whole or in part.

Limitation of Liens. The Authority will not (i) permit the validity or effectiveness of the Indenture or the Sale Agreement to be impaired, or permit the lien of the Indenture to be amended, hypothecated, subordinated, terminated or discharged, or permit any person to be released from any covenants or obligations with respect to the Bonds under the Indenture except as may be expressly permitted thereby, (ii) permit any lien, charge, excise, claim, security interest, mortgage or other encumbrance (other than the lien of the Indenture and any lien securing Bonds) to be created on or extend to or otherwise arise upon or burden the collateral or any part thereof or any interest therein or the proceeds thereof or (iii) permit the lien of the Indenture not to constitute a valid first priority security interest in the collateral.

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

- (a) an entity will survive such event, and such entity will be organized and existing under the laws of the United States, the State or any state and will expressly assume the due and punctual payment of all obligations owing to Beneficiaries and the performance or observance of every agreement and covenant of the Authority in the Indenture;
- (b) immediately after giving effect to such transaction, no Default has occurred under the Indenture;
- (c) the Authority has received an opinion of Transaction Counsel to the effect that such transaction will not adversely affect the exclusion of interest on any Tax-Exempt Bond from gross income for federal income tax purposes;
- (d) any action as is necessary to maintain the lien and security interest created by the Indenture has been taken; and
- (e) the Authority has delivered to the Trustee an Officer’s Certificate and an opinion of Counsel to the effect that such transaction complies with the Indenture and that all conditions precedent to such transaction have been complied with.

No Other Business. The Authority will not engage in any business other than financing, purchasing, owning and managing the Pledged Settlement Payments sold by the State to the Authority in the manner contemplated by the Indenture, the Sale Agreement and any other sale agreement with the State, and activities incidental thereto.

No Borrowing. The Authority will not issue, incur, assume, guarantee or otherwise become liable, directly or indirectly, for any indebtedness secured by the Pledged Settlement Payments except the Bonds. The Residual Certificate and Related Contracts are not indebtedness within the meaning of this covenant.

Guarantees, Loans, Advances and Other Liabilities. Except as otherwise contemplated by the Indenture and the Sale Agreement and any other sale agreement with the State, the Authority 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.

Restricted Payments. The Authority will not, directly or indirectly, make payments to or distributions from the Pledged Accounts except in accordance with the Indenture.

Restriction of Bankruptcy. In accordance with the Act, the Authority will have no authority to file a voluntary petition under or become a debtor or bankrupt under the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency, or moratorium law or statute as may, from time to time, be in effect and neither any public officer nor any organization, entity, or other person shall authorize the Authority to become a debtor or bankrupt under the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency or moratorium law or statute as may, from time to time, be in effect. The State acknowledges that clause (iv)(c) under the heading "Agreement with the State" applies to the foregoing provision. (Section 5.08)

Prior Notice

The Authority will give each Rating Agency thirty days' prior written notice of each issue of Bonds other than the Series 2010 Bonds, with a copy of the proposed Series Supplement, and of each Supplemental Indenture, amendment to the Sale Agreement, Related Contract or defeasance or redemption of Bonds. (Section 5.09)

Pledged Settlement Payments

The State has provided through the MSA, the Consent Decree and the Sale Agreement for (i) the Authority's ownership and receipt of the Pledged Settlement Payments, (ii) the receipt or other application of the net proceeds of the Bonds (not including Refunding Bonds) and (iii) the resulting benefits to the people of the State. Under the Indenture, the Authority acknowledges that the MSA, the Consent Decree and the Sale Agreement constitute important security provisions of the Bonds and waives any right to assert any claim to the contrary and agrees that it will neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the State or any other person of, any such claim to the contrary.

By acknowledging that the MSA, the Consent Decree and the Sale Agreement constitute important security provisions of the Bonds, the Authority also acknowledges under the Indenture that, in the event of any failure or refusal by the State to comply with its agreements included in the MSA, the Consent Decree or the Sale Agreement, the Holders of the Bonds may have suffered damage, the extent of the

remedy for which is set forth in the Indenture and the Act, and will be determined in the course of any action taken pursuant to the Indenture; and the Authority will waive 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 State or any other person of, any claim to the effect that no such damage has been suffered. (Section 6.01)

Resignation or Removal of the Trustee

Under the Indenture, the Trustee may resign at any time on not less than 30 days' written notice to the Authority, the Holders and each of the Rating Agencies. The Trustee will promptly certify to the Authority that it has sent written notice to all Holders and such certificate will be conclusive evidence that such notice was mailed as required hereby. Upon receiving such notice of resignation, the Authority will promptly appoint a successor and, upon the acceptance by the successor of such appointment, release the resigning Trustee from its obligations under the Indenture by written instrument, a copy of which instrument will be delivered to each of the Holders, the resigning Trustee and the successor Trustee. The Trustee may be removed by the Authority or by a Majority in Interest of Outstanding Bonds, upon written notice to the Trustee, if rated below investment grade by S&P and each successor Trustee will have an investment grade rating from S&P. The Trustee may also be removed by written notice from the Authority if no Default has occurred or from a Majority in Interest of the Holders of the Outstanding Bonds to the Trustee and the Authority. No such resignation or removal will take effect until a successor has been appointed and has accepted the duties of the Trustee. (Section 7.04)

Successor Fiduciaries

Any corporation or association which succeeds to the municipal corporate trust business of a Fiduciary as a whole or substantially as a whole, whether by sale, merger, consolidation or otherwise, will become vested under the Indenture, with all the property, rights, powers and duties under the Indenture, without any further act or conveyance and without the execution or filing of any paper with any party hereto except where an instrument of transfer or assignment is required by law to effect such succession, anything in the Indenture to the contrary notwithstanding.

In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary will with due care terminate its activities under the Indenture and a successor may, or in the case of the Trustee will, be appointed by the Authority. The Authority will notify the Holders and the Rating Agencies of the appointment of a successor Trustee in writing within 20 days from the appointment. The Authority will promptly certify to the successor Trustee that it has given such notice to all Holders and such certificate will be conclusive evidence that such notice was given as required by the Indenture. If no appointment of a successor Trustee is made within 45 days after the giving of written notice in accordance with the provisions of the Indenture summarized above under the caption "Resignation or Removal of the Trustee" or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Trustee or any Holder may apply to any court of competent jurisdiction for the appointment of such a successor, and such court may thereupon, after such notice, if any, as such court may deem proper, appoint such successor. Any successor Trustee appointed in accordance with the provisions of the Indenture will be a trust company or a bank having the powers of a trust company, having a capital and surplus of not less than \$50,000,000 and an investment grade rating from S&P or otherwise as approved by the Rating Agencies. Any such successor Trustee will notify the Authority of its acceptance of the appointment and, upon giving such notice, will become Trustee, vested with all the property, rights, powers and duties of the Trustee under the Indenture, without any further act or conveyance. Such successor Trustee will execute, deliver, record and file such instruments as are required to confirm or perfect its succession under the Indenture and any predecessor Trustee will from

time to time execute, deliver, record and file such instruments as the incumbent Trustee may reasonably require to confirm or perfect any succession under the Indenture. (Section 7.05)

Nonpetition Covenant

Notwithstanding any prior termination of the Indenture, no Fiduciary will, prior to the date that is one year and one day after the termination of the Indenture, acquiesce, petition or otherwise invoke or cause the Authority to invoke the process of any court of government authority for the purpose of commencing or sustaining a case against the Authority under any federal or state bankruptcy, insolvency or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official of the Authority or any substantial part of its property, or ordering the winding up or liquidation of the affairs of the Authority. (Section 7.06)

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 the Authority or the Trustee may nevertheless in its discretion require further or other proof in cases where it deems the same desirable. The fact and date of the execution by any Bondholder or his attorney of such instrument may be proved by the certificate or signature guarantee, which need not be acknowledged or verified, of an officer of a bank, trust company or securities dealer satisfactory to the Authority or to the Trustee; or of any notary public or other officer authorized to take acknowledgments of deeds to be recorded in the state in which he purports to act, that the person signing such request or other instrument acknowledged to him the execution thereof; or by an affidavit of a witness of such execution, duly sworn to before such notary public or other officer. The authority of the person or persons executing any such instrument on behalf of a corporate Holder may be established without further proof if such instrument is signed by a person purporting to be the president or a vice president of such Authority 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 by the owner of any Bond will be irrevocable and bind all future record and beneficial owners thereof. (Section 8.01)

Registered Owners

Certain provisions of the Indenture applicable to DTC as Holder of immobilized Bonds will not be construed in limitation of the rights of the Authority and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in the Indenture. Notwithstanding any other provisions in the Indenture, any payment to the registered owner of a Bond will satisfy the Authority's obligations thereon to the extent of such payment. (Section 8.02)

Remedies

If an Event of Default occurs the Trustee may, and upon written request of the Holders of 25% in principal amount of the Bonds Outstanding will, in its own name by action or proceeding in accordance with the law:

- (i) enforce all rights of the Holders and require the Authority or, to the extent permitted by law, the State to carry out its agreements with the Holders and to perform its duties under the Sale Agreement;

- (ii) sue upon such Bonds;
- (iii) require the Authority to account as if it were the trustee of an express trust for the Holders of such Bonds; and
- (iv) enjoin any acts or things which may be unlawful or in violation of the rights of the Holders of such Bonds.

In no event will the principal of any Bond be accelerated and declared due and payable in advance of its stated maturity.

The Trustee will, in addition to the other provisions of the “Remedies” section of the Indenture, have and possess all of the powers necessary or appropriate for the exercise of any functions incident to the general representation of Holders in the enforcement and protection of their rights.

Upon the occurrence of a Payment Default or a failure actually known to an Authorized Officer of the Trustee to make any other payment required by the Indenture within seven days after the same becomes due and payable, the Trustee will give written notice thereof to the Authority. The Trustee will give Default notices under certain provisions of the Indenture when instructed to do so by the written direction of another Fiduciary or the Holders of at least 25% in principal amount of the Outstanding Bonds. The Trustee will proceed for the benefit of the Holders in accordance with the written direction of a Majority in Interest of the Outstanding Bonds. The Trustee will not be required to take any remedial action (other than the giving of notice) unless indemnity satisfactory to the Trustee is furnished for any expense or liability to be incurred therein. Upon receipt of written notice, direction and indemnity, and after making such investigation, if any, as it deems appropriate to verify the occurrence of any event of which it is notified as aforesaid, the Trustee will promptly pursue the remedies provided by the Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Holders, and will 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. The foregoing provisions of the “Remedies” section of the Indenture to the contrary notwithstanding, the remedies available to the Trustee for any breach of the pledges and agreements of the State relating to the diligent enforcement of the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA will be limited to injunctive relief. (Section 9.02)

Extraordinary Prepayment

Upon the occurrence of a Payment Default, on each Distribution Date thereafter, any amounts remaining on deposit in the Pledged Revenues Account after making the deposits required by the Indenture as described in clauses (1), (2) and (4) under the heading “Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues”, shall be applied, together with any amounts on deposit in the Debt Service Reserve Account and any Partial Lump Sum Payments on deposit in the Lump Sum Account, to the mandatory redemption of the Outstanding Bonds, Pro Rata as to principal, among maturities and within a maturity, at a redemption price of 100% of the principal amount thereof, plus accrued interest to the redemption date. (Section 9.03)

Waiver

If the Trustee determines that a Default has been cured before becoming an Event of Default and before the entry of any final judgment or decree with respect to it, the Trustee may waive the Default and its consequences, by written notice to the Authority, and will do so upon written instruction of the Holders of at least 25% in principal amount of the Outstanding Bonds. (Section 9.04)

Individual Remedies

No one or more Holders will by his or their action affect, disturb or prejudice the pledge created by the Indenture, or enforce any right under the Indenture, except in the manner therein provided; and all proceedings at law or in equity to enforce any provision of the Indenture will be instituted, had and maintained in the manner provided therein and for the equal benefit of all Holders of the same class; but nothing in the Indenture will affect or impair the right of any Holder of any Bond to enforce payment of the principal of, premium, if any, or interest thereon at and after the same comes due pursuant to the Indenture, or the obligation of the Authority to pay such principal, premium, if any, and interest on each of the Bonds to the respective Holders thereof at the time, place, from the source and in the manner expressed in the Indenture and in the Bonds. (Section 9.07)

Venue and Governing Law

The venue of every action, suit or special proceeding against the Authority will be laid in the State and will be heard and determined in any court of the State of competent jurisdiction in accordance with the Act. (Section 9.08)

The Indenture will be construed in accordance with the laws of the State, without reference to its conflict of law provisions, and the obligations, rights and remedies of the parties hereunder will be determined in accordance with such laws. (Section 10.04)

Supplements and Amendments to the Indenture

The Indenture may be:

(i) supplemented by delivery to the Trustee of an instrument certified by an Authorized Officer of the Authority to (1) provide for earlier or greater deposits into the Funds and Accounts, (2) subject any property to the lien of the Indenture, (3) add to the covenants and agreements of the Authority or surrender or limit any right or power of the Authority, (4) identify particular Bonds for purposes not inconsistent with the provisions of the Indenture, including credit or liquidity support, serialization and defeasance, (5) cure any ambiguity or defect, (6) protect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes, or the exemption from registration of the Bonds under the Securities Act of 1933, as amended, or of the Indenture under the Trust Indenture Act of 1939, as amended, or (7) authorize Bonds of a Series and in connection therewith determine the matters referred to in the Indenture, or (8) any other things relative to such Bonds that are not materially adverse to the Holders of Outstanding Bonds, or to modify or rescind any such authorization or determination at any time prior to the first authentication and delivery of such Series of Bonds; or

(ii) amended in any other respect by the Authority and the Trustee, (1) to add provisions that are not materially adverse to the Holders, or (2) to adopt amendments that do not take effect unless and until (a) no Bonds Outstanding prior to the adoption of such amendment remain Outstanding or (b) such amendment is consented to by the Holders of such Bonds in accordance with the provisions of subparagraph (iii) below; or

(iii) Otherwise amended only with written notice to the Rating Agencies and the written consent of a Majority in Interest of the Bonds to be Outstanding and affected thereby. However, that the Indenture may not be amended so as to (1) extend the maturity of any Bond, (2) reduce the principal or Sinking Fund Installment amount, applicable premium or interest rate of any Bond, (3) make any Bond redeemable other than in accordance with its terms, (4) create a preference or priority of any Bond over any other Bond of the same class, or (5) reduce the percentage of the Bonds required to be represented by

the Holders giving their consent to any amendment, unless the Holders of the Bonds affected by such amendment have consented to it in writing.

Any amendment of the Indenture will be accompanied by a Transaction Counsel's opinion addressed to the Trustee to the effect that the amendment is authorized and permitted by law and by the Indenture and does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes.

When the Authority determines that the requisite number of consents have been obtained for an amendment to the Indenture which requires consents, it will file a certificate to that effect in its records and give written notice to the Trustee and the Holders. The Trustee will promptly certify to the Authority that it has given such notice to all Holders and such certificate will be conclusive evidence that such notice was given in the manner required by the Indenture. (Section 10.01)

Supplements and Amendments to the Sale Agreement

The Sale Agreement may be amended in accordance with the provisions of Section 6.01 thereof, with the consent of the Trustee but without the consent of the Holders of the Bonds (i) to cure any ambiguity, (ii) to correct or supplement any provisions in the Sale Agreement, (iii) to correct or amplify the description of the tobacco settlement payments sold thereunder, (iv) to add additional covenants for the benefit of the Authority, or (v) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Sale Agreement that will not, adversely affect in any material respect the interest of the Holders of Outstanding Bonds; provided that the Trustee receives a Transaction Counsel's opinion addressed to the Trustee to the effect that the amendment is authorized and permitted by law and by the Indenture and does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes. The Sale Agreement may also be amended from time to time by the Authority and the State, with the consent of a Majority in Interest of the Bondholders, for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Sale Agreement or of modifying in any manner the rights of the Bondholders, but no such amendment will reduce the aforesaid portion of the Outstanding amount of the Bonds, the Holders of which are required to consent to any such amendment, without the consent of all of the Bondholders. In the event that the Trustee receives a request for a consent or other action under the Sale Agreement, the 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 Trustee (and the Authority, if applicable) will proceed in accordance with such directions (if any), pursuant to the Indenture and the Sale Agreement. (Section 10.02)

APPENDIX E

FORM OF CONTINUING DISCLOSURE UNDERTAKING

CONTINUING DISCLOSURE AGREEMENT

by and between

RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY

and

THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., as Disclosure Agent

Dated as of December 1, 2017

Relating to:

**\$670,965,000
Railsplitter Tobacco Settlement Authority
Tobacco Settlement Revenue Bonds
Series 2017**

This **CONTINUING DISCLOSURE AGREEMENT** (this “**Agreement**”) is made and entered into as of December 1, 2017, by and between the **RAILSPLITTER TOBACCO SETTLEMENT AUTHORITY** (the “**Authority**”) and **THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A.**, as disclosure agent (the “**Disclosure Agent**”).

RECITALS

WHEREAS, the Authority will issue its Tobacco Settlement Revenue Bonds, Series 2017 in the aggregate principal amount of \$670,965,000 (the “**Series 2017 Bonds**”) pursuant to an Indenture dated as of December 1, 2010 (the “**Trust Indenture**”), as supplemented by a Series 2017 Supplement dated as of December 1, 2017 (the “**Series 2017 Supplement**” and, collectively with the Trust Indenture, the “**Indenture**”), each between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (in such capacity, the “**Trustee**”), and will to apply the proceeds of the Series 2017 Bonds to acquire from the State the Pledged Settlement Payments (as defined in the Indenture); and

WHEREAS, the Series 2017 Bonds have been offered and sold pursuant to a Preliminary Offering Circular, dated December 15, 2017, and a final Offering Circular dated December 20, 2017 (collectively, the “**Offering Circular**”); and the Authority has entered into a Bond Purchase Contract, dated December 20, 2017 (the “**Bond Purchase Agreement**”), with respect to the sale of the Series 2017 Bonds, with Jefferies LLC as representative of the Participating Underwriter, as hereinafter defined; and

WHEREAS, the Authority and the Disclosure Agent wish to provide for the disclosure of certain information concerning the Series 2017 Bonds and other matters on an on-going basis as set forth herein for the benefit of Bondholders in accordance with the provisions of Securities and Exchange Commission Rule 15c2-12, as amended from time to time (the “**Rule**”);

NOW, THEREFORE, in consideration of the mutual promises and agreements made herein and in the Indenture, the receipt and sufficiency of which consideration is hereby mutually acknowledged, the parties hereto agree as follows:

SECTION 1. Definitions; Scope of this Agreement.

(a) All terms capitalized but not otherwise defined herein shall have the meanings assigned to those terms in the Indenture, as may be amended and supplemented from time to time. Notwithstanding the foregoing, the term “Disclosure Agent” shall originally mean the Trustee, or any successor trustee under the Indenture; any such successor disclosure agent shall automatically succeed to the rights and duties of the Disclosure Agent hereunder, without any amendment hereto. The following capitalized terms shall have the following meanings:

“*Annual Financial Information*” shall mean a copy of the audited annual financial statements for the Authority. All such financial information shall be prepared using generally accepted accounting principles, except as may be modified from time to time and described in such financial statements.

“*Beneficial Owner*” shall mean any person that has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Series 2017 Bonds (including persons holding Series 2017 Bonds through nominees, depositories or other intermediaries).

“*Bondholders*” shall mean any registered owner of the Series 2017 Bonds and any Beneficial Owner thereof.

“*Business Day*” shall mean any day other than (i) a Saturday or a Sunday or a legal holiday or (ii) a day on which banking institutions in Chicago, Illinois or New York, New York, are required or authorized by law, regulation or executive order to be closed.

“*EMMA*” shall mean the MSRB’s Electronic Municipal Market Access system, accessed through the MSRB’s website at <http://www.msrb.org>.

“*Fiscal Year*” shall mean the twelve (12) month period commencing July 1 of each year and ending on June 30 of the succeeding year.

“*MSRB*” shall mean the Municipal Securities Rulemaking Board.

“*Notice Event*” shall mean any of the events listed in items (i) through (xiv) below with respect to the Series 2017 Bonds:

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults, if material;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) adverse tax opinions, the issuance by the Internal Revenue Service 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-exempt status of the Series 2017 Bonds, or other material events affecting the tax-exempt status of the Series 2017 Bonds;
- (vii) modifications to rights of security holders, if material;
- (viii) bond calls, if material, and tender offers;
- (ix) defeasances;
- (x) release, substitution or sale of property securing repayment of the securities, if material;
- (xi) rating changes;

- (xii) bankruptcy, insolvency, receivership or similar event of the Authority (such an Event will be considered to have occurred when any of the following occur: the appointment of a receiver, fiscal agent or similar officer of the Authority in a proceeding under the Bankruptcy Code or in any other proceeding under the state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Authority, or if such jurisdiction has 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 or an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Authority);
- (xiii) the consummation of a merger, consolidation, or acquisition involving the Authority or the sale of all or substantially all of the assets of the Authority, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such action, other than pursuant to its terms, if material; and
- (xiv) appointment of a successor or additional Trustee or the change of name of the Trustee, if material.

“*Operating Data*” shall mean an update of the actual operating data for the preceding Fiscal Year set forth in the Offering Circular in the table entitled “Projected Debt Service and Debt Service Coverage for the Bonds” in the columns titled “Projected Pledged Settlement Payments,” “Net Revenues Available for Debt Service,” “Debt Service Reserve Earnings,” “Net Debt Service,” and “Bond Debt Service Coverage” under the heading “TABLE OF BOND DEBT SERVICE AND COVERAGE” with such “Bond Debt Service Coverage” ratio for such preceding Fiscal Year determined in substantially the same manner as described therein.

“*Participating Underwriter*” shall mean any of the original underwriters of the Series 2017 Bonds required to comply with the Rule in connection with the offering of the Series 2017 Bonds.

“*SEC*” shall mean the Securities and Exchange Commission. “*State*” shall mean the State of Illinois.

“*Turn Around Period*” shall mean (i) five (5) Business Days, with respect to Annual Financial Information and Operating Data delivered by the Authority to the Disclosure Agent; (ii) five (5) Business Days with respect to Notice Event occurrences disclosed by the Authority to the Disclosure Agent; or (iii) five (5) Business Days with respect to the failure, on the part of the Authority, to deliver Annual Financial Information and Operating Data to the Disclosure Agent which period commences upon notification by the Authority of such failure, or upon the Disclosure Agent’s actual knowledge of such failure.

(b) This Agreement applies to the Series 2017 Bonds and any additional bonds issued under the Indenture.

(c) The Disclosure Agent shall have no obligation to make disclosure about the Series 2017 Bonds except as expressly provided herein; provided that nothing herein shall limit the duties or obligations of the Disclosure Agent, as Trustee, under the Indenture. The fact that the Disclosure Agent or any affiliate thereof may have any fiduciary or banking relationship with the Authority, apart from the relationship created by the Indenture, shall not be construed to mean that the Disclosure Agent has actual knowledge of any event or condition except in its capacity as Trustee under the Indenture or except as may be provided by written notice from the Authority.

SECTION 2. Disclosure of Information.

(a) General Provisions. This Agreement governs the Authority's direction to the Disclosure Agent, with respect to information to be made public. In its actions under this Agreement, the Disclosure Agent is acting not as Trustee but as the Authority's agent; provided that the Disclosure Agent shall be entitled to the same protection in so acting under this Agreement as it has in acting as Trustee under the Indenture.

(b) Information Provided to the Public. Except to the extent this Agreement is modified or otherwise altered in accordance with Section 3 hereof, the Authority shall make or cause to be made public the information set forth in subsections (1), (2) and (3) below:

(i) Annual Financial Information and Operating Data. Annual Financial Information and Operating Data at least annually not later than 180 days after the end of the Authority's Fiscal Year beginning (i) with respect to the Annual Financial Information, with the Fiscal Year ending June 30, 2017 and (ii) with respect to the Operating Data, with the Fiscal Year ending June 30, 2018, and, in each case, continuing with each Fiscal Year thereafter, for which the information is provided taking into account the Turn Around Period; provided, however, that if the State's Comprehensive Audited Financial Report ("CAFR") for such Fiscal Year has not yet been released by the State Comptroller, then the Annual Financial Information shall be delivered to EMMA within 30 days after release of the CAFR by the State Comptroller.

(ii) Notice Events. In a timely manner not in excess of ten (10) Business Days after the occurrence of the event, notice of the occurrence of a Notice Event.

(iii) Failure to Provide Annual Financial Information or Operating Data. In a timely manner, notice of the failure of Authority to provide the Annual Financial Information or Operating Data by the date required herein.

(c) Information Provided by Disclosure Agent to Public.

(i) The Authority directs the Disclosure Agent on its behalf to make public in accordance with subsection (D) of this Section 2 and within the time frame set forth in clause (3) below, and the Disclosure Agent agrees to act as the Authority's agent in so making public, the following:

(i) the Annual Financial Information and Operating Data;

- (ii) Notice Event occurrences;
 - (iii) the notices of failure to provide information which the Authority has agreed to make public pursuant to subsection (B)(3) of this Section 2;
 - (iv) such other information as the Authority shall determine to make public through the Disclosure Agent and shall provide to the Disclosure Agent in the form required by subsection (C)(2) of this Section 2. If the Authority chooses to include any information in any Annual Financial Information report or in any notice of occurrence of a Notice Event, in addition to that which is specifically required by this Agreement, the Authority shall have no obligation under this Agreement to update such information or include it in any future Annual Financial Information report or notice of occurrence of a Notice Event.
- (ii) The information which the Authority has agreed to make public shall be in the following form:
- (i) as to all notices, reports and financial statements to be provided to the Disclosure Agent by the Authority, in the form required by the Indenture or other applicable document or agreement; and
 - (ii) as to all other notices or reports, in such form as the Disclosure Agent shall deem suitable for the purpose of which such notice or report is given.
- (iii) The Disclosure Agent shall make public the Annual Financial Information, the Operating Data, the Notice Event occurrences and the failure to provide the Annual Financial Information and Operating Data within the applicable Turn Around Period. Notwithstanding the foregoing, Annual Financial Information, Operating Data and Notice Events shall be made public on the same day as notice thereof is given to the Bondholders of outstanding Series 2017 Bonds, if required in the Indenture, and shall not be made public before the date of such notice. If on any such date, information required to be provided by the Authority to the Disclosure Agent has not been provided on a timely basis, the Disclosure Agent shall make such information public as soon thereafter as it is provided to the Disclosure Agent.
- (d) Means of Making Information Public.
- (i) Information shall be deemed to be made public by the Authority or the Disclosure Agent under this Agreement if it is transmitted as provided in subsection (D)(2) of this Section 2 by the following means:
 - (i) to the Bondholders of outstanding Series 2017 Bonds, by the method prescribed in (ii) below; and
 - (ii) to the MSRB, by electronic transmissions through EMMA (or such other service as may be prescribed in the future by the SEC).

(ii) Information shall be transmitted to the following:

(i) all Annual Financial Information and Operating Data shall be made available to MSRB through EMMA; and

(ii) notice of all Notice Event occurrences and all notices of the failure to provide Annual Financial Information or Operating Data within the time specified in Section 2(B)(1) hereof shall be made available to the MSRB through EMMA.

Nothing in this subsection shall be construed to relieve the Disclosure Agent, as Trustee, of its obligation to provide notices to the holders of all Series 2017 Bonds if such notice is required by the Indenture.

With respect to requests for periodic or occurrence information from Bondholders, the Disclosure Agent may require payment by requesting of holders a reasonable charge for duplication and transmission of the information and for the Disclosure Agent's administrative expenses incurred in providing the information.

Nothing in this Agreement shall be construed to require the Disclosure Agent to interpret or provide an opinion concerning the information made public. If the Disclosure Agent receives a request for an interpretation or opinion, the Disclosure Agent may refer such request to the Authority for response.

(iii) Information may be made public pursuant to this Agreement solely by the transmitting of such information MSRB through EMMA.

(e) Disclosure Agent. The Disclosure Agent, including its officers, directors, employees and agents, shall:

(i) not be liable for any action taken or omitted with respect to this Agreement so long as it shall have acted in good faith and without gross negligence;

(ii) be entitled to compensation for its services hereunder as provided in a separate written agreement with the Authority, which is made a part hereof, and for reimbursement of its out-of-pocket expenses including, but not by way of limitation, the fees and costs of attorneys or agents which it may find necessary to engage in performance of its duties hereunder, all to be paid by the Authority;

(iii) have only those duties as are specifically provided herein, which shall be deemed purely ministerial in nature, and shall under no circumstance be deemed a fiduciary for the Authority. IN NO EVENT SHALL THE DISCLOSURE AGENT BE LIABLE, DIRECTLY OR INDIRECTLY, FOR ANY DAMAGES OR EXPENSES ARISING OUT OF THE SERVICES PROVIDED HEREUNDER, OTHER THAN DAMAGES WHICH RESULT FROM THE DISCLOSURE AGENT'S FAILURE TO ACT IN ACCORDANCE WITH THE STANDARDS SET FORTH IN THIS AGREEMENT;

- (iv) have the right, but not the obligation, to consult with counsel of choice and shall not be liable for action taken or omitted to be taken by the Disclosure Agent either in accordance with the advice of such counsel or in accordance with any opinion of counsel to the Authority addressed and delivered to the Disclosure Agent; and
- (v) have the right to perform any of its duties hereunder through agents, attorneys, custodians or nominees.

Any banking association or corporation into which the Disclosure Agent may be merged, converted or with which the Disclosure Agent may be consolidated, or any corporation resulting from any merger, conversion or consolidation to which the Disclosure Agent shall be a party, or any banking association or corporation to which all or substantially all of the corporate trust business of the Disclosure Agent shall be transferred, shall succeed to all the Disclosure Agent's rights, obligations and immunities hereunder without the execution or filing of any paper or any further act on the part of any of the parties hereto, anything herein to the contrary notwithstanding.

SECTION 3. Amendment or Waiver.

Notwithstanding any other provision of this Agreement, the Authority and the Disclosure Agent may amend this Agreement (and the Disclosure Agent shall agree to any reasonable amendment requested by the Authority) and any provision of this Agreement may be waived, if such amendment or waiver is supported by an opinion of nationally recognized bond counsel or counsel expert in federal securities laws acceptable to both the Authority and the Disclosure Agent to the effect that such amendment or waiver would not, in and of itself, cause the undertakings herein to violate the Rule if such amendment or waiver had been effective on the date hereof but taking into account any subsequent change in or official interpretation of the Rule as well as any change in circumstance.

SECTION 4. Miscellaneous.

(a) Representations. Each of the parties hereto represents and warrants to each other party that it has (i) duly authorized the execution and delivery of this Agreement by the officer of such party whose signature appears on the execution pages hereto, (ii) that it has all requisite power and authority to execute, deliver and perform this Agreement under its organizational documents and any corporate resolutions now in effect, (iii) that the execution and delivery of this Agreement, and performance of the terms hereof, does not and will not violate any law, regulation, ruling, decision, order, indenture, decree, agreement or instrument by which such party is bound, and (iv) such party is not aware of any litigation or proceeding pending, or, to the best of such party's knowledge, threatened, contesting or questioning its existence, or its power and authority to enter into this Agreement, or its due authorization, execution and delivery of this Agreement, or otherwise contesting or questioning the issuance of the Series 2017 Bonds.

(b) Governing Law. This Agreement shall be governed by and interpreted in accordance with the laws of the State; provided that, to the extent that the SEC, the MSRB or any other federal or state agency or regulatory body with jurisdiction over the Series 2017 Bonds

shall have promulgated any rule or regulation governing the subject matter hereof, this Agreement shall be interpreted and construed in a manner consistent therewith.

(c) Severability. If any provision hereof shall be held invalid or unenforceable by a court of competent jurisdiction, the remaining provisions hereof shall survive and continue in full force and effect.

(d) Counterparts. This Agreement may be executed in one or more counterparts, each and all of which shall constitute one and the same instrument.

(e) Termination. This Agreement may be terminated by any party to this Agreement upon thirty (30) days' written notice of termination delivered to the other party or parties to this Agreement; provided the termination of this Agreement shall not be effective until (i) the Authority, or its successor, enters into a new continuing disclosure agreement with a disclosure agent who agrees to continue to provide, to MSRB and the Bondholders of the Series 2017 Bonds, all information required to be communicated pursuant to the rules promulgated by the SEC or the MSRB, (ii) nationally recognized bond counsel or counsel expert in federal securities law provides an opinion that the new continuing disclosure agreement is in compliance with all State and Federal Securities laws and (iii) notice of the termination of this Agreement is provided to MSRB.

This Agreement shall terminate when all of the Series 2017 Bonds are or are deemed to be no longer outstanding by reason of redemption or legal defeasance or at maturity.

(f) Defaults: Remedies. A party shall be in default of its obligations hereunder if it fails to carry out or perform its obligations hereunder.

If an event of default occurs and continues beyond a period of thirty (30) days following notice of default given in writing to such defaulting party by any other party hereto or by a beneficiary hereof as identified in Section 4(G), the non-defaulting party or any such beneficiary may (and, at the request of the Participating Underwriter or the holders of at least 25% aggregate principal amount of Outstanding Bonds, the non-defaulting party shall) enforce the obligations of the defaulting party under this Agreement; provided, however, the sole remedy available in any proceeding to enforce this Agreement shall be an action in mandamus, for specific performance or similar remedy to compel performance.

The occurrence of any event of default as provided in this Agreement shall not constitute an event of default under the Indenture.

(g) Beneficiaries. This Agreement is entered into by the parties hereof and shall inure solely to the benefit of the Authority, the Disclosure Agent, the Trustee, the Participating Underwriter and the Bondholders, and shall create no rights in any other person or entity.

SECTION 5. Notices.

Unless otherwise expressly provided, all notices to the Authority or the Disclosure Agent shall be in writing and shall be deemed sufficiently given if sent by registered or certified mail, postage prepaid, or delivered during business hours as follows:

To the Authority: Railsplitter Tobacco Settlement Authority
State Office of Management and Budget
100 West Randolph Street
Chicago, Illinois 60601
Attention: Chairman

To the Disclosure Agent: The Bank of New York Mellon Trust
Company, N.A.
Two North LaSalle Street, Suite 700
Chicago, Illinois 60602
Attention: Corporate Trust – Public Finance

[The remainder of this page has been intentionally left blank.]

IN WITNESS WHEREOF, the Authority and the Disclosure Agent have each caused their duly authorized officers to execute this Agreement, as of the day and year first above written.

**RAILSPLITTER TOBACCO SETTLEMENT
AUTHORITY**

By: _____
Name:
Title:

**THE BANK OF NEW YORK MELLON
TRUST COMPANY, N.A., as Disclosure Agent**

By: _____
Name:
Title:

APPENDIX F

BOOK-ENTRY ONLY SYSTEM

The information in this Appendix concerning The Depository Trust Company (“DTC”), New York, New York, and DTC’s book-entry system has been obtained from DTC, and the Authority and the Underwriters take no responsibility for the completeness or accuracy thereof. The Authority and the Underwriters cannot and do not give any assurances that DTC, Direct Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of principal of and interest on the Series 2017 Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Series 2017 Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2017 Bonds, or that they will do so on a timely basis, or that DTC, Direct Participants or Indirect Participants will act in the manner described in this Appendix. The current “Rules” applicable to DTC are on file with the Securities and Exchange Commission and the current “Procedures” of DTC to be followed in dealing with DTC Participants are on file with DTC.

DTC will act as securities depository for the Series 2017 Bonds. The Series 2017 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 2017 Bonds, each in the aggregate principal amount of such maturity, 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 2017 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2017 Bonds on DTC’s records. The ownership interest of each actual purchaser of each Series 2017 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 2017 Bonds are to be accomplished by entries made on the books of

Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2017 Bonds, except in the event that use of the book-entry system for the Series 2017 Bonds is discontinued.

To facilitate subsequent transfers, all Series 2017 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 2017 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 2017 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2017 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 2017 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2017 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2017 Bond documents. For example, Beneficial Owners of Series 2017 Bonds may wish to ascertain that the nominee holding the Series 2017 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 shall be sent to DTC. If less than all of the Series 2017 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 Series 2017 Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Series 2017 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Series 2017 Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Authority or the Trustee, on a 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 Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest on the Series 2017 Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the 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 2017 Bonds at any time by giving reasonable notice to the Authority or the Trustee. Under such circumstances, in the

event that a successor depository is not obtained, such Series 2017 Bond certificates are required to be printed and delivered.

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

So long as Cede & Co. is the registered owner of the Series 2017 Bonds, as nominee for DTC, references herein to Bondholders or registered owners of the Series 2017 Bonds (other than under the heading "TAX MATTERS" herein) shall mean Cede & Co., as aforesaid, and shall not mean the beneficial owners of the Series 2017 Bonds.

NEITHER THE AUTHORITY NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DIRECT PARTICIPANTS, TO INDIRECT PARTICIPANTS, OR TO ANY BENEFICIAL OWNER WITH RESPECT TO (I) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, ANY DIRECT PARTICIPANT, OR ANY INDIRECT PARTICIPANT; (II) ANY NOTICE THAT IS PERMITTED OR REQUIRED TO BE GIVEN TO THE OWNERS OF THE SERIES 2017 BONDS UNDER THE INDENTURE; (III) THE SELECTION BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY PERSON TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE SERIES 2017 BONDS; (IV) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OR REDEMPTION PREMIUM, IF ANY, OR INTEREST DUE WITH RESPECT TO THE SERIES 2017 BONDS; (V) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS THE REGISTERED OWNER OF THE SERIES 2017 BONDS; OR (VI) ANY OTHER MATTER.

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