NOT A NEW ISSUE **BOND ENHANCEMENT MEMORANDUM** **March 6, 2014**

TOBACCO SETTLEMENT FINANCING CORPORATION
Tobacco Settlement Asset-Backed Bonds

Series 2007-1B First Subordinate Capital Appreciation Bonds (Turbo Term Bonds)

Maturity Date	Maturity Value	First Optional Redemption Date*	CUSIP†
June 1, 2041	$855,000,000	June 1, 2017	888808DG4

Series 2007-1C Second Subordinate Capital Appreciation Bonds (Turbo Term Bonds)

Maturity Date	Maturity Value	First Optional Redemption Date*	CUSIP†
June 1, 2041	$425,850,000	June 1, 2017	888808DH2

On March 7, 2014 (the "**Effective Date**"), the Tobacco Settlement Financing Corporation (the "**Corporation**"), a public body corporate and politic and an instrumentality of the State of New Jersey (the "**State**") created by the Tobacco Settlement Financing Corporation Act, codified as Chapter 32 of the Laws of 2002 of the State of New Jersey (the "**Act**") will enter into (i) a Series 2007-1B Pledge Agreement with The Bank of New York Mellon, as trustee (the "**Series 2007-1B Pledge Agreement Trustee**") dated as of March 1, 2014 (the "**Series 2007-1B Pledge Agreement**") relating to the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1B First Subordinate Capital Appreciation Bonds (the "**Series 2007-1B Bonds**") and (ii) a Series 2007-1C Pledge Agreement with The Bank of New York Mellon, as trustee (the "**Series 2007-1C Pledge Agreement Trustee**" and, together with the Series 2007-1B Pledge Agreement Trustee, the "**Pledge Agreement Trustees**") dated as of March 1, 2014 (the "**Series 2007-1C Pledge Agreement**") relating to the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1C Second Subordinate Capital Appreciation Bonds (the "**Series 2007-1C Bonds**" and together with the Series 2007-1B Bonds, the "**Series B and C Bonds**"). The Series 2007-1B Pledge Agreement and the Series 2007-1C Pledge Agreement are sometimes referred to herein individually as a "**Pledge Agreement**" and collectively as the "**Pledge Agreements**."

Pursuant to the Act and purchase and sale agreements, the State sold to the Corporation all amounts (the "**TSRs**") payable to the State under the Master Settlement Agreement (the "**MSA**") entered into by participating cigarette manufacturers (the "**PMs**"), 46 states (including the State) and six other U.S. jurisdictions in November 1998 in the settlement of certain smoking-related litigation.

The Series B and C Bonds are secured by a pledge of 76.26% of the TSRs sold to the Corporation by the State (the "**Pledged TSRs**") and were issued pursuant to a Trust Indenture, dated as of January 1, 2007 (as supplemented, the "**Indenture**"), between the Corporation and The Bank of New York Mellon, as trustee (the "**Trustee**") as part of an issue of Tobacco Settlement Asset-Backed Bonds, Series 2007-1, consisting of (i) the Series 2007-1A Senior Current Interest Serial Bonds and the Series 2007-1A Senior Current Interest Turbo Term Bonds (collectively, the "**Series 2007-1A Bonds**"), (ii) the Series 2007-1B Bonds and (iii) the Series 2007-1C Bonds.

Pursuant to the Series 2007-1B Pledge Agreement, the Corporation will additionally pledge 15.99% of the TSRs owned by the Corporation and received by The Bank of New York Mellon, as depository agent (the "**Depository Agent**") on and after July 1, 2016 (the "**Series 2007-1B Additional Pledged TSRs**") to the Series 2007-1B Bonds to be applied to the optional redemption of the Series 2007-1B Bonds on June 1, 2017 and on each June 1 thereafter until the Series 2007-1B Bonds have been Fully Paid. Pursuant to the Series 2007-1C Pledge Agreement, the Corporation will additionally pledge 7.75% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "**Series 2007-1C Additional Pledged TSRs**" and collectively with the Series 2007-1B Additional Pledged TSRs, the "**Additional Pledged TSRs**") to the Series 2007-1C Bonds to be applied to the optional redemption of the Series 2007-1C Bonds on June 1, 2017 and on each June 1 thereafter until the Series 2007-1C Bonds have been Fully Paid. The Additional Pledged TSRs are not currently pledged to any of the Corporation's Outstanding Bonds.

The Corporation will enter into the Pledge Agreements pursuant to the Act and pursuant to a Resolution of the Corporation duly adopted on March 5, 2014. The Pledge Agreements will constitute "ancillary facilities" within the meaning of the Act and will be entitled to the benefits of the Act. However, the Pledge Agreements and the Additional Pledged TSRs pledged thereunder will not be subject to the lien of the Indenture.

All of the original terms of the Series B and C Bonds will remain exactly the same after the execution and delivery of the Pledge Agreements, except that the Series B and C Bonds will be additionally secured by the respective Additional Pledged TSRs which are not Collections or part of the Collateral and are not governed by the Indenture.

Such original terms and certain other factors relating to the Series B and C Bonds are described in the Offering Circular, dated January 23, 2007 (the "**2007 Offering Circular**"), relating to the issuance of the Series 2007-1A Bonds and the Series B and C Bonds. The 2007 Offering Circular is available through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("**EMMA**") and certain sections described herein are incorporated herein by reference. **The Series B and C Bonds are not being reoffered or remarketed.**

The Corporation will enter into the Series 2007-1B Pledge Agreement in consideration of the payment of a bond enhancement premium by the identified holders of the Series 2007-1B Bonds (the "**Series 2007-1B Bond Enhancement Premium**"), and the Corporation will enter into the Series 2007-1C Pledge Agreement in consideration of the payment of a bond enhancement premium by the identified holders of the Series 2007-1C Bonds (the "**Series 2007-1C Bond Enhancement Premium**" and, together with the Series 2007-1B Bond Enhancement Premium, the "**Bond Enhancement Premium**"). **Each Pledge Agreement will apply to and enhance all of the Bonds of the applicable Series.**

The Additional Pledged TSRs are not pledged to the payment of the Series 2007-1A Bonds and are not subject to the lien of the Indenture. The claim of Bondholders to the 76.26% of the TSRs constituting Pledged TSRs is on parity with the exclusive right of the Corporation to receive, retain and dispose of the remaining 23.74% of the TSRs that are the Additional Pledged TSRs which will be paid upon receipt from time to time (i) prior to July 1, 2016, to the State, as the registered owner of the Second Amended and Restated Residual Certificate (as defined herein), (ii) on and after July 1, 2016 and until the Series B and C Bonds, as applicable, have been Fully Paid, to the applicable Pledge Agreement Trustee, to be held and applied to the optional redemption of the Series B and C Bonds, as applicable, as provided in the applicable Pledge Agreement, and (iii) after the Series B and C Bonds, as applicable, have been Fully Paid, to the State, as the registered owner of the Second Amended and Restated Residual Certificate.

Payment of the Series B and C Bonds is dependent on receipt of Pledged TSRs and Additional Pledged TSRs. The amount of Pledged TSRs and Additional Pledged TSRs actually collected is dependent on many factors including, but not limited to, domestic cigarette consumption and the financial strength of the PMs.

See "RISK FACTORS" for a discussion of certain factors that should be considered in connection with the transactions described in this Bond Enhancement Memorandum.

Interest on the Series B and C Bonds is not payable currently but is compounded on each June 1 and December 1 (each a "**Distribution Date**") (to become part of Accreted Value as more fully described herein), until such Series B and C Bonds are redeemed or paid.

On the Effective Date, DeCotiis, FitzPatrick & Cole, LLP, Special Counsel to the Corporation in connection with the execution and delivery of the Pledge Agreements ("**Special Counsel**"), will render its opinion that pursuant to the applicable provisions of the Internal Revenue Code of 1986, as amended (the "**Code**") and related rulings, regulations and judicial decisions, and assuming compliance by the Corporation and the State with the Tax Certificate (as defined herein), Original Issue Discount (as defined herein) on the Series B and C Bonds is not included in gross income for Federal income tax purposes and is not an item of tax preference for purposes of calculating the alternative minimum tax imposed on individuals and corporations. In the opinion of Special Counsel, Original Issue Discount on the Series B and C Bonds is included in the relevant income computation for calculation of the alternative minimum tax imposed on corporations under the Code as a result of the inclusion of interest on the Series B and C Bonds in "adjusted current earnings." In the opinion of Special Counsel, interest on and any gain from the sale of the Series B and C Bonds is not includable as gross income under the New Jersey Gross Income Tax Act. See "TAX MATTERS" herein.

THE PLEDGE AGREEMENTS ARE ANCILLARY FACILITIES WITHIN THE MEANING OF THE ACT. THE ACT PROVIDES THAT THE ISSUANCE OF SECURITIES AND THE EXECUTION OF ANY ANCILLARY FACILITY UNDER THE PROVISIONS OF THE ACT SHALL NOT DIRECTLY, OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO PAY ANY AMOUNTS TO THE CORPORATION OR OWNER OF SECURITIES OR BENEFITTED PARTIES OR LEVY OR PLEDGE ANY FORM OF TAXATION WHATSOEVER THEREFOR. THE SECURITIES AND ANY ANCILLARY FACILITY SHALL NOT BE A DEBT OR LIABILITY OF THE STATE OR ANY AGENCY OR INSTRUMENTALITY THEREOF (OTHER THAN THE CORPORATION AS SET FORTH IN THE ACT), EITHER LEGAL, MORAL OR OTHERWISE, AND NOTHING CONTAINED IN THE ACT SHALL BE CONSTRUED TO AUTHORIZE THE CORPORATION TO INCUR ANY INDEBTEDNESS ON BEHALF OF OR IN ANY WAY TO OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF, AND THE SECURITIES AND ANY ANCILLARY FACILITY SHALL CONTAIN ON THE FACE THEREOF OR OTHER PROMINENT PLACE THEREON IN BOLD TYPEFACE A STATEMENT TO THE FOREGOING EFFECT. NO APPROPRIATION OF ANY MONEYS BY THE STATE TO THE CORPORATION IS AUTHORIZED IN THE ACT.

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The transaction is subject to the approval of legality by DeCotiis, FitzPatrick & Cole, LLP, Teaneck, New Jersey, as Special Counsel to the Corporation and by Orrick, Herrington & Sutcliffe LLP, Counsel to the Enhancement Agent.

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* Optional Redemptions of the Series B and C Bonds will be made from Additional Pledged TSRs pursuant to the Pledge Agreements at the Accreted Value calculated as of each redemption date.

† Copyright 2006, American Bankers Association. CUSIP data herein were provided by Standard & Poor's CUSIP Service Bureau, a Division of the McGraw-Hill Companies, Inc. The CUSIP numbers listed above were provided solely for the convenience of Bondholders only at the time of issuance of the Series B and C Bonds and the Corporation does not make any representation with respect to such numbers or undertake any responsibility for their accuracy. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series B and C Bonds.

NO DEALER, BROKER, SALESPERSON OR OTHER PERSON IS AUTHORIZED TO GIVE ANY INFORMATION OR MAKE ANY REPRESENTATION OTHER THAN AS CONTAINED HEREIN, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE CORPORATION OR THE STATE OR THE ENHANCEMENT AGENT. THIS BOND ENHANCEMENT MEMORANDUM DOES NOT CONSTITUTE AN OFFER TO SELL, OR A SOLICITATION OF AN OFFER TO BUY, ANY SECURITIES.

THERE CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES B OR C BONDS WILL DEVELOP SUBSEQUENT TO THE EXECUTION AND DELIVERY OF THE PLEDGE AGREEMENTS, OR IF ONE DEVELOPS, THAT SUCH SECONDARY MARKET WILL PROVIDE SERIES B OR C BONDHOLDERS WITH LIQUIDITY OR BE MAINTAINED FOR THE LIFE OF THE SERIES B OR C BONDS.

This Bond Enhancement Memorandum contains information furnished by the Corporation, IHS Global and other sources, all of which are believed to be reliable. The information contained under the caption "IHS GLOBAL REPORT" attached as APPENDIX A hereto 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 the delivery of this Bond Enhancement Memorandum shall not, under any circumstances, create any implication that there has been no change in the affairs of the Corporation or the matters covered by the report of IHS Global included as APPENDIX A since the date hereof or that the information contained herein is correct as of any date subsequent to the date hereof.

This Bond Enhancement Memorandum contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the important factors that may materially affect the amount of Collections and Additional Pledged TSRs (see "RISK FACTORS" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" herein), the inclusion in this Bond Enhancement Memorandum of such forecasts, projections and estimates should not be regarded as a representation by the Corporation, the State, IHS Global, the Financial Advisor or the Enhancement Agent that the results of such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

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

THE SERIES B AND C BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION OR ANY OTHER REGULATORY AUTHORITY, NOR HAVE ANY OF THE FOREGOING PASSED UPON THE ACCURACY OR ADEQUACY OF THIS BOND ENHANCEMENT MEMORANDUM. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Bond Enhancement Memorandum and should not be considered a complete statement of the facts material to making an investment decision. Defined terms used but not defined herein have the meanings ascribed thereto in the Indenture, the Pledge Agreements, the Assignment Agreement or the Amended and Restated Depository Trust Agreement. For locations of definitions of certain terms used herein, see "APPENDIX J — INDEX OF DEFINED TERMS" attached hereto.

Overview	On March 7, 2014 (the "**Effective Date**"), the Tobacco Settlement Financing Corporation (the "**Corporation**"), a public body corporate and politic and an instrumentality of the State of New Jersey (the "**State**") created by the Tobacco Settlement Financing Corporation Act, codified as Chapter 32 of the Laws of 2002 of the State of New Jersey (the "**Act**") will enter into (i) a Series 2007-1B Pledge Agreement with The Bank of New York Mellon, as trustee (the "**Series 2007-1B Pledge Agreement Trustee**") dated as of March 1, 2014 (the "**Series 2007-1B Pledge Agreement**") relating to the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1B First Subordinate Capital Appreciation Bonds (the "**Series 2007-1B Bonds**") and (ii) a Series 2007-1C Pledge Agreement with The Bank of New York Mellon, as trustee (the "**Series 2007-1C Pledge Agreement Trustee**" and, together with the Series 2007-1B Pledge Agreement Trustee, the "**Pledge Agreement Trustees**") dated as of March 1, 2014 (the "**Series 2007-1C Pledge Agreement**") relating to the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1C Second Subordinate Capital Appreciation Bonds (the "**Series 2007-1C Bonds**" and together with the Series 2007-1B Bonds, the "**Series B and C Bonds**"). The Series 2007-1B Pledge Agreement and the Series 2007-1C Pledge Agreement are sometimes referred to herein individually as a "**Pledge Agreement**" and collectively as the "**Pledge Agreements**." Pursuant to the Series 2007-1B Pledge Agreement, the Corporation will additionally pledge 15.99% of the TSRs owned by the Corporation and received by The Bank of New York Mellon, as depository agent (the "**Depository Agent**") on and after July 1, 2016 (the "**Series 2007-1B Additional Pledged TSRs**") to the Series 2007-1B Bonds to be applied to the optional redemption of the Series 2007-1B Bonds on June 1, 2017 and on each June 1 thereafter until the Series 2007-1B Bonds have been Fully Paid. Pursuant to the Series 2007-1C Pledge Agreement, the Corporation will additionally pledge 7.75% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "**Series 2007-1C Additional Pledged TSRs**" and collectively with the Series 2007-1B Additional Pledged TSRs, the "**Additional Pledged TSRs**") to the Series 2007-1C Bonds to be applied to the optional redemption of the Series 2007-1C Bonds on June 1, 2017 and on each June 1 thereafter until the Series 2007-1C Bonds have been Fully Paid. The Additional Pledged TSRs are not currently pledged to any of the Corporation's Outstanding Bonds. The Corporation will enter into the Pledge Agreements pursuant to the Act and pursuant to a Resolution of the Corporation duly adopted on March 5, 2014. The Pledge Agreements will constitute "ancillary facilities" within the meaning of the Act and will be entitled to the benefits of the Act. However, the Pledge Agreements and the Additional Pledged TSRs pledged thereunder will not be subject to the lien of the Indenture.
Corporation	The Corporation is a public body corporate and politic and an instrumentality of the State exercising public and essential governmental functions, established in, but not of, the Department of the Treasury, and created by the Act.

Master Settlement Agreement ...... The MSA was entered into on November 23, 1998, among the attorneys general of 46 states (including the State), the District of Columbia, Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively, the "**Settling States**") and the then four largest U.S. tobacco manufacturers: Philip Morris Incorporated ("**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**"). Philip Morris, Reynolds Tobacco, B&W and Lorillard are collectively referred to as the "**Original Participating Manufacturers**" or the "**OPMs**"). On January 5, 2004, Reynolds American Inc. ("**Reynolds American**") was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities and operations of B&W with those of Reynolds Tobacco. References herein to the "Original Participating Manufacturers" or "OPMs" means, for the period prior to June 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard and for the period on and after June 30, 2004, collectively, Philip Morris, Reynolds American and Lorillard.

The MSA resolved cigarette smoking-related litigation between the Settling States and the OPMs and released the OPMs from past and present smoking-related claims by the Settling States, and provides for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the Settling States (including Initial Payments, Annual Payments and Strategic Contribution Fund Payments, each as defined herein), and the imposition of certain tobacco advertising and marketing restrictions, among other things.

The MSA is an industry-wide settlement of litigation between the Settling States and the Participating Manufacturers (as such term is defined below). The MSA permits tobacco companies other than the OPMs to become parties to the MSA. Tobacco companies that become parties to the MSA after the OPMs are referred to herein as "**Subsequent Participating Manufacturers**" or "**SPMs**" and the SPMs, together with the OPMs, are referred to herein as the "**Participating Manufacturers**" or "**PMs**." Tobacco companies that do not become parties to the MSA are referred to herein as "**Non-Participating Manufacturers**" or "**NPMs**." See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT."

MSA Payments .... Under the MSA, the OPMs are required to pay to the Settling States; (i) five initial payments, all of which have been made (the "**Initial Payments**"), (ii) annual payments (the "**Annual Payments**") on each April 15, commencing April 15, 2000 and continuing in perpetuity (of which the April 15, 2000 through April 15, 2013 annual payments have already been paid); and (iii) ten annual payments in the amount of $861 million each (the "**Strategic Contribution Fund Payments**") subject to adjustment as described herein) required to be made on each April 15, commencing April 15, 2008 and continuing through April 15, 2017 (of which the April 15, 2008 through April 15, 2013 payments have already been paid).

Under the MSA, each OPM is required to pay an allocable portion of each Annual Payment and Strategic Contribution Fund Payment based on its respective market share of the U.S. cigarette market during the preceding calendar year, in each case, subject to certain adjustments as described herein. Each SPM has Annual Payment and Strategic Contribution Fund 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.

The payment obligations under the MSA follow tobacco product brands if they are transferred by any of the PMs. Payments by the PMs under the MSA are required to be made to the MSA Escrow Agent (as defined herein), which is required pursuant to the instructions of the MSA Escrow Agreement (as defined herein) to remit an allocable share of such payments to the parties entitled thereto.

As reported by the National Association of Attorneys General ("**NAAG**"), the OPMs accounted for approximately 84.81% of the U.S. domestic cigarette market in payment year 2013 (sales year 2012), based upon shipments and measuring roll-your-own cigarettes at a 0.09 ounces per cigarette conversion rate or approximately 84.52%* measuring roll-your-own cigarettes at a 0.0325 ounces per cigarette conversion rate.

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

Under the MSA, the Annual Payments and the Strategic Contribution Fund Payments due may be subject to numerous adjustments, withholding and disputes, some of which have occurred and may continue to occur and may be material. Such adjustments include, among others, reductions when a PM experiences a loss of market share to Non-Participating Manufacturers as a result of such PM's participation in the MSA (the "**NPM Adjustment**"), reductions for decreased domestic cigarette shipments and to account for those states that settle or have settled their claims against the PMs independently of the MSA, increases related to inflation in an amount of not less than 3% per year and offsets for disputed and/or miscalculated payments. See "RISK FACTORS–Potential Payment Decreases Under the Terms of the MSA" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Adjustments to Payments" herein

Consent Decree............................. On December 4, 1998, the Consent Decree and Final Judgment (the "**Consent Decree**") that governs the State's action against the tobacco companies was entered in the Superior Court, Chancery Division, in Middlesex County, New Jersey. The Consent Decree, which is final and non-appealable, settled the litigation brought by the State against the OPMs and resulted in the achievement of New Jersey State-Specific Finality under the MSA.

Cigarette Consumption................. As described in the IHS Global Report (as defined herein), domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980s and 1990s, falling to less than 400 billion cigarettes in 2003 and, when measured by cigarette shipments, is estimated to have fallen to approximately 290 billion cigarettes (measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate) in sales year 2012, as reported by NAAG. See "IHS GLOBAL REPORT" herein and "APPENDIX A — IHS GLOBAL REPORT"

* The aggregate market share information is based on information as reported by NAAG and may differ materially from the market share information as reported by the OPMs for purposes of their filings with the Securities and Exchange Commission. See "SUMMARY OF COLLECTION METHODOLOGY AND BOND REDEMPTION ASSUMPTIONS" herein. The aggregate market share information for the sales year 2012 from NAAG utilized in the collection methodology may differ materially in the future from the market share information used by the MSA Auditor in calculating the adjustments to Annual Payments and Strategic Contribution Fund Payments in future years. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT— Adjustments to Payments."

attached hereto.

IHS Global Report........................ IHS Global Inc. ("**IHS Global**"), formerly known as DRI·WEFA, Inc., has prepared a report dated March 6, 2014 on the consumption of cigarettes in the United States from 2014 through 2041 entitled, "*A Forecast of U.S. Cigarette Consumption (2014-2041) for the Tobacco Settlement Financing Corporation*" (the "**IHS Global Report**"). IHS Global is an internationally recognized econometric and consulting firm of over 300 economists and is a part of IHS Inc., a global information company with over 1,000 researchers, analysts, and economists in more than 31 countries.

IHS has developed a cigarette consumption model based on historical United States data between 1965 and 2013. IHS Global constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building this empirical model of adult per capita cigarette consumption in the U.S. (real cigarette prices, real per capita disposable personal income, the impact of workplace smoking restrictions first instituted widely in the 1980s, the stricter restrictions on smoking in public places instituted over the last decade, and the trend over time in individual behavior and preferences), IHS Global employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The multivariate regression analysis showed, among other things, (i) long-run price elasticity of consumption of -0.33; (ii) income elasticity of consumption of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.4% per year, resulting in IHS Global's projection of the average annual rate of decline in U.S. cigarette consumption from 2012 through 2041 to be 3.0% and of total consumption in 2041 to be 118 billion cigarettes (a 57% decline from the 2013 level) The projections and forecasts regarding future cigarette consumption included in the IHS Global Report are estimates which have been prepared on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of, and no representation or warranty should be inferred from, these projections and forecasts. See "SUMMARY OF IHS GLOBAL REPORT" herein and "APPENDIX A — IHS GLOBAL REPORT" attached hereto.

Original Collateral .... The Series B and C Bonds are secured by a pledge of 76.26% of the TSRs sold to the Corporation by the State (the "**Pledged TSRs**") and were issued pursuant to a Trust Indenture, dated as of January 1, 2007 (as supplemented, the "**Indenture**"), between the Corporation and The Bank of New York Mellon, as trustee (the "**Trustee**") as part of an issue of Tobacco Settlement Asset-Backed Bonds, Series 2007-1, consisting of (i) the Series 2007-1A Senior Current Interest Serial Bonds and the Series 2007-1A Senior Current Interest Turbo Term Bonds (collectively, the "**Series 2007-1A Bonds**"), (ii) the Series 2007-1B Bonds and (iii) the Series 2007-1C Bonds.

The Additional Pledged TSRs are not pledged to the payment of the Series 2007-1A Bonds and are not subject to the lien of the Indenture. The claim of Bondholders to the 76.26% of the TSRs constituting Pledged TSRs is on parity with the exclusive right of the Corporation to receive, retain and dispose of the remaining 23.74% of the TSRs that are the Additional Pledged TSRs.

Pledge of Additional Pledged TSRs……………………………	The Corporation will enter into the Series 2007-1B Pledge Agreement in consideration of the payment of a bond enhancement premium by the identified holders of the Series 2007-1B Bonds (the "**Series 2007-1B Bond Enhancement Premium**"), and the Corporation will enter into the Series 2007-1C Pledge Agreement in consideration of the payment of a bond enhancement premium by the identified holders of the Series 2007-1C Bonds (the "**Series 2007-1C Bond Enhancement Premium**" and, together with the Series 2007-1B Bond Enhancement Premium, the "**Bond Enhancement Premium**"). Each Pledge Agreement will apply to and enhance all of the Bonds of the applicable Series. Pursuant to the Pledge Agreements, the Corporation will additionally pledge the 23.74% of the TSRs that constitute the Additional Pledged TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 to the Series B and C Bonds, as applicable, to be applied to the optional redemption of the Series B and C Bonds, as applicable, on June 1, 2017 and on each June 1 thereafter until the Series B and C Bonds, as applicable, have been Fully Paid. The Additional Pledged TSRs are not currently pledged to any of the Corporation's Outstanding Bonds. Pursuant to an Amended and Restated Depository Trust Agreement, by and among the State, the Corporation, the Depository Agent, the Trustee, the Series 2007-1B Pledge Agreement Trustee and the Series 2007-1C Pledge Agreement Trustee, dated as of March 1, 2014 (the "**Amended and Restated Depository Trust Agreement**"), the Depository Agent will transfer (i) the Series 2007-1B Additional Pledged TSRs to the Series 2007-1B Pledge Agreement Trustee for deposit in the Series 2007-1B Additional Pledged TSRs Account pledged under the Series 2007-1B Pledge Agreement and (ii) the Series 2007-1C Additional Pledged TSRs to the Series 2007-1C Pledge Agreement Trustee for deposit in the Series 2007-1C Additional Pledged TSRs Account pledged under the Series 2007-1C Pledge Agreement. The Additional Pledged TSRs will be paid upon receipt from time to time (i) prior to July 1, 2016, to the State, as the registered owner of the Second Amended and Restated Residual Certificate (as defined herein), (ii) on and after July 1, 2016 and until the Series B and C Bonds, as applicable, have been Fully Paid, to the applicable Pledge Agreement Trustee, to be held and applied to the optional redemption of the Series B and C Bonds, as applicable, as provided in the applicable Pledge Agreement, and (iii) after the Series B and C Bonds, as applicable, have been Fully Paid, to the State, as the registered owner of the Second Amended and Restated Residual Certificate. All of the original terms of the Series B and C Bonds will remain exactly the same after the execution and delivery of the Pledge Agreements, except that the Series B and C Bonds will be additionally secured by the respective Additional Pledged TSRs which are not Collections or part of the Collateral and are not governed by the Indenture. Such original terms and certain other factors relating to the Series B and C Bonds are described in the Offering Circular, dated January 23, 2007 (the "**2007 Offering Circular**"), relating to the issuance of the Series 2007-1A Bonds and the Series B and C Bonds. The 2007 Offering Circular is available through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("**EMMA**") and certain sections described herein are incorporated herein by reference. The Series B and C Bonds are not being reoffered or remarketed.
Optional Redemption....................	The Series B and C Bonds are subject to redemption at the option of the Corporation in whole or in part on any date on or after June 1, 2017, on such

basis as the Trustee shall deem fair and appropriate, including by lot, at a redemption price equal to 100% of the Accreted Value on the redemption date.

The Additional Pledged TSRs received by the Depository Agent pursuant to the Pledge Agreements on and after July 1, 2016, will be applied on each June 1 beginning June 1, 2017 to the optional redemption of Series B and C Bonds, as applicable, to the fullest extent possible until all Series B and C Bonds, as applicable, have been redeemed.

Pledge Agreements .... Pursuant to the Pledge Agreements, the Corporation will pledge to the applicable Pledge Agreement Trustee, and grant to the applicable Pledge Agreement Trustee a first priority lien and security interest in, all of the Corporation's right, title, and interest, whether now owned or later acquired, in, to, and under: (i) the applicable Additional Pledged TSRs, (ii) the applicable Additional Pledged TSRs Account, (iii) all money, instruments, investment property, and other property credited to or on deposit in the applicable Additional Pledged TSRs Account, and all investment earnings thereon; (iv) all present and future claims, demands, causes and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments, payment intangibles and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing; and (v) all proceeds of the foregoing. The property described in the preceding sentence is referred to herein as the "**Additional Pledged Property**." The Additional Pledged Property does not include any other Pledged TSRs or Unpledged TSRs (as defined herein), including, without limitation, Unpledged TSRs received prior to July 1, 2016, and including, without limitation, Additional Pledged TSRs received after the Series B and C Bonds, as applicable, have been Fully Paid, or rights in and to such other TSRs.

Whenever all Series B and C Bonds, as applicable, have been Fully Paid, then the applicable Pledge Agreement and the lien, rights and security interests created by the applicable Pledge Agreement will terminate and become null and void.

Litigation .... There is no litigation pending or threatened in any court (either in State or federal court) to restrain or enjoin the execution of the Pledge Agreements and the pledge of the Additional Pledged TSRs or questioning the transfer of the Additional Pledged TSRs by the Corporation to the respective Pledge Agreement Trustee for the benefit of the holders of the Series B and C Bonds.

Ratings.. Upon execution of the Pledge Agreements, Standard & Poor's Ratings Services ("**S&P**") is expected to upgrade its existing ratings on each of the Series B and C Bonds to "A-". A rating is not a recommendation to buy, sell or hold securities, and such ratings are subject to revision or withdrawal at any time. See "RATINGS" herein.

Legal Considerations .... Reference is made to "LEGAL CONSIDERATIONS" for a description of certain legal issues that should be considered in connection with the transactions described in this Bond Enhancement Memorandum.

Risk Factors .... Reference is made to "RISK FACTORS" for a description of factors that should be considered in connection with the transactions described in this Bond Enhancement Memorandum.

Tax Matters..................................	Reference is made to "TAX MATTERS" for a description of certain tax issues that should be considered by in connection with the transactions described in this Bond Enhancement Memorandum.
Availability of Documents...........	Included herein are brief summaries of certain documents and reports, which summaries do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statements of the contents thereof. Copies of the Indenture may be obtained by written request from the Trustee at The Bank of New York Mellon, 385 Rifle Camp Road, 3rd Floor, West Paterson, New Jersey 07424, Attention: Corporate Trust.

Any statements in this Bond Enhancement Memorandum involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Bond Enhancement Memorandum is not to be construed as a contract or agreement among the Corporation or the State and the Series B or C Bondholders.

INTRODUCTION

This Bond Enhancement Memorandum has been prepared to provide certain information in connection with the execution and delivery by the Tobacco Settlement Financing Corporation (the "**Corporation**"), a public body corporate and politic and an instrumentality of the State of New Jersey (the "**State**") created by the Tobacco Settlement Financing Corporation Act, codified as Chapter 32 of the Laws of 2002 of the State of New Jersey (the "**Act**") of (i) a Series 2007-1B Pledge Agreement, dated as of March 1, 2014 (the "**Series 2007-1B Pledge Agreement**"), with The Bank of New York Mellon, as trustee (in such capacity, the "**Series 2007-1B Pledge Agreement Trustee**") relating to the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1B First Subordinate Capital Appreciation Bonds (the "**Series 2007-1B Bonds**"), and (ii) a Series 2007-1C Pledge Agreement, dated as of March 1, 2014 (the "**Series 2007-1C Pledge Agreement**"), with The Bank of New York Mellon, as trustee (in such capacity, the "**Series 2007-1C Pledge Agreement Trustee**" and, together with the Series 2007-1B Pledge Agreement Trustee, the "**Pledge Agreement Trustees**"), relating to the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1C Second Subordinate Capital Appreciation Bonds (the "**Series 2007-1C Bonds**" and together with the Series 2007-1B Bonds, the "**Series B and C Bonds**"). The Series 2007-1B Pledge Agreement and the Series 2007-1C Pledge Agreement are sometimes referred to herein individually as a "**Pledge Agreement**" and collectively as the "**Pledge Agreements**."

Pursuant to the Act and certain purchase and sale agreements, the State sold to the Corporation all amounts (the "**TSRs**") payable to the State under the Master Settlement Agreement (the "**MSA**") entered into by participating cigarette manufacturers (the "**PMs**"), 46 states (including the State) and six other U.S. jurisdictions in November 1998 in the settlement of certain smoking-related litigation.

The Series B and C Bonds are secured by a pledge of the Pledged TSRs (as defined below) and were issued pursuant to a Trust Indenture, dated as of January 1, 2007 (as supplemented, the "**Indenture**"), between the Corporation and The Bank of New York Mellon, as trustee (the "**Trustee**") as part of an issue of Tobacco Settlement Asset-Backed Bonds, Series 2007-1, consisting of (i) the Series 2007-1A Senior Current Interest Serial Bonds and the Series 2007-1A Senior Current Interest Turbo Term Bonds (collectively, the "**Series 2007-1A Bonds**"), (ii) the Series 2007-1B Bonds and (iii) the Series 2007-1C Bonds.

Pursuant to the Series 2007-1B Pledge Agreement, the Corporation will additionally pledge 15.99% of the TSRs owned by the Corporation and received by The Bank of New York Mellon, as Depository Agent (in such capacity, the "**Depository Agent**") on and after July 1, 2016 (the "**Series 2007-1B Additional Pledged TSRs**") to the Series 2007-1B Bonds, to be applied to the optional redemption of the Series 2007-1B Bonds on June 1, 2017 and on each June 1 thereafter until the Series 2007-1B Bonds have been Fully Paid. Pursuant to the Series 2007-1C Pledge Agreement, the Corporation will additionally pledge 7.75% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "**Series 2007-1C Additional Pledged TSRs**" and, together with the 2007-1B Additional Pledged TSRs, the "**Additional Pledged TSRs**") to the Series 2007-1C Bonds, to be applied to the optional redemption of the Series 2007-1C Bonds on June 1, 2017 and on each June 1 thereafter until the Series 2007-1C Bonds have been Fully Paid. The Additional Pledged TSRs are not currently pledged to any of the Corporation's Outstanding Bonds.

The Corporation will enter into the Pledge Agreements pursuant to the Act and pursuant to a Resolution of the Corporation duly adopted on March 5, 2014. The Pledge Agreements constitute "ancillary facilities" within the meaning of the Act and are entitled to the benefits of the Act. However, the Pledge Agreements and the Additional Pledged TSRs pledged thereunder are not subject to the lien of the Indenture.

All of the original terms of the Series B and C Bonds will remain exactly the same after the execution and delivery of the Pledge Agreements, except that the Series B and C Bonds will be additionally secured by the respective Additional Pledged TSRs which are not Collections or part of the Collateral and are not governed by the Indenture. Such terms and certain other factors relating to the Series B and C Bonds are described in the Offering Circular, dated January 23, 2007 (the "**2007 Offering Circular**"), in connection with the issuance of the Series 2007-1A Bonds and the Series B and C Bonds. The 2007 Offering Circular is available through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("**EMMA**") and certain sections described herein are incorporated herein by reference. The Series B and C Bonds are not being reoffered or remarketed.

Defined terms used but not defined herein have the meanings ascribed thereto in the Indenture, the Pledge Agreements, the Assignment Agreement or the Amended and Restated Depository Trust Agreement. For locations of definitions of certain terms used herein, see "APPENDIX J— INDEX OF DEFINED TERMS" attached hereto.

INCLUSION BY SPECIFIC REFERENCE

The portions under the captions identified below of the 2007 Offering Circular, available on EMMA, are included herein by specific reference:

THE SERIES 2007-1 BONDS
General
Certain Definitions
Payments of Interest
Payments of Principal or Accreted Value on Turbo Term Bond Maturities
Sinking Fund Installments
Turbo Redemptions
Redemptions Credited by Payment Priorities
Mandatory Clean-up Call
Optional Redemption
Notice of Redemption
Selection of Bonds for Redemption
Book-Entry Only System
SECURITY FOR THE SERIES 2007-1 BONDS
General
Senior Liquidity Reserve Account
Limited Obligations
Payment Priorities
Application of Collections
Events of Default
Additional Bonds
Additional Subordinate Bonds
SUMMARY OF PRINCIPAL LEGAL DOCUMENTS
Definitions
The Indenture
The Series 2002 Purchase Agreement
The Series 2003 Purchase Agreement
CONTINUING DISCLOSURE
LEGAL INVESTMENTS
APPENDIX B MASTER SETTLEMENT AGREEMENT
APPENDIX C CONTINUING DISCLOSURE AGREEMENT
APPENDIX D FORM OF OPINION OF BOND COUNSEL

THE SERIES B AND C BONDS

For a general description of the Series B and C Bonds, reference is made to the information relating to the Series B and C Bonds contained under the heading "THE SERIES 2007-1 BONDS" contained in the 2007 Offering Circular, which information is incorporated herein by reference.

PROJECTED OPTIONAL REDEMPTION

The Series B and C Bonds are subject to redemption at the option of the Corporation in whole or in part on any date on or after June 1, 2017, on such basis as the Trustee shall deem fair and appropriate, including by lot, in either case at a redemption price equal to 100% of the Accreted Value on the redemption date.

The Additional Pledged TSRs received by the Depository Agent pursuant to the Pledge Agreements on and after July 1, 2016, will be applied on each Distribution Date beginning June 1, 2017 to the optional redemption of

Series B and C Bonds, as applicable to the fullest extent possible until all Series B and C Bonds, as applicable have been redeemed.

The following tables present the projected optional redemption of the Series B and C Bonds based on the Collection Methodology and Bond Redemption Assumptions described herein under "SUMMARY OF COLLECTION METHODOLOGY AND BOND REDEMPTION ASSUMPTIONS." ***No assurance can be given that actual cigarette consumption in the United States during the term of the Series B and Series C Bonds will be as assumed, or that the other assumptions underlying the Collection Methodology and Bond Redemption Assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Collection Methodology and Bond Redemption Assumptions, the amounts available to the Corporation to optionally redeem the Series B and C Bonds could be adversely affected. See "RISK FACTORS" herein.***

Projected Series 2007-1B Bonds Optional Redemption
Based on IHS Global Forecast Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1B Additional Pledged TSRs Account Balance
2017	$37,967,787	$855,000,000	$224,505,900	$37,967,755	$144,595,000	$32
2018	41,953,955	710,405,000	197,226,899	41,953,453	151,115,000	502
2019	41,741,901	559,290,000	164,169,512	41,741,718	142,205,000	183
2020	41,561,817	417,085,000	129,443,164	41,560,788	133,915,000	1,029
2021	41,440,821	283,170,000	92,917,705	41,440,043	126,290,000	778
2022	41,353,338	156,880,000	54,427,320	41,353,037	119,195,000	302
2023	41,324,736	37,685,000	13,823,386	13,823,386	37,685,000	27,501,350

[1] Total available funds for the optional redemption of the Series 2007-1B Bonds include Series 2007-1B Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1B Additional Pledged TSRs Account at the end of the prior annual period.

Projected Series 2007-1C Bonds Optional Redemption
Based on IHS Global Forecast Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1C Additional Pledged TSRs Account Balance
2017	$18,402,148	$425,850,000	$107,973,416	$18,401,246	$72,575,000	$902
2018	20,335,043	353,275,000	94,842,326	20,334,957	75,745,000	85
2019	20,231,220	277,530,000	78,891,788	20,231,069	71,170,000	151
2020	20,144,158	206,360,000	62,112,296	20,143,756	66,925,000	402
2021	20,085,354	139,435,000	44,437,935	20,084,474	63,020,000	880
2022	20,043,553	76,415,000	25,786,547	20,043,080	59,395,000	473
2023	20,029,514	17,020,000	6,081,416	6,081,416	17,020,000	13,948,098

[1] Total available funds for the optional redemption of the Series 2007-1C Bonds include Series 2007-1C Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1C Additional Pledged TSRs Account at the end of the prior annual period.

OPTIONAL REDEMPTION UNDER ALTERNATIVE CONSUMPTION DECLINE SCENARIOS

Constant Year-Over-Year Consumption Declines

The following tables present the projected optional redemption of the Series B and C Bonds based on alternative assumptions for annual cigarette consumption in the United States over the term of the Series B and C Bonds and, with the exception of the forecast of cigarette consumption contained in the IHS Global Report, application of the Collection Methodology and Bond Redemption Assumptions described herein under "SUMMARY OF COLLECTION METHODOLOGY AND BOND REDEMPTION ASSUMPTIONS." In order to calculate Additional Pledged TSRs under these alternative scenarios, constant year-over-year shipment declines of (i) 5%, (ii) 7%, (iii) 11.09%, and (iv) 11.89% were applied to NAAG reported sales year 2012 domestic cigarette shipments of 290.10 billion (measuring roll-your-own cigarettes at a 0.0325 ounces per cigarette conversion rate). The resulting calculated annual cigarette shipments in the United States corresponding to these four constant annual rates of decline are shown below along with the forecast of cigarette consumption contained in the IHS Global Report:

Cigarette Consumption (in Billions of Cigarettes)

Sales Year	IHS Global Case	5% Decline Case	7% Decline Case	11.09% Decline Case	11.89% Decline Case
2013	276.74	275.60	269.80	257.93	255.61
2014	268.70	261.82	250.91	229.33	225.22
2015	259.45	248.73	233.35	203.89	198.44
2016	250.43	236.29	217.01	181.28	174.84
2017	241.45	224.48	201.82	161.18	154.06
2018	232.84	213.25	187.69	143.30	135.74
2019	224.70	202.59	174.55	127.41	119.60
2020	217.15	192.46	162.34	113.28	105.38
2021	210.03	182.84	150.97	100.72	92.85
2022	203.43	173.69	140.40	89.55	81.81
2023	197.29	165.01	130.58	79.62	72.08
2024	191.61	156.76	121.44	70.79	63.51
2025	186.29	148.92	112.94	62.94	55.96
2026	181.25	141.48	105.03	55.96	49.31
2027	176.42	134.40	97.68	49.75	43.44
2028	171.72	127.68	90.84	44.23	38.28
2029	167.12	121.30	84.48	39.33	33.73
2030	162.64	115.23	78.57	34.97	29.72
2031	158.28	109.47	73.07	31.09	26.18
2032	154.03	104.00	67.95	27.64	23.07
2033	149.80	98.80	63.20	24.58	20.33
2034	145.65	93.86	58.77	21.85	17.91
2035	141.61	89.16	54.66	19.43	15.78
2036	137.64	84.71	50.83	17.27	13.90
2037	133.76	80.47	47.27	15.36	12.25
2038	129.97	76.45	43.97	13.65	10.79
2039	126.21	72.63	40.89	12.14	9.51
2040	122.53	68.99	38.03	10.79	8.38
2041	118.98	65.54	35.36	9.60	7.38

5% Year-Over-Year Consumption Declines

Projected Series 2007-1B Bonds Optional Redemption
5% Year-Over-Year Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1B Additional Pledged TSRs Account Balance
2017	$35,754,956	$855,000,000	$224,505,900	$35,754,206	$136,165,000	$750
2018	39,138,826	718,835,000	199,567,286	39,138,325	140,975,000	501
2019	38,395,105	577,860,000	169,620,402	38,393,986	130,800,000	1,119
2020	37,671,177	447,060,000	138,745,965	37,670,526	121,380,000	651
2021	36,964,768	325,680,000	106,866,681	36,964,295	112,650,000	473
2022	36,276,944	213,030,000	73,907,776	36,275,628	104,560,000	1,315
2023	35,608,139	108,470,000	39,788,315	35,606,635	97,070,000	1,504
2024	34,956,385	11,400,000	4,421,285	4,421,285	11,400,000	30,535,101

[1] Total available funds for the optional redemption of the Series 2007-1B Bonds include Series 2007-1B Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1B Additional Pledged TSRs Account at the end of the prior annual period.

Projected Series 2007-1C Bonds Optional Redemption
5% Year-Over-Year Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1C Additional Pledged TSRs Account Balance
2017	$17,329,638	$425,850,000	$107,973,416	$17,328,738	$68,345,000	$ 900
2018	18,970,261	357,505,000	95,977,937	18,969,808	70,660,000	454
2019	18,609,471	286,845,000	81,539,707	18,609,343	65,465,000	128
2020	18,257,973	221,380,000	66,633,166	18,256,548	60,655,000	1,425
2021	17,917,116	160,725,000	51,223,058	17,915,721	56,215,000	1,395
2022	17,583,800	104,510,000	35,267,318	17,583,041	52,105,000	759
2023	17,258,600	52,405,000	18,724,831	17,258,073	48,300,000	527
2024	16,942,387	4,105,000	1,553,061	1,553,061	4,105,000	15,389,326

[1] Total available funds for the optional redemption of the Series 2007-1C Bonds include Series 2007-1C Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1C Additional Pledged TSRs Account at the end of the prior annual period.

7% Year-Over-Year Consumption Declines

Projected Series 2007-1B Bonds Optional Redemption
7% Year-Over-Year Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1B Additional Pledged TSRs Account Balance
2017	$32,737,670	$855,000,000	$224,505,900	$32,737,162	$124,675,000	$508
2018	35,380,680	730,325,000	202,757,208	35,380,657	127,440,000	22
2019	34,027,884	602,885,000	176,966,040	34,027,697	115,925,000	187
2020	32,736,788	486,960,000	151,129,010	32,735,929	105,480,000	859
2021	31,504,800	381,480,000	125,176,558	31,504,145	96,010,000	654
2022	30,328,196	285,470,000	99,039,820	30,327,410	87,415,000	785
2023	29,205,952	198,055,000	72,649,347	29,205,731	79,620,000	221
2024	28,134,897	118,435,000	45,932,883	28,133,333	72,540,000	1,564
2025	27,115,588	45,895,000	18,819,428	18,819,428	45,895,000	8,296,160

(1) Total available funds for the optional redemption of the Series 2007-1B Bonds include Series 2007-1B Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1B Additional Pledged TSRs Account at the end of the prior annual period.

Projected Series 2007-1C Bonds Optional Redemption
7% Year-Over-Year Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1C Additional Pledged TSRs Account Balance
2017	$15,867,226	$425,850,000	$107,973,416	$15,867,034	$62,580,000	$192
2018	17,148,180	363,270,000	97,525,644	17,146,923	63,870,000	1,257
2019	16,493,810	299,400,000	85,108,642	16,492,997	58,020,000	813
2020	15,867,520	241,380,000	72,652,966	15,866,688	52,715,000	832
2021	15,270,097	188,665,000	60,127,536	15,268,917	47,910,000	1,180
2022	14,700,270	140,755,000	47,498,338	14,699,496	43,560,000	774
2023	14,155,873	97,195,000	34,728,745	14,154,836	39,615,000	1,037
2024	13,637,294	57,580,000	21,784,472	13,637,049	36,045,000	245
2025	13,141,814	21,535,000	8,626,835	8,626,835	21,535,000	4,514,979

(1) Total available funds for the optional redemption of the Series 2007-1C Bonds include Series 2007-1C Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1C Additional Pledged TSRs Account at the end of the prior annual period.

11.09% Year-Over-Year Consumption Declines

Projected Series 2007-1B Bonds Optional Redemption
11.09% Year-Over-Year Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1B Additional Pledged TSRs Account Balance
2017	$27,145,551	$855,000,000	$224,505,900	$27,145,520	$103,380,000	$31
2018	28,638,423	751,620,000	208,669,254	28,637,122	103,150,000	1,302
2019	26,444,925	648,470,000	190,346,696	26,444,298	90,090,000	627
2020	24,440,860	558,380,000	173,294,350	24,440,220	78,750,000	640
2021	22,612,941	479,630,000	157,382,910	22,611,714	68,910,000	1,227
2022	20,946,471	410,720,000	142,493,554	20,946,261	60,375,000	210
2023	19,425,937	350,345,000	128,511,451	19,424,635	52,955,000	1,301
2024	18,042,833	297,390,000	115,337,358	18,041,945	46,520,000	888
2025	16,782,371	250,870,000	102,870,247	16,781,460	40,925,000	911
2026	15,636,260	209,945,000	91,021,655	15,635,981	36,065,000	279
2027	14,594,050	173,880,000	79,704,853	14,592,846	31,835,000	1,205
2028	13,649,387	142,045,000	68,842,962	13,647,913	28,160,000	1,474
2029	12,792,219	113,885,000	58,357,635	12,790,153	24,960,000	2,066
2030	12,016,358	88,925,000	48,178,320	12,014,105	22,175,000	2,253
2031	11,314,515	66,750,000	38,236,403	11,313,393	19,750,000	1,123
2032	10,679,782	47,000,000	28,465,644	10,677,645	17,630,000	2,137
2033	10,110,136	29,370,000	18,807,197	10,107,988	15,785,000	2,148
2034	9,597,415	13,585,000	9,197,670	9,197,670	13,585,000	399,745

[1] Total available funds for the optional redemption of the Series 2007-1B Bonds include Series 2007-1B Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1B Additional Pledged TSRs Account at the end of the prior annual period.

Projected Series 2007-1C Bonds Optional Redemption
11.09% Year-Over-Year Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1C Additional Pledged TSRs Account Balance
2017	$13,156,849	$425,850,000	$107,973,416	$13,156,606	$51,890,000	$244
2018	13,880,640	373,960,000	100,395,545	13,879,692	51,700,000	948
2019	12,817,588	322,260,000	91,606,917	12,817,464	45,090,000	125
2020	11,845,766	277,170,000	83,425,398	11,845,461	39,355,000	305
2021	10,959,988	237,815,000	75,791,641	10,958,500	34,385,000	1,488
2022	10,153,186	203,430,000	68,648,267	10,152,304	30,085,000	882
2023	9,416,103	173,345,000	61,937,902	9,415,119	26,350,000	985
2024	8,745,317	146,995,000	55,613,206	8,745,190	23,115,000	126
2025	8,133,740	123,880,000	49,625,832	8,132,099	20,300,000	1,641
2026	7,579,750	103,580,000	43,935,321	7,577,761	17,865,000	1,989
2027	7,075,267	85,715,000	38,496,835	7,073,735	15,750,000	1,533
2028	6,616,505	69,965,000	33,272,136	6,614,956	13,910,000	1,549
2029	6,200,941	56,055,000	28,225,710	6,198,528	12,310,000	2,413
2030	5,825,475	43,745,000	23,323,259	5,824,817	10,925,000	658
2031	5,483,462	32,820,000	18,528,072	5,481,645	9,710,000	1,817
2032	5,177,528	23,110,000	13,814,095	5,176,550	8,660,000	978
2033	4,900,102	14,450,000	9,145,781	4,898,847	7,740,000	1,255
2034	4,651,869	6,710,000	4,496,827	4,496,827	6,710,000	155,042

[1] Total available funds for the optional redemption of the Series 2007-1C Bonds include Series 2007-1C Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1C Additional Pledged TSRs Account at the end of the prior annual period.

11.89% Year-Over-Year Consumption Declines

Projected Series 2007-1B Bonds Optional Redemption
11.89% Year-Over-Year Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1B Additional Pledged TSRs Account Balance
2017	$26,138,087	$855,000,000	$224,505,900	$26,137,213	$99,540,000	$874
2018	27,457,904	755,460,000	209,735,338	27,457,211	98,900,000	693
2019	25,151,889	656,560,000	192,721,370	25,151,289	85,685,000	600
2020	23,066,169	570,875,000	177,172,198	23,065,361	74,320,000	808
2021	21,180,801	496,555,000	162,936,578	21,179,409	64,545,000	1,392
2022	19,477,579	432,010,000	149,879,821	19,476,987	56,140,000	592
2023	17,938,158	375,870,000	137,874,378	17,937,205	48,900,000	953
2024	16,550,040	326,970,000	126,809,429	16,548,791	42,670,000	1,248
2025	15,298,347	284,300,000	116,578,352	15,297,064	37,305,000	1,282
2026	14,170,508	246,995,000	107,084,682	14,168,414	32,680,000	2,094
2027	13,156,338	214,315,000	98,239,853	13,155,793	28,700,000	545
2028	12,242,513	185,615,000	89,959,423	12,242,411	25,260,000	103
2029	11,423,274	160,355,000	82,170,071	11,421,976	22,290,000	1,298
2030	10,690,779	138,065,000	74,801,684	10,689,438	19,730,000	1,342
2031	10,034,652	118,335,000	67,785,838	10,033,117	17,515,000	1,534
2032	9,449,315	100,820,000	61,061,835	9,448,171	15,600,000	1,144
2033	8,927,805	85,220,000	54,570,968	8,926,535	13,940,000	1,270
2034	8,465,571	71,280,000	48,259,839	8,463,075	12,500,000	2,496
2035	8,058,083	58,780,000	42,076,958	8,056,757	11,255,000	1,326
2036	7,697,210	47,525,000	35,969,581	7,693,441	10,165,000	3,769
2037	7,384,765	37,360,000	29,896,294	7,382,048	9,225,000	2,717
2038	7,109,845	28,135,000	23,804,236	7,107,005	8,400,000	2,840
2039	6,873,682	19,735,000	17,653,944	6,870,144	7,680,000	3,538
2040	6,672,569	12,055,000	11,401,715	6,667,946	7,050,000	4,622
2041	6,503,509	5,005,000	5,005,000	5,005,000	5,005,000	1,498,509

[1] Total available funds for the optional redemption of the Series 2007-1B Bonds include Series 2007-1B Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1B Additional Pledged TSRs Account at the end of the prior annual period.

Projected Series 2007-1C Bonds Optional Redemption
11.89% Year-Over-Year Consumption Decline

June 1	Total Available Funds[1]	Outstanding Maturity Value	Outstanding Accreted Value	Accreted Value Redeemed	Maturity Value Redeemed	Ending Series 2007-1C Additional Pledged TSRs Account Balance
2017	$12,668,554	$425,850,000	$107,973,416	$12,668,526	$49,965,000	$28
2018	13,307,844	375,885,000	100,912,342	13,306,517	49,565,000	1,327
2019	12,191,557	326,320,000	92,761,028	12,190,662	42,885,000	895
2020	11,180,267	283,435,000	85,311,101	11,178,769	37,140,000	1,499
2021	10,266,974	246,295,000	78,494,217	10,266,921	32,215,000	53
2022	9,439,731	214,080,000	72,242,152	9,438,588	27,970,000	1,143
2023	8,695,085	186,110,000	66,498,964	8,693,352	24,330,000	1,733
2024	8,022,709	161,780,000	61,206,875	8,022,572	21,205,000	137
2025	7,414,303	140,575,000	56,313,783	7,413,029	18,505,000	1,274
2026	6,868,785	122,070,000	51,778,188	6,867,280	16,190,000	1,505
2027	6,377,076	105,880,000	47,553,461	6,375,344	14,195,000	1,733
2028	5,935,145	91,685,000	43,601,168	5,934,914	12,480,000	231
2029	5,536,790	79,205,000	39,882,569	5,536,378	10,995,000	411
2030	5,181,367	68,210,000	36,367,116	5,179,688	9,715,000	1,679
2031	4,864,602	58,495,000	33,022,533	4,863,478	8,615,000	1,125
2032	4,580,256	49,880,000	29,815,970	4,578,796	7,660,000	1,460
2033	4,328,015	42,220,000	26,722,136	4,326,049	6,835,000	1,966
2034	4,104,426	35,385,000	23,713,895	4,101,428	6,120,000	2,998
2035	3,907,363	29,265,000	20,766,503	3,906,359	5,505,000	1,004
2036	3,731,029	23,760,000	17,852,219	3,730,483	4,965,000	547
2037	3,577,953	18,795,000	14,952,663	3,576,069	4,495,000	1,883
2038	3,446,551	14,300,000	12,046,005	3,445,326	4,090,000	1,225
2039	3,331,370	10,210,000	9,106,769	3,326,959	3,730,000	4,412
2040	3,236,744	6,480,000	6,119,893	3,234,666	3,425,000	2,078
2041	3,151,945	3,055,000	3,055,000	3,055,000	3,055,000	96,945

(1) Total available funds for the optional redemption of the Series 2007-1C Bonds include Series 2007-1C Additional Pledged TSRs received each year plus balances remaining in the Series 2007-1C Additional Pledged TSRs Account at the end of the prior annual period.

SECURITY FOR THE SERIES B AND C BONDS

Security for the Series B and C Bonds under the Indenture

The information relating to the Series B and C Bonds contained in the 2007 Offering Circular under the heading "SECURITY FOR THE 2007-1 BONDS" (other than under the paragraph titled "SECURITY FOR THE SERIES 2007-1 BONDS – General – *Payment by MSA Escrow Agent to Depository Agent*") is incorporated herein by reference.

Additional Security for the Series B and C Bonds under the Pledge Agreements

Pursuant to the Pledge Agreements, the Corporation will pledge to the applicable Pledge Agreement Trustee, and grant to the applicable Pledge Agreement Trustee a first priority lien and security interest in, all of the Corporation's right, title, and interest, whether now owned or later acquired, in, to, and under: (i) the applicable Additional Pledged TSRs, (ii) the applicable Additional Pledged TSRs Account, (iii) all money, instruments, investment property, and other property credited to or on deposit in the applicable Additional Pledged TSRs Account, and all investment earnings thereon; (iv) all present and future claims, demands, causes and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments, payment intangibles and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing; and (v) all proceeds of the foregoing. The property described in the preceding sentence is referred to herein as the "**Additional Pledged Property**." The Additional Pledged Property does not include any other Pledged TSRs or Unpledged TSRs (as defined herein), including, without limitation, Unpledged TSRs received prior to July 1, 2016, and including, without limitation, Additional Pledged TSRs received after the Series B and C Bonds, as applicable, have been Fully Paid, or rights in and to such other TSRs.

Whenever all Series B and C Bonds, as applicable, have been Fully Paid, then the applicable Pledge Agreement and the lien, rights and security interests created by the applicable Pledge Agreement will terminate and become null and void.

The Additional Pledged Property is pledged exclusively to the Series B and C Bonds, as applicable, pursuant to the Act and pursuant to the applicable Pledge Agreement, and the Additional Pledged Property is not Collateral within the meaning of the Indenture and is not subject to the lien of the Indenture.

Amended and Restated Depository Trust Agreement

Simultaneously with the execution and delivery of the Pledge Agreements, the State, the Corporation, the Trustee, the Series 2007-1B Pledge Agreement Trustee, the Series 2007-1C Pledge Agreement Trustee, and the Depository Agent will enter into an Amended and Restated Depository Trust Agreement (the "**Amended and Restated Depository Trust Agreement**"). As permitted by the Act, the State will cause the MSA Escrow Agent (as defined in the MSA) to wire all TSRs directly to the Depository Agent, which will deposit such TSRs to the credit of the "**TSRs Depository Trust Account**", which trust account is created by the Amended and Restated Depository Trust Agreement. Within one (1) Business Day, the Depository Agent will apply the amounts on deposit in the TSRs Depository Trust Account as follows:

(a) The Depository Agent will transfer that percentage of the amounts in the TSRs Depository Trust Account as will constitute Pledged TSRs to the Trustee for deposit in the Collection Account maintained under the Indenture. In all respects, the Depository Agent will act as agent for the Trustee and the owners of the Series B and C Bonds with respect to the collection, custody and remittance of the Pledged TSRs, and the pledge of the Pledged TSRs under the Indenture will not be impaired in any respect by the temporary holding thereof, for the account of the Trustee, by the Depository Agent in the TSRs Depository Trust Account and the temporary pledge thereof under the Amended and Restated Depository Trust Agreement.

(b) Simultaneously with the transfer of Pledged TSRs to the Trustee as described in paragraph (a) immediately above, the Depository Agent will transfer that percentage of the amounts in the TSRs Depository Trust Account as will constitute Series 2007-1B Additional Pledged TSRs to the Series 2007-1B Pledge Agreement Trustee for deposit in the Series 2007-1B Additional Pledged TSRs Account maintained under the Series 2007-1B Pledge Agreement. In all respects, the Depository Agent will act as agent for the Series 2007-1B Pledge Agreement Trustee and the owners of the Series 2007-1B Bonds with respect to the collection, custody and remittance of the Series 2007-1B Additional Pledged TSRs, and the pledge of the Series 2007-1B Additional Pledged TSRs under the Series 2007-1B Pledge Agreement will not be impaired in any respect by the temporary holding thereof, for the account of the Series 2007-1B Pledge Agreement Trustee, by the Depository Agent in the TSRs Depository Trust Account and the temporary pledge thereof under the Amended and Restated Depository Trust Agreement.

(c) Simultaneously with the transfer of Pledged TSRs to the Trustee as described in paragraph (a) above, the Depository Agent will transfer that percentage of the amounts in the TSRs Depository Trust Account as will constitute Series 2007-1C Additional Pledged TSRs to the Series 2007-1C Pledge Agreement Trustee for deposit in the Series 2007-1C Additional Pledged TSRs Account maintained under the Series 2007-1C Pledge Agreement. In all respects, the Depository Agent will act as agent for the Series 2007-1C Pledge Agreement Trustee and the owners of the Series 2007-1C Bonds with respect to the collection, custody and remittance of the Series 2007-1C Additional Pledged TSRs, and the pledge of the Series 2007-1C Additional Pledged TSRs under the Series

2007-1C Pledge Agreement will not be impaired in any respect by the temporary holding thereof, for the account of the Series 2007-1C Pledge Agreement Trustee, by the Depository Agent in the TSRs Depository Trust Account and the temporary pledge thereof under the Amended and Restated Depository Trust Agreement.

(d) Simultaneously with the transfer of Pledged TSRs to the Trustee as described in paragraph (a) above, the Depository Agent will transfer to the registered owner of the Second Amended and Restated Residual Certificate (i) all Unpledged TSRs received by the Depository Agent prior to July 1, 2016, (ii) all Series 2007-1B Additional Pledged TSRs received by the Depository Agent after the Series 2007-1B Bonds have been Fully Paid, and (iii) all Series 2007-1C Additional Pledged TSRs received by the Depository Agent after the Series 2007-1C Bonds have been Fully Paid (collectively, the "**Unpledged TSRs**"). In all respects, the Depository Agent will act as agent for the owner of the Second Amended and Restated Residual Certificate with respect to the collection, custody and remittance of the Unpledged TSRs, and the Unpledged TSRs will never be subject to the pledge or lien of the Indenture or either Pledge Agreement but will at all times be the property of the registered owner of the Second Amended and Restated Residual Certificate.

RISK FACTORS

The Series B and C Bonds differ from many other tax-exempt securities in a number of respects. The factors set forth below regarding the transactions contemplated by this Bond Enhancement Memorandum as well as other information contained in this Bond Enhancement Memorandum should be carefully reviewed. The following discussion of risks is not meant to be a complete list of the risks associated with the Series B and C Bonds and does not necessarily reflect the relative importance of the various risks. Any one or more of the risks discussed, and others, could lead to a decrease in the market value and/or the liquidity of the Series B and C Bonds or, in certain circumstances, could lead to a complete loss of a Series B or C Bondholder's investment. There can be no assurance that other risk factors will not become material in the future.

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

Further information regarding these risk factors can be found under "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" below.

Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments

The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material, including without limitation, the NPM Adjustment. Such adjustments, offsets and recalculations could significantly reduce the Pledged TSRs and Additional Pledged TSRs available to the Corporation. Any such adjustments could trigger the Offset for Miscalculated or Disputed Payments (as defined herein) and lead to significant reductions in Pledged TSRs and Additional Pledged TSRs. For additional information regarding the MSA and the payment adjustments, see *"Disputed MSA Payments and Potential for Significant Future Year Offsets to MSA Payments"* below and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments".

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

The Settling States and one or more of the PMs are disputing or have disputed the calculations of some Annual Payments and Strategic Contribution Fund Payments totaling over $8.5 billion for the sales years 2003 through 2012 according to the National Association of Attorneys General ("**NAAG**"); including, with respect to

April 2006 through April 2013 payments due, moneys withheld outright, deposited to the Disputed Payments Account or, as in the case of the largest OPM (Philip Morris for the payment years prior to 2011) moneys actually paid by the PM to the states, but with the PM asserting a reservation of right to dispute such amount paid pursuant to the MSA. This total includes amounts that the OPMs have indicated that they have filed dispute notices with respect to significant additional amounts that may lead to claimed reductions in their MSA payments due in future years. The "**Original Participating Manufacturers**" or "**OPMs**" as referred to herein are Philip Morris Incorporated (now Philip Morris USA Inc., "**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**").

Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments that arise in prior years may result in the application of offsets against subsequent Annual Payments and Strategic Contribution Fund Payments and such offsets may materially adversely affect the amount and timing of the payment of Pledged TSRs and Additional Pledged TSRs. The future diversion of disputed payments to the Disputed Payments Account, the withholding of all or a portion of any disputed amounts, or the application of offsets against future payments could adversely affect the amount and/or timing of Pledged TSRs and Additional Pledged TSRs. Amounts held in the Disputed Payments Account with respect to a sales year could be released to the PMs if, in the future, any Settling State is found to have not diligently enforced its Qualifying Statute (as defined herein) during such sales year, or to those Settling States which, in the future, are found to have diligently enforced their Qualifying Statutes, or pursuant to a settlement of the disputes among Settling States and the PMs. As discussed below, certain states are expected to receive payments with respect to the 2003 NPM Adjustment pursuant to the decision by a panel of three former federal judges arbitrating the 2003 NPM Adjustment claims (the "**Arbitration Panel**") that such states diligently enforced their Qualifying Statute in 2003; however, no assurance can be given as to the timing of such payments or as to amounts withheld in the Disputed Payments Account with respect to the NPM Adjustment in subsequent years. Amounts held in the Disputed Payments Account could also be released pursuant to a settlement of the disputes among the Settling States and the PMs, as was the case in April 2013 in connection with the partial settlement regarding the NPM Adjustment, as discussed below.

The cash flow assumptions used to prepare the redemption tables herein do not factor in an offset for miscalculated or disputed payments or any release of funds currently held in the Disputed Payments Account to the State. Any adjustments made in the form of a credit against future MSA payments could lead to material reductions in the Pledged TSRs and Additional Pledged TSRs available to pay principal and interest on the Series B and C Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT —Adjustments to Payments —*Offset for Miscalculated or Disputed Payments"* and "—Potential Payment Decreases Under the Terms of the MSA —*NPM Adjustment —Application of the NPM Adjustment."*

NPM Adjustment

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

Results of 2003 NPM Adjustment Arbitration; Future NPM Adjustment Arbitrations. The PMs have disputed MSA payments in sales years 2003 through 2012 on the basis that certain Settling States, including the State, did not diligently enforce their respective Qualifying Statutes in each of those years. Following the completion of discovery, the PMs determined to continue to contest the 2003 diligent enforcement claims of 33 states (excluding the State), the District of Columbia and Puerto Rico and to no longer contest such claims by 12 states (including the State) and four U.S. territories (the "**non-contested states**"). After some Settling States (including the State) settled their disputes with the PMs in March 2013, 15 contested states continued in arbitration proceedings with the PMs regarding the 2003 NPM Adjustment. The Arbitration Panel released its decision on September 11, 2013. The Arbitration Panel unanimously determined that nine states diligently enforced their Qualifying Statutes during sales year 2003 and therefore are not subject to the NPM Adjustment for 2003 pursuant to the MSA. The 2003 NPM Adjustment was allocated among those six states, comprising an aggregate allocable share of 14.6792685%, that were determined by the Arbitration Panel to have failed to diligently enforce their respective Qualifying Statutes during sales year 2003. Proceedings to determine state diligent enforcement claims for sales years 2004 through 2012 have not yet been scheduled. The decision that a state diligently enforced its Qualifying Statute during sales year 2003 may not necessarily indicate that such state will be determined in future arbitrations to have diligently enforced its Qualifying Statute in additional sales years. A future determination that a state failed to diligently enforce its Qualifying Statute could result in a complete loss or substantial reduction in the amount of future Pledged TSRs and Additional Pledged TSRs up to the amount of the State's Pledged TSRs and Additional Pledged TSRs for such future sales year or years, plus interest due on all or a portion of such amount, if any. The State's Attorney General's office maintains that the State has been and is diligently enforcing its Qualifying Statute. For a more complete description of the 2003 NPM Adjustment arbitration and the 2004 through 2012 NPM Adjustment claims, as well as certain states' motions to amend or contest the Arbitration Panel's final award, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Potential Payment Decreases Under the Terms of the MSA—2003 through 2012 NPM Adjustment Claims Generally," "—Ongoing 2004 through 2012 NPM Adjustment Claims," and "—2003 NPM Adjustment; Arbitration Results."

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

Non-signatory jurisdictions ("**Term Sheet Non-Signatories**") have objected to the NPM Adjustment Settlement Term Sheet and the jurisdiction of the Arbitration Panel and had attempted to instruct the MSA Auditor not to take any action to implement the NPM Adjustment Stipulated Partial Settlement and Award until proceedings initiated by Term Sheet Non-Signatories in objection to the NPM Adjustment Stipulated Partial Settlement and Award have been concluded. Two states, Colorado and Ohio, filed motions for preliminary injunctions against the implementation of the NPM Adjustment Stipulated Partial Settlement and Award in connection with the April 2013 MSA payment; both such motions were denied. As noted above, the MSA Auditor implemented the NPM Adjustment Stipulated Partial Settlement and Award as it related to the April 2013 MSA payments, over the objections of the Term Sheet Non-Signatories. Fourteen Term Sheet Non-Signatories filed motions to vacate and/or modify the NPM Adjustment Stipulated Partial Settlement and Award, including Connecticut and South Carolina, which subsequently became Term Sheet Signatories in May 2013. No assurance can be given that other challenges to the NPM Adjustment Stipulated Partial Settlement and Award will not be commenced in other MSA courts. For a discussion of the terms of the NPM Adjustment Settlement Term Sheet, the NPM Adjustment Stipulated Partial Settlement and Award and subsequent developments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT —Potential Payment Decreases Under the Terms of the MSA —*NPM Adjustment* —2003 NPM Adjustment Claims; Arbitration Results." No assurance can be given as to the impact or the magnitude of the effect of the NPM Adjustment Stipulated Partial Settlement and Award on Term Sheet Non-Signatories, as to whether or not the NPM Adjustment Stipulated Partial Settlement and Award will be revised or reversed and any consequences thereto, or as to any final settlement or resolution of disputes concerning the NPM Adjustment Stipulated Partial Settlement and Award and the effect of such factors on the amount and/or timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation to pay debt service on the Series B and C Bonds.

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

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

All of the judgments rendered to date on the merits have rejected challenges to the MSA, Qualifying Statutes and Complementary Legislation presented in the cases. In the most recent decision, *VIBO Corporation, Inc. d/b/a/ General Tobacco v. Conway*, *et al.*, 669 F.3d 675 (6th Cir. 2012) ("***VIBO***"), a three-judge panel of the U.S. Court of Appeals for the Sixth Circuit (the "**Sixth Circuit**") ruled on February 22, 2012 that the MSA does not amount to an unlawful conspiracy or anti-competitive behavior by the government and, accordingly, affirmed the district court's order dismissing plaintiffs' federal antitrust, federal constitutional and common law challenges to the enforceability of the MSA. The time period for the plaintiffs to file a petition for certiorari to the U.S. Supreme Court expired. In *Grand River Enters. Six Nations, Ltd. v. King*, 2012 WL 263100 (S.D.N.Y. 2012) ("***Grand River***"), the U.S. District Court for the Southern District of New York (the "**Southern District**") on January 30, 2012 denied the plaintiffs' motion to amend the Southern District's March 22, 2011 dismissal by summary judgment of plaintiffs' claims that the MSA and related legislation violated Section 1 of the Sherman Antitrust Act of 1890 (the "**Sherman Act**") and the Commerce Clause of the U.S. Constitution. Plaintiffs had appealed to the U.S. Court of Appeals for the Second Circuit (the "**Second Circuit**") both the Southern District's March 22, 2011 dismissal and January 30, 2012 denial, but on June 1, 2012 withdrew both appeals, which withdrawals were ordered by the Second Circuit on August 10, 2012. In *Freedom Holdings v. Cuomo,* 624 F.3d 38 (2d Cir. 2010) ("***Freedom Holdings***"), the Second Circuit affirmed the judgment of the Southern District that New York State's Qualifying Statute did not violate federal antitrust laws or the Commerce Clause of the U.S. Constitution. The U.S. Supreme Court denied plaintiff's petition for certiorari. These cases are discussed more fully herein under "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Litigation Challenging the MSA, the Qualifying Statute and Related Legislation."

The MSA and related state legislation may continue to be challenged in the future. A determination by a court having jurisdiction over the State and the Corporation that the MSA or related State legislation is void or unenforceable could have a materially adverse effect on the payments by the PMs under the MSA and the amount and/or the timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT."

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

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

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

Numerous legal actions, proceedings and claims arising out of the sale, distribution, manufacture, development, advertising, marketing and claimed health effects of cigarettes are pending against the PMs and it is likely that similar claims will continue to be filed for the foreseeable future. The claimants have sought recovery on a variety of legal theories, including, among others, negligence, fraud, misrepresentation, strict liability in tort, design defect, breach of warranty, enterprise liability (including claims asserted under the Racketeering Influenced and Corrupt Organizations Act ("**RICO**")), civil conspiracy, intentional infliction of harm, injunctive relief, indemnity, restitution, unjust enrichment, public nuisance, unfair trade practices, claims based on antitrust laws and state consumer protection acts, and claims based on failure to warn of the harmful or addictive nature of tobacco products. Various forms of relief are sought, including compensatory and, where available, punitive damages in amounts ranging in some cases into the hundreds of millions or even billions of dollars. Claimants in some of the cases have sought treble damages, statutory damages, disgorgement of rights, equitable and injunctive relief and medical monitoring, among other damages.

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

Any of the foregoing results could potentially lower the volume of cigarette sales and thus the amounts of payments under the MSA.

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

However, the Florida Supreme Court ruling in *Engle* permitted members of the *Engle* class to file individual claims, including claims for punitive damages. The PMs are currently defendants in over 5,000 cases (involving nearly 6,500 plaintiffs) pending in various state and federal courts in Florida that were filed by members of the *Engle* class (the "**Engle Progeny Cases**"). The Florida Supreme Court held that these individual plaintiffs are entitled to rely on a number of the jury's findings in favor of the plaintiffs in the first phase of the *Engle* trial. According to Lorillard, various intermediate state and federal Florida appellate courts have issued rulings that address the scope of the preclusive effect of the findings from the first phase of the *Engle* trial, including whether those findings relieve plaintiffs from the burden of proving certain legal elements of their claims, and these courts have come to differing conclusions, as further discussed herein. Following review of one of those cases, the Florida Supreme Court ruled on March 14, 2013 that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. On August 12, 2013, Philip Morris, Reynolds American and Liggett Group filed a petition for writ of certiorari with the U.S. Supreme Court with respect to that ruling. This petition for review was denied on October 7, 2013. In two other cases, the United States Court of Appeals for the Eleventh Circuit ruled that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. Reynolds American moved for rehearing of the cases and on October 31, 2013 the Eleventh Circuit vacated its opinion and issued a new opinion that again concluded that the use of Phase I *Engle* findings does not violate a tobacco manufacturer's due process rights. On November 7, 2013, the Court denied defendant's petition for rehearing. On November 7, 2013, the defendant filed a second petition seeking review of the October 31, 2013 opinion. On January 6, 2014, the Court denied this petition. It is not possible to predict the final outcomes of any of the Engle Progeny Case litigation, but such outcomes may adversely affect the operations of the defendants and thus payments under the MSA.

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. The Supreme Court's decision also could encourage litigation involving cigarettes labeled as "lights" or "low tar" and medical monitoring cause of action

In December 2008, the 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 U.S. 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 Food and Drug Administration's ("**FDA**") ban thereof in June 2010. According to Lorillard's Form 10-K filed with the SEC for the fiscal year ended December 31, 2013, there are approximately 19 such "lights" class actions and two class action cases that seek court-supervised medical monitoring programs pending in various courts.

The amount or range of losses that could result from unfavorable outcomes of pending litigation is 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 that (i) their management has concluded that it is not probable that a loss has been incurred in any material pending litigation against them and (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 adversely affected by an unfavorable outcome of certain pending or future litigation, potentially leading to cessation of operations or insolvency or bankruptcy of one or more PMs.

The ultimate outcome of these and any other pending or future lawsuits is uncertain. Verdicts of substantial magnitude that are enforceable as to one or more PMs, if they occur, could encourage commencement of additional litigation, or could negatively affect perceptions of potential triers of fact with respect to the tobacco industry, possibly to the detriment of pending litigation. An unfavorable outcome or settlement or one or more adverse judgments could result in bankruptcy, insolvency or a decision by the affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption. In addition, the financial condition of any or all of the PM defendants could be adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected PM's ability to make payments under the MSA and could have an adverse effect on the amount and/or timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation. See "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 (including the State) and various other governments and jurisdictions to settle asserted and unasserted health care cost recovery and other claims. Certain U.S. tobacco product manufacturers had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota (the "**Previously Settled State Settlements**" and, together with the MSA, are referred to as the "**State Settlement Agreements**").

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

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

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

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

In August 2006, a final judgment and remedial order was entered in *United States of America v. Philip Morris USA, Inc., et al.* (U.S. District Court, District of Columbia, filed September 22, 1999) (the "**DOJ Case**") and in June 2010 the U.S. Supreme Court denied all petitions for review of the case. The district court based its final judgment and remedial order on the government's only remaining claims, which were based on the tobacco industry defendants' alleged violations of RICO. Although the verdict did not award monetary damages to the plaintiff U.S.

government, the final judgment and remedial order imposed a number of requirements on the defendants. Such requirements include, but are not limited to, corrective statements by defendants related to the health effects of smoking. The remedial order placed certain prohibitions on the manner in which defendants market their cigarette products and enjoined any use of "lights" or similar product descriptors. In March 2011, defendants filed a motion to vacate the court's factual findings and remedial order on two grounds; that the Tobacco Control Act extinguished the court's jurisdiction, or that the court should decline to move forward with an injunctive remedy in deference to the FDA's authority. On June 1, 2011, the trial court denied defendants' motion. The defendants appealed the trial court's ruling to the U.S. Court of Appeals for the District of Columbia Circuit. On July 27, 2012, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the district court's denial of the defendants' motion to vacate. On November 27, 2012, the district court released its order on the required text of the corrective statements that the defendants must put on their websites and ordered the parties to engage in negotiations with the special master on a number of issues related to the implementation of the corrective statements remedy, which negotiations are ongoing. According to Altria, unresolved issues will be decided by the special master and the court. Further proceedings are pending before the district court to determine whether the corrective statements will have to be displayed at retail points of sale. On January 25, 2013, defendants appealed to the U.S. Court of Appeals for the District of Columbia Circuit the district court's November 2012 order on the text of the corrective statements. On January 30, 2013, defendants also filed a motion to hold the appeal in abeyance pending the completion of related proceedings in the district court regarding the implementation of the corrective statements, which motion the Court of Appeals granted on February 15, 2013. On January 10, 2014, the parties submitted a motion for entry of a consent order in the district court, setting forth their agreement on the implementation details of the corrective communications remedy. The agreement provides that the "trigger date" for implementation is after the appeal on the content of the communications has been exhausted. It is possible that the remedial order, including the prohibitions on the use of the descriptors relating to low tar cigarettes and the stark text required in the corrective statements, will negatively affect the PMs' sales of and profits from cigarettes, as well as result in significant compliance costs.

Declines in Cigarette Consumption May Materially Adversely Affect Pledged TSRs and Additional Pledged TSRs available for the Series B and C Bonds

Cigarette consumption in the U.S. has declined significantly over the last several decades. According to a preliminary report issued by the Centers for Disease Control ("CDC") in December 2013, the smoking rate for adults in the United States fell to 17.4% for January to June 2013, after hovering at 20% to 21% for more than seven years, and approximately 19% in 2010 and 2011. Continuing declines in cigarette consumption could adversely impact the amount and timing of the Pledged TSRs and Additional Pledged TSRs available to the Corporation. The following factors, among others, may negatively impact cigarette consumption in the U.S.

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

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

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

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

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

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

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

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

- requires the disclosure of ingredients and additives to consumers;

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

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

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

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

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

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

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

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

The FDA has yet to issue guidance with respect to many provisions of the FSPTCA, which may result in less efficient operation by the PMs in the near term as they may be reluctant to increase production, research or development prior to final regulations from the FDA. According to Lorillard, the FDA has indicated that it intends to regulate electronic cigarettes under the FSPTCA through the issuance of deeming regulations that would include electronic cigarettes under the definition of a "tobacco product" under the FSPTCA subject to the FDA's jurisdiction. According to Lorillard, as of February 14, 2014, the FDA had not taken such action. In letters to the Commissioner of the FDA dated September 24, 2013 and October 23, 2013, the attorneys general of 41 states requested that the FDA "take all available measures" to issue proposed regulations that will address the advertising, ingredients, and sale to minors of electronic cigarettes by the FDA's previously stated deadline of October 31, 2013. The letter asked the FDA to regulate electronic cigarettes like other tobacco products, and to move quickly to ensure that all tobacco products are tested and regulated to ensure that tobacco companies do not continue to sell or advertise to young people. In addition, fifteen public health organizations sent a letter to President Obama, dated September 19, 2013, asking for his leadership in ensuring that the FDA moves forward promptly with rules that would assert the FDA's authority over all tobacco products, including e-cigarettes. It is likely that regulations promulgated by the FSPTCA, including regulation of menthol short of an outright ban thereof, could result in a decrease in cigarette sales in the U.S., and an increase in costs to PMs, potentially resulting in a material adverse effect on the PMs' financial condition, results of operations and cash flows. Additionally, the ability of the PMs to gain efficient market clearance for new cigarette products or establish a new brand name could be affected by FDA rules and regulations. The negative impact of the foregoing factors could be to reduce consumption of cigarettes in the U.S. thereby reducing payments under the MSA which could have an adverse effect on the amount and/or timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation.

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 the incidents 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 (excluding the State) sent a letter to the FDA in support of a ban on menthol flavored cigarettes. Any ban or material limitation on the use of menthol in cigarettes could materially adversely affect the results of operations, cash flow and financial condition of the PMs, especially Lorillard, which is heavily dependent on sales of its *Newport* brand mentholated cigarettes. According to Lorillard, mentholated cigarettes are reported to have comprised 31.1% of the U.S. domestic cigarette market in 2012 and 31.4% in 2013. The FSPTCA directs the TPSAC to evaluate issues surrounding the use of menthol as a flavoring or ingredient in cigarettes. In addition, the legislation permits the FDA to ban menthol upon a finding that such a prohibition would be appropriate for the public health. The TPSAC or the Menthol Report

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

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

Payments under the MSA are determined in part by the volume of cigarettes sold by the PMs in the U.S. cigarette market. Price increases, restrictions on advertising and promotions, funding of smoking prevention campaigns, increases in regulation and excise taxes, health concerns, a decline in the social acceptability of smoking, smoking bans in public places, increased pressure from anti-tobacco groups and other factors have reduced U.S. cigarette consumption. U.S. cigarette consumption is expected to continue to decline for the reasons stated above and others such as the raising of the minimum age to possess or purchase tobacco products. In January 2010, an amendment to New Jersey's Smokefree Air Act was passed which banned the use of e-cigarettes in indoor public places and workplaces and banned the sale of e-cigarettes to anyone under 19 years old. On October 30, 2013, the New York City Council voted to ban the sale of both cigarettes and e-cigarettes to anyone under 21 years old; the Mayor of New York City signed the bill on November 19, 2013. A similar bill was introduced in the District of Columbia on November 5, 2013 and referred to a committee for further consideration. A South Dakota Senate Committee on February 24, 2014 sent to the full Senate a bill that would classify e-cigarettes containing nicotine as tobacco products that cannot be sold to or used by anyone aged below 18. Reductions in consumption could lead to reductions of payments under the MSA and could have an adverse effect on the amount and/or timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation.

In the U.S., tobacco products are subject to substantial and increasing federal and state excise taxation, which has a negative effect on consumption. On April 2, 2009, Congress increased the federal excise tax per pack of cigarettes to \$1.01 per pack (an increase of \$0.62), and significantly increased taxes on other tobacco products. The federal excise tax rate for snuff increased \$0.925 per pound to \$1.51 per pound. The federal excise tax on small cigars, defined as those weighing three pounds or less per thousand, increased from $48.502 per thousand to $50.33 per thousand. All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2012 ranged from $0.17 per pack in Missouri to $4.35 per pack in New York. Since January 1, 2002, 47 states, the District of Columbia and several U.S. territories have raised their cigarette taxes, many of them more than once. According to the American Lung Association's Tobacco Policy Project/State Legislated Actions on Tobacco Issues ("**SLATI**"), the current nationwide average state cigarette tax is $1.51 per pack. In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold. According to Lorillard, for the twelve months ended December 31, 2013, combined state and local excise taxes ranged from $0.17 to $5.85 per pack. According to Reynolds American, as of December 31, 2013, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.30, compared with the 12-month rolling average of $1.28 as of December 31, 2012. According to Philip Morris, between the end of 1998 (the year that the MSA was executed) and February 21, 2014, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.47 per pack. In 2013, Massachusetts, Minnesota, Oregon, New Hampshire and Puerto Rico enacted legislation to increase their cigarette taxes, two California State Senate committees recommended a bill to raise the state excise by $1.95 per pack and New York City passed an ordinance that set a minimum retail price of a pack of cigarettes at $10.50, and prohibited the use of coupons and promotions to discount that price. According to the Form 10-K of Altria (Philip Morris's parent company) filed with the SEC for the year ended December 31, 2013, no state has increased its cigarette excise tax in 2014.

Legislation introduced by Senator Tom Harkin on January 22, 2013, the Healthy Lifestyles and Prevention America Act (or the HeLP America Act), would double the federal excise tax on cigarettes and roll-your-own tobacco and increase the taxes on smokeless tobacco products (making the excise taxes on smokeless tobacco products comparable to those on cigarettes). Legislation introduced by Senator Richard Durbin on January 31, 2013, the Tobacco Tax Equity Act, would similarly equalize federal excise tax rates on all tobacco products, including pipe tobacco, cigars and smokeless tobacco, so that the tax rates on such products would approximate those of cigarettes. Similar bills have not been introduced in the U.S. House of Representatives. President Obama's fiscal year 2015 budget proposes significant increases in the federal excise tax for all tobacco products. The proposed budget would increase the federal excise tax on a pack of cigarettes by $0.94 per pack, raising the total federal excise tax to $1.95 per pack, indexed for inflation, and would also increase the tax on other tobacco products by a proportionate amount.

In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold. Increased excise taxes are likely to result in declines in overall sales volume and shifts by consumers to less expensive brands, deep discount brands, counterfeit brands or pipe tobacco for roll-your-own consumers. Reductions in consumption will lead to reductions of payments under the MSA and could have a negative effect on the amount and/or timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation.

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

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

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

Certain of the major cigarette makers have developed and marketed alternative cigarette products. For example, numerous manufacturers have developed and are marketing **"electronic cigarettes"** or **"e-cigarettes,"** which are battery powered devices that vaporize liquid nicotine which is then inhaled. The manufacturers of e-cigarettes have taken the position that e-cigarettes do not constitute "cigarettes" within the meaning of the MSA because they do not contain or burn tobacco. There are currently over 250 e-cigarette brands on the market. Altria's Nu Mark LLC introduced an electronic cigarette under the "MarkTen" brand with distribution in Indiana initiated in August 2013. MarkTen is a disposable e-cigarette that can be reused with a separate battery recharging kit and additional cartridges in both tobacco and menthol flavors. Altria stated that the MarkTen's "Four Draw" technology is designed to give users a "more consistent experience" that closely resembles the draw of a traditional cigarette. Lorillard has boosted distribution of its blu eCigs to more than 136,000 stores since acquiring the brand in 2012. Reynolds American launched a revamped version of its e-cigarette, VUSE, in Colorado retail outlets in July 2013, with a plan to quickly expand sales nationwide. Reynolds American has stated that it is targeting existing smokers with VUSE and expects some smokers to give up cigarettes in favor of VUSE.

The CDC in February 2013 reported results of a survey that indicated that 6.2% of the adult population, and 21% of smokers, had tried e-cigarettes at some time, which results were approximately double the estimates in 2010. A report released by the CDC and the FDA in September 2013 showed a doubling, to 10%, of the number of high school students who have tried e-cigarettes. Certain reports have predicted that sales of e-cigarettes could outpace traditional cigarettes before 2050. No assurance can be given that regulation of e-cigarettes by the FDA will stop these trends.

In addition, Philip Morris developed an alternative cigarette, called Accord, in which the tobacco is heated rather than burned. Reynolds Tobacco has developed and is marketing dissolvable tobacco tablets, orbs, strips and sticks. Sales of moist snuff products have increased recently. Reynolds Tobacco and Philip Morris are both marketing their versions of "**snus**", a smokeless, spitless tobacco product that originated in Sweden. In May 2006, Reynolds Tobacco introduced Camel Snus. Philip Morris manufactures Marlboro Snus and Marlboro Smokeless Tobacco Stick, and a subsidiary of Altria (Philip Morris's parent company) manufactures Copenhagen and Skoal smokeless products. In January 2012, Altria announced that it entered into an agreement with Okono, an affiliate of Fertin Pharma, a Danish maker of nicotine chewing gum, to develop non-combustible nicotine-containing products. In May 2012, Altria announced that its subsidiary Nu Mark LLC introduced Verve nicotine discs, a mint-flavored, chewable, disposable tobacco product that contains tobacco-derived nicotine, and on June 11, 2013, Altria announced its intention to expand its distribution of Verve discs from 60 stores to about 1,200 stores throughout Virginia in the second half of 2013.

It has been reported that increases in cigarette taxes have caused an increase in the sale of e-cigarettes and other alternatives to cigarettes. The manufacturers of e-cigarettes have taken the position that such products do not constitute "cigarettes" within the meaning of the MSA. While such alternative cigarette products continue to be deemed not to constitute "cigarettes" under the MSA and gain market share of the domestic cigarette market, payments under the MSA could decrease, and thus amounts of Pledged TSRs and Additional Pledged TSRs available to the Corporation may decrease.

On February 12, 2014, Senator Tom Harkin, U.S. Representative Henry Waxman of Virginia and U.S. Representative Peter Welch of Vermont sent a letter to the Attorneys General of Iowa, California and Vermont urging the attorneys general to classify electronic cigarettes as "cigarettes" under the MSA. Such classification could mitigate the potential decrease in payments under the MSA if electronic cigarettes gain market share over "cigarettes." There can be no assurance that such classification will occur. Also, on February 26, 2014, Senators Barbara Boxer, Dick Durbin, Tom Harkin, Richard Blumenthal and Edward Markey introduced legislation that would permit the FTC to determine what constitutes marketing e-cigarettes to children, and would allow the FTC to work with state attorneys general to enforce a ban on such marketing. There can be no assurance that such legislation will be enacted.

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

Television and radio advertisements of tobacco products have been prohibited since 1971. U.S. tobacco companies generally cannot use billboard advertising, cartoon characters, sponsorship of concerts, non-tobacco merchandise bearing brand names and various other advertising and marketing techniques. In addition, the MSA prohibits the targeting of youth in advertising, promotion or marketing of tobacco products. Accordingly, the tobacco companies have determined not to advertise cigarettes in magazines with large readership among people under the age of 18. The FSPTCA grants authority over the regulation of tobacco products to the FDA. Under the FSPTCA, the FDA has issued rules restricting access and marketing of cigarettes and smokeless tobacco products to youth, and announced its plans to issue 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 cigarette manufacturers to launch new premium brands. Moreover, these limitations may make it difficult to maintain sales volume of cigarettes in the U.S.

"Electronic cigarettes" are not currently subject to the advertising restrictions to which tobacco products are subject. Therefore, electronic cigarettes, which can currently be marketed more extensively than traditional cigarettes and other tobacco products, could gain market share to the detriment of the domestic cigarette market.

Certain vendors of tobacco products may discontinue sales of cigarettes, negatively impacting sales volume

CVS Caremark announced on February 5, 2014 that it will stop selling cigarettes and other tobacco products at its CVS/Pharmacy stores by October 1, 2014. It cannot be known at this time whether other vendors will also stop selling cigarettes and other tobacco products. However, such discontinuation of sales may result in reduced sales volume that could adversely affect payments due under the MSA.

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

Large pharmaceutical companies have developed and increasingly expanded their marketing of smoking cessation products. Companies such as GlaxoSmithKline, Johnson & Johnson, Novartis and Pfizer are very well capitalized public companies that have entered this market and have the capability to fund significant investments in research and development and marketing of these products. Smoking cessation products now can be obtained both in prescription and over-the-counter forms. From Nicorette gum in 1984, to nicotine patches, nicotine inhalers and tablets, as well as other non-pharmaceutical smoking cessation products, this market has evolved into a $1 billion business in the U.S., according to some estimates. Studies have shown that these programs are effective, and that excise taxes and smoking restrictions drive additional expenditures to the smoking cessation market. In 2004, it was estimated that over 50% of all smokers had quit smoking, and it is likely that many of those former smokers were aided by smoking cessation products. Results of a study by the Centers for Disease Control ("**CDC**"), released in November 2011 found that, in 2010, 52.4% of smokers had attempted to quit and 6.2% had recently quit. To the extent that these products, new products or products used in combination become more effective and more widely available, or that more smokers avail themselves of these products, sales volumes of cigarettes in the U.S. may decline, adversely affecting payments under the MSA.

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

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

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

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

A decline in the overall consumption of cigarettes could have an adverse effect on the payments by PMs under the MSA and the amount and/or timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation.

Other Risks Relating to the MSA and Related Statutes

Severability

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

Amendments, Waivers and Termination

As a settlement agreement between the PMs and the Settling States, the MSA is subject to amendment in accordance with its terms, and may be terminated upon consent of the parties thereto. Parties to the MSA, including the State, may waive the performance provisions of the MSA. See "COVENANTS OF THE STATE – Amendments Affecting State Covenants." The Corporation is not a party to the MSA; accordingly, the Corporation has no right to challenge any such amendment, waiver or termination. While the economic interests of the State and the Series B and C Bondholders will presumably be the same in many circumstances, no assurance can be given that such an amendment, waiver or termination of the MSA would not have a material adverse effect on the receipt of Pledged TSRs and Additional Pledged TSRs by the Corporation. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT —Amendments and Waivers."

Reliance on State Enforcement of the MSA and State Non-Impairment

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

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

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

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

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

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

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

If one or more PMs were to become a debtor in a case under Title 11 of the United States Code (the "**Bankruptcy Code**"), there could be delays in or reductions or elimination of Pledged TSRs and Additional Pledged TSRs.

In the event of the bankruptcy of a PM, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the Corporation, the Trustee, the Pledge Agreement Trustees, the Series B and C Bondholders, or the beneficial owners of the Series B and C Bonds to collect any Pledged TSRs and Additional Pledged TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying the Pledged TSRs and Additional Pledged TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of Pledged TSRs and Additional Pledged TSRs. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to reject the MSA and stop making payments under it.

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

Rating Agency Actions

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

Uncertainty as to Timing of Optional Redemption

No assurance can be given as to the timing of optional redemption of the Series B and C Bonds. No assurance can be given that actual cigarette consumption in the United States during the term of the Series B and C Bonds will be as had been assumed, or that the other assumptions underlying the Series B and C bond redemption assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Series B and C bond redemption assumptions, the amount of Collections and Additional Pledged TSRs available to make optional redemption payments will be affected and the resulting weighted average lives of the Series B and C Bonds will vary.

Limited Resources of the Corporation

To the extent the Series B and C Bonds are secured by the Pledged TSRs, they are payable only from the Pledged TSRs and Pledged Accounts of the Corporation pledged under the Indenture and to the extent the Series B and C Bonds are secured by the Additional Pledged TSRs, they are payable only from the Additional Pledged TSRs of the Corporation pledged under the Pledge Agreements. In the event that such assets of the Corporation have been exhausted, no amounts will thereafter be available to be paid on the Series B and C Bonds. The Series B and C Bonds are not legal or moral obligations of the State, and no recourse may be had with respect thereto for payment of amounts owing on the Series B and C Bonds. Investors in the Series B and C Bonds must look solely to the assets of the Corporation pledged under the Indenture and the Pledge Agreements for the payment of interest and principal and premium, if any. The Corporation has no taxing power and no assets are available to pay Series B and C Bonds other than the assets acquired pursuant to the Purchase Agreements and Assignment Agreement, as applicable, and pledged under the Indenture and the Pledge Agreements, as applicable. No assets of the State are pledged to secure or will be available to pay debt service on the Series B and C Bonds.

Limited Remedies

The Trustee and the Pledge Agreement Trustees, respectively, are limited under the terms of the Purchase Agreements and the Pledge Agreements to enforcing the terms of the respective agreements and to receiving the Pledged TSRs and Additional Pledged TSRs and applying them in accordance with the Indenture and the Amended and Restated Depository Trust Agreement, respectively. If an Event of Default occurs, the Trustee and the Pledge Agreement Trustees, respectively, cannot sell their rights under the Purchase Agreements or the Pledge Agreements. The Corporation is not a party to the MSA and has not made any representation or warranty that the MSA is enforceable. Remedies under the Purchase Agreements, the Assignment Agreement and the Pledge Agreements do not include the repurchase by the State of the Pledged TSRs or Additional Pledged TSRs under any circumstances, including unenforceability of the MSA, the State's Qualifying Statute or breach of any representation or warranty. The remedies of the Series B and C Bondholders are no greater than those afforded to the Trustee or the Pledge Agreement Trustees, as applicable.

Limited Liquidity of the Series B and C Bonds; Price Volatility

There can be no assurance that a secondary market for the Series B and C Bonds will develop subsequent to the execution and delivery of the Pledge Agreements, or if a secondary market does develop, that it will provide

Series B and C Bondholders with liquidity or that it will continue for the life of the Series B and C Bonds. Tobacco settlement revenue bonds generally have also exhibited greater price volatility than traditional municipal bonds. Owners of the Series B and C Bonds must be prepared to hold such securities for an indefinite period of time or until redemption or final payment of such securities.

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

Any rating assigned to the Series B and C Bonds by a rating agency will reflect such rating agency's assessment of the likelihood of the payment of principal or and interest on the Series B and C Bonds. The rating of the Series B and C Bonds will not be a recommendation to buy, hold or sell such Bonds and such rating will not address the marketability of such Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by a rating agency if, in such rating agency's judgment, circumstances so warrant based on factors prevailing at the time. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market for, or the market price of, the Series B and C Bonds.

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal issues that could affect the Series B and C Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the Pledged TSRs and Additional Pledged TSRs to be reduced or eliminated.

Bankruptcy Considerations

General

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

Chapter 7 Bankruptcy

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

Chapter 11 Reorganization

Should a PM become a debtor in a Chapter 11 reorganization bankruptcy case, the PM may not be authorized to make any payments owing under the MSA, or may be required to obtain bankruptcy court approval before making such payments. Legal proceedings necessary to determine whether such PM's obligations under the MSA can be paid during the pendency of the bankruptcy proceedings could be time-consuming and could result in delays in, or elimination of, payments by the bankrupt PM.

Examples of other bankruptcy-related risks include:

MSA as Executory Contract

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

Assumption or Rejection of MSA

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

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

Modification of MSA Obligations

If the MSA is determined not to be an "executory contract", the PM determines to reject the MSA or the PM is otherwise not authorized to make payments under the MSA, then a bankruptcy of the PM could result in long delays and possibly in large reductions in the amount of Pledged TSRs and Additional Pledged TSRs available to pay the Series B and C Bondholders because, under the Bankruptcy Code, the obligations of the PM under the MSA could be modified or discharged in their entirety. For example, the bankruptcy court may approve a plan of reorganization or liquidation of the PM that alters the timing or the amount of payments to be made by the PM under the MSA to the State (and, thus, to the Corporation, the Trustees, the Pledge Agreement Trustees and the Series B and C Bondholders).

MSA and Qualifying Statute Enforceability

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

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

The Qualifying Statutes and related legislation, like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the U.S. Constitution or state constitutions or are preempted by federal antitrust laws. The lawsuits have sought, among other relief, injunctions against the enforcement of the Qualifying Statutes and related legislation. To date, such challenges have not been ultimately successful. The Qualifying Statutes and related legislation may continue to be challenged in the future. Although a determination that a Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA, such a determination could have an adverse effect on payments to be made under the MSA if an NPM were to gain market share in the future and there occurred the requisite impact on the market share of the PMs under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT —Litigation Challenging the MSA, the Qualifying Statute and Related Legislation."

Limitations on Certain Opinions

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

Enforcement of Rights to Pledged TSRs and Additional Pledged TSRs

It is possible that the State could in the future attempt to claim some or all of the Pledged TSRs and Additional Pledged TSRs for itself, or otherwise interfere with the security for the Series B and C Bonds. In that event, the Series B and C Bondholders, the Trustee, the Pledge Agreement Trustees or the Corporation could assert claims based on contractual or constitutional rights.

Contractual Remedies

Under State law, settlements are treated as contracts and may be enforced according to their terms. The Consent Decree coupled with the MSA is a court-approved settlement of lawsuits that establishes the State's right to receive the Pledged TSRs and Additional Pledged TSRs. The Purchase Agreements, the Assignment Agreement, the Indenture and the Pledge Agreements obligate the State to take all necessary action to protect the Corporation's interest in the Pledged TSRs and Additional Pledged TSRs, as applicable, in all material respects. Thus, if the State violates such pledge and agreement so as to impair the Corporation's right to the Pledged TSRs or the Additional Pledged TSRs, the Trustee or the Pledge Agreement Trustees, as assignees of the Corporation's rights under the Purchase Agreements and the Assignment Agreement, respectively, could seek to compel the State to honor such pledge and agreement. In general, as interested parties, the Corporation on its own behalf, and the Trustee or the Pledge Agreement Trustees on behalf of the Series B and C Bondholders, could also seek to enforce the State's rights under the MSA, although, as third parties to the MSA, their rights to do so are uncertain.

Based on the U.S. Supreme Court's standard of review for Contract Clause challenges in *Energy Reserves Group, Inc. v. Kansas Power Light Co.*, 459 U.S. 400 (1983), the State must justify the exercise of its inherent police power to safeguard the vital interests of its people before the State may alter contracts similar to the MSA or the financing arrangements in a manner that would substantially impair the rights of the Series B and C Bondholders to be paid from the Pledged TSRs and Additional Pledged TSRs. In those instances, however, where a state's own contractual obligations involving financing will be substantially impaired, the U.S. Supreme Court applies a stricter standard of judgment to a state's actions due to the risk that a state's self-interest rather than any public necessity will be the motivation for its actions. Indeed, in *United States Trust Company of New York v. New Jersey*, 431 U.S. 1 (1977), the U.S. Supreme Court noted that only once in an entire century had the U.S. Supreme Court upheld the alteration of a municipal bond contract. Thus, in order to justify the enactment by the State of legislation that substantially impairs the contractual rights of the Series B and C Bondholders to be paid from the Pledged TSRs and Additional Pledged TSRs, the State not only must demonstrate a significant and legitimate public purpose, such as the remedying of a broad and general social or economic problem, but must also demonstrate that its actions under such circumstances satisfy the U.S. Supreme Court's strict standard of judgment employed in *United States Trust Company* and also that the impairment of the Series B and C Bondholder's rights are based upon reasonable conditions and are of a character appropriate to the public purpose justifying the legislation's adoption.

Constitutional Rights

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

No Assurance as to the Outcome of Litigation

With respect to all matters of litigation mentioned above 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 TSRs and Additional Pledged TSRs or otherwise filed in connection with the tobacco industry, the outcome of such litigation, 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 (ii) the courts, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation and any such adverse outcome could have a material and adverse impact on the amount of Pledged TSRs and Additional Pledged TSRs available to the Corporation to pay the Series B and C Bonds.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

The following is a brief summary of certain provisions of the MSA and related information. This summary is not complete and is subject to, and qualified in its entirety by reference to, the MSA, as amended. A copy of the MSA in its original form is attached as APPENDIX B to the 2007 Offering Circular, available on EMMA, but several amendments have been made to the MSA which are not included in APPENDIX B to the 2007 Offering Circular. Except for those amendments pursuant to which certain tobacco companies became SPMs (as defined below), such amendments involve technical and administrative provisions not material to the summary below. In addition, the following includes certain information related to litigation challenges to the MSA and disputes regarding the NPM Adjustment, both of which are referenced under "RISK FACTORS" herein.

General

The MSA is an industry-wide settlement of litigation between the Settling States (including the State) and the OPMs and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for other tobacco companies (the "**SPMs**") to become parties to the MSA. The three OPMs together with the 52 SPMs are referred to as the "**PMs**." The settlement represents the resolution of a large potential financial liability of the PMs for smoking-related injuries, the costs of which have been borne and will likely continue to be borne by states. Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking-related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

Parties to the MSA

The Settling States are all of the states, territories and the District of Columbia, except for the four states (Florida, Minnesota, Mississippi and Texas) that separately settled with the OPMs prior to the adoption of the MSA (the "**Previously Settled States**"). According to NAAG, as of June 28, 2013, the most recent posting by NAAG, 55 PMs were parties to the MSA. The chart below identifies each of the PMs which was a party to the MSA as of June 28, 2013 (the most current reference date cited by NAAG):

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

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."

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

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" below.

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

Overview of Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments (as defined below), Annual Payments and Strategic Contribution Fund Payments.* See "—Initial Payments", "—Annual Payments" and "—Strategic Contribution Fund Payments" 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

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

make Initial Payments. Thus far, the OPMs have made all of the Initial Payments, and most of the PMs[†] have made the Annual Payments for 2000 through, and including, 2013 (subject to certain withholdings and payments into the Disputed Payments Account under the MSA described in "RISK FACTORS —Potential Payment Decreases Under the Terms of the MSA"). See "—Payments Made to Date" below. Strategic Contribution Fund Payments began April 15, 2008 and will continue through April 15, 2017.

Payments required to be made by the OPMs are calculated annually based on actual domestic shipments of cigarettes in the prior calendar year by reference to the OPMs' domestic shipment of cigarettes in 1997, with consideration under certain circumstances for the profitability of each OPM. Payments to be made by the SPMs are recalculated each year based on the Market Share (as defined below) 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 and Strategic Contribution Fund Payments are to be made to Citibank, N.A., as escrow agent (the "**MSA Escrow Agent**"), which in turn will disburse the funds to the Settling States. The State has covenanted to irrevocably direct the MSA Escrow Agent and the MSA Auditor (as defined below) to transfer all Pledged TSRs directly to the Trustee and will covenant to irrevocably direct the MSA Escrow Agent and the MSA Auditor to transfer the Additional Pledged TSRs to the applicable Pledge Agreement Trustee.

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

Initial Payments

"**Initial Payments**" were required to be made only by the OPMs at inception of the MSA and in January of each year from 2000 through and including 2003, all of which have been paid. Such payments were subject to various adjustments pursuant to the MSA.

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 first fourteen Annual Payments due April 15 in each of the years 2000 through 2013. The scheduled base amounts of Annual Payments and the appropriate amounts actually paid after application of adjustments discussed herein are set forth in the following table:

[†] 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.

Annual Payments

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

* The Annual Payments from 2000 through 2013 have been made and were subject to various adjustments, withholdings and disputes, as described herein. Subsequent adjustments to Annual Payments for a given year may impact Annual Payments due in subsequent years.

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 (each such term as defined below), 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**").

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 from the scheduled base amounts for the years 2000 through 2013, as discussed below under the caption "—Payments Made to Date."

"**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.

Strategic Contribution Fund Payments

The OPMs are also required to make Strategic Contribution Fund Payments on April 15 of each year from 2008 through 2017. The base amount of each Strategic Contribution Fund Payment is $861 million. The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM's Relative Market Share during the preceding calendar year. The SPMs will be required to make Strategic

Contribution Fund Payments if their market share increases above their respective Base Shares. See "—Subsequent Participating Manufacturers."

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

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

Application of these adjustments resulted in a material reduction of the Strategic Contribution Fund Payments due to the State from the scheduled base amounts for the years 2008 through 2013, as discussed below under the caption "- Payments Made to Date".

Adjustments to Payments

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

Inflation Adjustment

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

Volume Adjustment

Each of the Initial Payments was, and each of the Annual Payments and Strategic Contribution Fund 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 Fund 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 Fund 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 (as defined below) has been reached and divided by four, then added to the payment due. However, in no case will the amount added back due to the increase in operating income exceed the amount deducted due to the decrease in domestic volume. Any add-back due to an increase in Actual Operating Income will be allocated among the OPMs on a pro rata basis in accordance with their respective increases in Actual Operating Income over 1997 Base Operating Income.

Previously Settled States Reduction

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

Non-Settling States Reduction

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

Non-Participating Manufacturers Adjustment

The "**NPM Adjustment**" is based upon market share increases, measured by domestic sales of cigarettes by NPMs, and operates to reduce the payments of the PMs under the MSA in the event that the PMs incur losses in market share to NPMs during a calendar year as a result of the MSA. 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. The "NPM Adjustment" is applied to the subsequent year's Annual Payment and Strategic Contribution Fund Payment and the decrease in total funds available as a result of the NPM Adjustment is then allocated on a pro rata basis among those Settling States that have been found (i) to not diligently enforce their Qualifying Statutes, or (ii) to have enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate market share is between 0% and 16 ⅔% 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 ⅔%, the NPM Adjustment will be calculated as follows:

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

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

The NPM Adjustment is also state-specific, in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute. Any Settling State that adopts and diligently enforces the Model Statute or a Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute. 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. 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 —Potential Payment Decreases Under the Terms of the MSA" above and "—MSA Provisions Relating to Model/Qualifying Statutes" below. See also "—'Most Favored Nation' Provisions" and "- Potential Payment Decreases Under the Terms of the MSA" below. For a discussion of recent developments regarding disputes with respect to the NPM Adjustment, including arbitration decisions regarding the 2003 NPM Adjustment and the NPM Adjustment Stipulated Partial Settlement and Award, and objections thereto, see "- NPM Adjustment – 2003 NPM Adjustment; Arbitration Results" and "-NPM Adjustment Settlement and Award" below.

Offset for Miscalculated or Disputed Payments

If the MSA Auditor receives notice of a miscalculation of an Initial Payment made by an OPM, an Annual Payment made by a PM within four years, or a Strategic Contribution Fund 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 —Potential Payment Decreases Under the Terms of the MSA."

Litigating Releasing Parties Offset

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

Offset for Claims-Over

If a Releasing Party pursues and collects on a released claim against an NPM or a retailer, supplier or distributor arising from the sale or distribution of tobacco products of any NPM or the supply of component parts of tobacco products to any NPM (collectively, the "**Non-Released Parties**"), and the Non-Released Party in turn successfully pursues a claim for contribution or indemnification against a Released Party (as defined herein), the Releasing Party must (i) reduce or credit against any judgment or settlement such Releasing Party obtains against the

Non-Released Party the full amount of any judgment or settlement such Non-Released Party may obtain against the Released Party, and (ii) obtain from such Non-Released Party for the benefit of such Released Party a satisfaction in full of such Non-Released Party's judgment or settlement against the Released Party. In the event that such reduction or satisfaction in full does not fully relieve the Released Party of its duty to pay to the Non-Released Party, the PM is entitled to a dollar-for-dollar offset from its payment to the applicable Settling State (the "**Offset for Claims-Over**"). For purposes of the Offset for Claims-Over, any person or entity that is enumerated in the definition of Releasing Party set forth above is treated as a Releasing Party without regard to whether the applicable attorney general had the power to release claims of such person or entity. The Offset for Claims-Over is state-specific and would apply only to MSA payments owed to the Settling State of the Releasing Party.

Subsequent Participating Manufacturers

SPMs are obligated to make Annual Payments and Strategic Contribution Fund Payments which are made at the same times as the Annual Payments and Strategic Contribution Fund Payments to be made by OPMs. Annual Payments and Strategic Contribution Fund Payments for SPMs are calculated differently, however, from Annual Payments and Strategic Contribution Fund Payments for OPMs. Each SPM's payment obligation is determined according to its market share if, and only if, its "**Market Share**" (defined in the MSA to mean a manufacturer's share, expressed as a percentage, of the total number of cigarettes sold in the United States in a given year, as measured by excise taxes (or similar taxes, in the case of Puerto Rico)), for the year preceding the payment exceeds its Base Share. If an SPM executes the MSA after February 22, 1999 (i.e., 90 days after the effective date of the MSA), its Base Share is deemed to be zero. Fourteen of the current 52 SPMs signed the MSA on or before the February 22, 1999 deadline.

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

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, most PMs have made Annual Payments since 2000 and Strategic Contribution Fund Payments since 2008, and the MSA Escrow Agent has disbursed to the State its allocable portions thereof and certain other amounts under the MSA totaling approximately $3.72 billion to date, according to NAAG as of October 29, 2013. Under the MSA, the computation of Initial Payments, Annual Payments and Strategic Contribution Fund Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA. The following table sets forth the State's Share of unadjusted payments due to the State pursuant to the MSA and the State's Share of the amounts actually received by the State in the years indicated, which may reflect adjustments attributable to prior years' payments.

Payments Made to Date

State Unadjusted Allocable Share of MSA Base Payment Amounts

Payment Year	Initial Payments[1]	Annual Payments[1]	Strategic Contribution Fund Payments[2]	Total MSA Base Payments	State's Actual Receipts[3]
Up-Front	$92,807,911	$ -	$ -	$92,807,911	$ -
2000	95,592,149	174,014,834	-	269,606,982	402,508,702
2001	98,459,913	193,349,815	-	291,809,728	235,804,611
2002	101,413,710	251,354,760	-	352,768,470	267,867,044
2003	104,456,122	251,354,760	-	355,810,881	224,161,261
2004	-	309,359,704	-	309,359,704	243,079,129
2005	-	309,359,704	-	309,359,704	246,521,584
2006	-	309,359,704	-	309,359,704	225,549,762
2007	-	309,359,704	-	309,359,704	234,732,937
2008	-	314,734,829	24,512,262	339,247,091	262,244,310
2009	-	314,734,829	24,512,262	339,247,091	287,427,596
2010	-	314,734,829	24,512,262	339,247,091	240,030,452
2011	-	314,734,829	24,512,262	339,247,091	226,830,339
2012	-	314,734,829	24,512,262	339,247,091	231,300,314
2013	-	314,734,829	24,512,262	339,247,091	396,361,449

(1) The State of New Jersey is entitled to 3.8669963% of the Initial Payments and the Annual Payments under the MSA.
(2) The State of New Jersey is entitled to 2.8469526% of the Strategic Contribution Fund Payments under the MSA.
(3) As reported by NAAG.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the captions "—Initial Payments", "—Annual Payments", "—Strategic Contribution Fund Payments" and "—Adjustments to Payments." One or more of the PMs are disputing or have disputed the calculations of some of the Initial Payments for the years 2000 through 2003, and some Annual Payments for the years 2000 through 2013 and Strategic Contribution Fund Payments in years 2008 through 2013, as described further herein. In addition, subsequent revisions in the information delivered to the MSA Auditor (on which the MSA Auditor's calculations of the Initial Payments and Annual Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

"Most Favored Nation" Provisions

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

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

State-Specific Finality and Final Approval

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

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

"**Final Approval**" 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.

Disbursement of Funds from Escrow

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

Disbursement of the funds by the MSA Escrow Agent from the escrow accounts will 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 will render the PM liable for interest thereon from the date such payment is due to (but not including) the date paid at the prime rate published from time to time by The Wall Street Journal or, in the event The Wall Street Journal is no longer published or no longer publishes such rate, an equivalent successor reference to rate determined by the MSA Auditor, plus three percentage points. In addition, any Settling State may bring an action in court to enforce the terms of the MSA. Before initiating such proceeding, the Settling State is required to provide thirty (30) days' written notice to the attorney general of each Settling State, to NAAG and to each PM of its intent to initiate proceedings.

Termination of 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.

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

MSA Provisions Relating to Model/Qualifying Statutes

General

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

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

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

Summary of the Model Statute

One of the objectives of the MSA (as set forth in the Findings and Purpose section of the Model Statute) is to shift the financial burdens of cigarette smoking from the Settling States to the tobacco product manufacturers. The Model Statute provides that any tobacco manufacturer who does not join the MSA 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). "Units sold" is defined in the State's Qualifying Statute as the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs bearing the excise tax stamp of the State, or on "roll-your-own" tobacco containers.

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

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

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

New Jersey Qualifying Statute

The New Jersey Qualifying Statute, in the form of a Model Statute attached to the MSA as Exhibit T, became effective on June 28, 1999. By letter dated April 27, 1999, counsel to the OPMs confirmed that the OPMs will not dispute that the New Jersey statute constitutes a Model Statute under the MSA.

Statutory Enforcement Framework and Enforcement Agencies for New Jersey

State Statutory Enforcement Provisions

The State's statutory framework for enforcing laws relating to the manufacture, distribution, sale, possession and taxation of cigarettes within the State of New Jersey includes the New Jersey Qualifying Statute and Complementary Legislation (as amended, including the Allocable Share Release Amendments previously described herein), as well as, but not limited to, the following:

- New Jersey Smoke-Free Air Act, *New Jersey Public Law 2005, Chapter 383*
- Minimum Age for Sale and Purchase of Tobacco Raised from 18 to 19, *New Jersey Public Law 2005, Chapter 384*
- Civil Penalties for Illegal Sale of Tobacco Products to Minors, *New Jersey Public Law 2000, Chapter 87*
- Penalties for Illegal Sale of Tobacco Products to Minors, *New Jersey Public Law 1995, Chapter 304*
- Law Authorizing Commissioner to Enforce Existing Law Prohibiting Sale of Tobacco to Minors, *New Jersey Public Law 1995, Chapter 320*
- Cigarette Tax Act, *N.J.S.A. 54:40A-1, et seq.*
- Tobacco Products Wholesale Sales and Use Tax Act, *N.J.S.A. 54:40B-1, et seq.*
- Law Prohibiting Sale of Certain Flavored Cigarettes, *N.J.S.A. 2A:170-51.5, -51.6*
- Cigarette Sales Act, *N.J.S.A. 54:40A-46, et seq.*

Federal Laws. In addition to State laws, rules and regulations, state enforcement agencies have certain shared enforcement powers under various federal laws relating to tobacco control, including the Jenkins Act (regulating and restricting the mail order and internet sales of tobacco and other controlled products), as amended by the Prevent All Cigarette Trafficking ("**PACT**") Act of 2010, and the Family Smoking Prevention and Tobacco Control Act of 2009 ("**FSPTCA**") (amending the FDA's Food, Drug and Cosmetics Act).

This statutory enforcement framework is administered and enforced by the Tobacco Age of Sale Enforcement Program, New Jersey Office of the Attorney General, Department of Law and Public Safety – Division of Law ("**DOL**"), New Jersey Department of Treasury, Office of Criminal Investigation ("**OCI**"), and State of New Jersey Department of Treasury, Division of Taxation, Excise Tax ("**Excise Tax**"), among other agencies and divisions.

Tobacco Age of Sale Enforcement Program. The Tobacco Age of Sale Enforcement Program (the "**TASE Program**") enforces New Jersey's tobacco control laws, which prohibit the sale of tobacco to persons under the age of 19.

The TASE Program (i) enforces the law through random, unannounced compliance check inspections that are conducted by department staff or local health officers accompanied by underage youth and (ii) educates retail merchants on the law and makes available merchant education packets, store signs, and flyers in 11 languages. Currently, more than 88% of merchants comply with the law and refuse to sell tobacco to underage youth.

Two laws enacted in 1996 strengthened New Jersey's tobacco age-of-sale enforcement effort and led to the creation of the TASE Program. One law gave the Commissioner of Health clear authority to enforce tobacco control laws, and to delegate that responsibility to local health departments. The second law provided a funding mechanism for enforcement activities.

Excise Tax, OCI, and DOL are responsible for enforcing the MSA, maintaining files of compliant NPMs by manufacturer and brand-name, and for receiving and approving the annual compliance certifications from PMs and NPMs. Pursuant to the Cigarette Tax Act, licensed distributors submit monthly sales reports to Excise Tax. Such distributors may be subject to audits by Excise Tax. All PMs and NPMs are required to submit annual certifications to DOL and DOL, Excise Tax, and OCI coordinate to ensure compliance with all reporting requirements. The State's Qualifying Statute provides an automatic statutory enforcement mechanism that complements the Model Statute and which allows the State to immediately ban the stamping and selling of cigarettes from non-compliant NPMs without the delay of waiting for two known violations and then obtaining a judgment. Consequently, litigation is not necessary to enforce NPM escrow compliance. In addition, the Cigarette Tax Act grants OCI the authority to immediately seize any and all contraband cigarettes and pursue criminal charges for any violations.

The DOL, in coordination with Excise Tax and OCI, has been responsible since inception for pursuing non-compliant NPMs. The Qualifying Statute requires that an NPM deposit funds into an escrow account for the benefit of New Jersey for all "units sold" in the State during the preceding year. As noted above, a "unit sold" is defined as a cigarette upon which State excise tax has been paid and which bears the State's excise tax stamp. The State believes there currently are no non-compliant NPMs for which licensed distributors have reported sales of units sold in the State of New Jersey 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 2013. The State estimates that the market share of NPMs in New Jersey in each year since 2004 has been less than 0.65% and believes that all NPMs currently certified are in compliance with their NPM escrow obligations under the New Jersey Qualifying Statute.

DOL 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 State 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 in favor of the Settling States. Two states have filed suit seeking full payment by General Tobacco (*VIBO Corp. d/b/a General Tobacco*) of its MSA payment obligations. Such actions will benefit all Settling States, including the State, if payments are ordered and made. General Tobacco is no longer certified to sell cigarettes in the State. The State also has participated actively in various multi-state initiatives against certain OPMs to enforce the advertising and promotion restrictions in the MSA.

OCI investigates and seizes unstamped cigarettes. The State may pursue criminal actions and/or revoke or suspend the license of any New Jersey State licensed cigarette stamping agent and the appointment of any tobacco products distributor that violates the Cigarette Tax Act in regards to any cigarettes and roll-your-own tobacco that have been sold, offered for sale or possessed for sale in the State or imported into the State and are considered contraband.

Excise Tax is responsible for licensing all New Jersey State cigarette stamping agents and appointing all tobacco product distributors, receiving returns filed by agents and distributors of purchases of cigarette and roll-your-own shipments from inside and outside of the State of New Jersey, and collaborating with OCI and DOL with the enforcement of State and federal laws, among other duties. The State also shares data with the U.S. Treasury's Alcohol and Tobacco Tax Bureau and with other state revenue departments and has used the provisions of the Federal Jenkins Act.

Internet Sales Prohibition. Prior to enactment of the PACT Act in 2010, New York, on behalf of all states, including the State, entered into voluntary compliance agreements with several major national package delivery firms, including FedEx, UPS and DHL, prohibiting the private package delivery to consumers of cigarettes into New York and in other states nationwide. The PACT Act broadens this prohibition to include a prohibition of the delivery of cigarettes by U.S. Mail except to licensed distributors.

Nation or Tribal Reservation Cigarette Sales. Under federal case law, Indian nations and tribes are exempt from the State's taxes on cigarettes that they purchase on their own reservation for their own personal consumption.

But the State has authority to tax "[o]n reservation cigarette sales to persons other than reservation Indians." *Dep't of Taxation & Finance of N.Y. v. Milhelm Attea & Bros.,* 512 U.S. 61, 64 (1994). According to the State, there are no tribal manufacturers of cigarettes located in the State. Further, the State does not believe it has experienced significant sales of unstamped, untaxed "contraband" cigarettes within the State.

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation

General Overview

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

Qualifying Statute and Related Legislation

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

In addition, at least 45 Settling States (including the State) have passed legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making escrow payments required by the states' respective Qualifying Statutes, as well as other legislation to assist in the regulation of tobacco sales. Pursuant to the State's Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold in the State, directly or through an intermediary, must provide a detailed listing of the brands sold in the State, certify that it is in compliance with escrow requirements of the MSA or the Qualifying Statute, as applicable, and retain and make available to the State invoices and documentation of sales for a period of five years or for any longer period required by law. Each stamping agent, licensed distributor, holder of a certificate of authority or tobacco product manufacturer must also submit any additional information deemed necessary by the State Attorney General to determine compliance with the New Jersey Complementary Legislation. Pursuant to the requirements of the New Jersey Complementary Legislation, the State Attorney General developed and publishes on the Internet a directory containing the names of manufacturers (and brand families sold) that are in compliance with the requirements of the New Jersey Complementary Legislation. Non-resident or foreign manufacturers must, as a condition to listing in the directory, appoint an agent in the State for service of process. No tax stamp or other impression of a tax may be affixed to a package or container of cigarettes of manufacturers that are not listed in the directory. It is unlawful for any person to sell or distribute cigarettes or acquire, hold, own, possess, transport, import, or cause to be imported cigarettes that the person should know are intended for distribution or sale in violation of the New Jersey Complementary Legislation. Penalties for violation of the New Jersey Complementary Legislation include disgorgement of all profits obtained from the violation. To date, the New Jersey Complementary Legislation has not been the subject of litigation.

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

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

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

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

Litigation

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

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

performance of the [MSA] any and all claims that the provisions of [the MSA] violate the state or federal constitutions." The district court further held that plaintiffs' Compact Clause claim should be dismissed because the MSA does not enhance state power to the detriment of the federal government power. Plaintiff appealed the dismissal of its claims to the U.S. Court of Appeals for the Sixth Circuit. On February 22, 2012, a three judge panel of the U.S. Court of Appeals for the Sixth Circuit ruled that the MSA does not amount to an unlawful conspiracy or anti-competitive behavior by the government and, accordingly, affirmed the district court's order and dismissed plaintiffs' appeal in this case. The time period for the plaintiffs to file a petition for certiorari to the U.S. Supreme Court expired.

In *Grand River*, certain cigarette manufacturers and distributors who were NPMs brought suit in 2002 against 31 states, excluding the State, and their attorneys general, alleging, among other things, that the Escrow Statutes contravened the Commerce Clause of the U.S. Constitution, the Sherman Act, and in the case of plaintiff Grand River, the Constitution's Indian Commerce Clause. The district court had dismissed all claims against the states other than New York for lack of personal jurisdiction, and dismissed all claims except the antitrust claim against New York. On interlocutory appeal, the Second Circuit reversed the district court's dismissal against the non-New York defendants, reversed the dismissal of the dormant Commerce Clause claim, and affirmed the dismissal of the plaintiffs' other constitutional claims. As to the Commerce Clause claim, the Second Circuit held that the plaintiffs "state a possible claim that the practical effect of the challenged statutes and the MSA is to control prices outside of the enacting states by tying both the SPM settlement and NPM escrow payments to national market share, which in turn affects interstate pricing decisions." On remand, the Southern District on March 22, 2011 granted summary judgment to the defendants on all of plaintiffs' Sherman Act and Commerce Clause claims. Plaintiffs appealed to the Second Circuit and petitioned the Southern District to amend its dismissal of plaintiffs' Sherman Act and Commerce Clause claims. On January 30, 2012 the Southern District denied the plaintiffs' motion to amend the Southern District's March 22, 2011 dismissal by summary judgment of plaintiffs' claims that the MSA and related legislation violated the Sherman Act and the Commerce Clause. Plaintiffs then appealed this denial to the Second Circuit. On June 1, 2012 plaintiffs withdrew both appeals before the Second Circuit, which withdrawals were ordered by the Second Circuit on August 10, 2012. The case is now closed before the Second Circuit.

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

In *S&M Brands v. Caldwell*, certain NPMs and cigarette distributors brought an action in a federal district court in Louisiana in 2005 seeking, among other relief: (1) a declaration that the MSA and Louisiana's Qualifying Statute and Complementary Legislation are invalid as violations of the U.S. Constitution and the Federal Cigarette

Labeling and Advertising Act; and (2) an injunction barring the enforcement of the MSA and Louisiana's Qualifying Statute and Complementary Legislation. Following the state defendant's motion to dismiss the complaint for lack of jurisdiction, the U.S. District Court for the Western District of Louisiana (the "**Western District**") allowed the case to proceed on claims that the MSA and Louisiana's Complementary Legislation are violations of the federal antitrust laws and of the Compact Clause, Commerce Clause, Due Process Clause and First Amendment of the U.S. Constitution, and the Federal Cigarette Labeling and Advertising Act, and dismissed the claims that alleged violation of the Tenth Amendment of the U.S. Constitution. In September 2009, the Western District granted defendant's motion for summary judgment and dismissed with prejudice all claims by the plaintiffs. In August 2010, the Fifth Circuit affirmed the Western District's order granting summary judgment for the defendants. The Fifth Circuit held that the district court correctly concluded that the MSA did not violate the Compact Clause because the MSA only increases states' power vis-à-vis the PMs and does not result in an accompanying decrease of the power of the federal government. The Fifth Circuit also ruled that the Escrow Statute did not violate the federal antitrust laws for the reasons set forth in its prior decision in *Xcaliber Int'l Ltd. v. Caldwell*, and held that the MSA did not violate federal antitrust laws after adopting the rationales of the Sixth Circuit and other circuits that previously considered the issue. In addition, the Fifth Circuit affirmed the dismissal of plaintiffs' Commerce Clause and Due Process Clause claims because plaintiffs had failed to show that the Louisiana Escrow Statute and the MSA had the effect of increasing cigarette prices outside of Louisiana. With respect to plaintiffs' First Amendment challenge to the MSA and the Escrow Statute, the Fifth Circuit found that the only statute applicable to plaintiffs as NPMs was the Escrow Statute, which the court determined did not compel or abridge plaintiffs' speech. Similarly, the Fifth Circuit found that the MSA and Escrow Statute did not violate the Federal Cigarette Labeling and Advertising Act because plaintiffs are not compelled to join the MSA and the Escrow Statute does not have any connection with cigarette packaging, advertising, or promotion. The U.S. Supreme Court denied plaintiffs' petition for writ of certiorari.

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

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

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

The MSA and related state legislation may be challenged in the future. A determination by a court having jurisdiction over the State and the Corporation that the MSA or related State legislation is void or unenforceable could have a materially adverse effect on the payments by the PMs under the MSA and the amount and/or the timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation and could ultimately result in the complete cessation of the Pledged TSRs and Additional Pledged TSRs available to the Corporation. A determination by any court that the MSA or State legislation enacted pursuant to the MSA is void or unenforceable could also lead to a decrease in the market value and/or liquidity of the Series B and C Bonds. See "LEGAL CONSIDERATIONS" for a further discussion of these matters as well as a description of the opinions of DeCotiis, FitzPatrick & Cole, LLP, Special Counsel to the Corporation, addressing such matters.

Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments

The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT —Adjustments to Payments." Such adjustments, offsets and recalculations could reduce the Pledged TSRs and Additional Pledged TSRs available to the Corporation below the respective amounts required to pay the Series B and C Bonds and could lead to a decrease in the market value and/or the liquidity of the Series B and C Bonds. See "*NPM Adjustment— 2003 Adjustment Claims; Arbitration Results*" for a discussion of arbitration proceedings with respect to the 2003 NPM Adjustment and the recent determination of the Arbitration Panel with respect to diligent enforcement of state Qualifying Statutes in 2003, and see "*NPM Adjustment—NPM Adjustments Settlement and Award*" below for a discussion of a recent settlement entered into by 22 jurisdictions, including the State, and the OPMs and certain SPMs regarding disputes with respect to the NPM Adjustment.

Growth of NPM Market Share and Other Factors

Should a decline in consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments and Strategic Contribution Fund Payments by the PMs due to application of the Volume Adjustment, even for Settling States (including the State) that have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and are thus exempt from the NPM Adjustment. One SPM has introduced a cigarette with reportedly no nicotine. If consumers used this product to quit smoking, it could reduce the size of the cigarette market. The capital costs required to establish a profitable cigarette manufacturing facility are relatively low, and new cigarette manufacturers, whether SPMs or NPMs, are less likely than OPMs to be subject to frequent litigation.

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

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

NPM Adjustment

The following discussion describes how the NPM Adjustment works under the MSA. See "*—2003 Adjustment Claims; Arbitration Results*" for a discussion of arbitration proceedings with respect to the 2003 NPM Adjustment and the recent determination of the Arbitration Panel with respect to diligent enforcement of state Qualifying Statutes in 2003, and see "*NPM Adjustment Settlement and Award*" below for a discussion of a recent settlement entered into by 22 jurisdictions, including the State, the OPMs and certain of the SPMs, and the calculation and application of the NPM Adjustment under such settlement.

Description of the NPM Adjustment. The NPM Adjustment, measured by domestic sales of cigarettes by NPMs, operates in certain circumstances to reduce the payments of the PMs under the MSA in the event of losses in market share to NPMs during a calendar year as a result of the MSA. Three conditions must be met in order to trigger an NPM Adjustment for one or more Settling States: (1) a Market Share Loss (as defined in the MSA) for the applicable year must exist, which means that the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997 (a condition that has existed for every year since 2000); (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the market share loss for the year in question; and (3) the Settling States in question must be found to not have diligently enforced their Qualifying Statutes.[**]

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

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

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

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

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

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

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

in such year, and could have a material adverse effect on the amount and/or timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation.

As previously noted, any Settling State that adopts, maintains and diligently enforces its Qualifying Statute is exempt from the NPM Adjustment. The "diligent enforcement" exemption afforded a Settling State is based on actual enforcement efforts for the calendar year preceding each Annual Payment. A final resolution of "diligent enforcement" for a sales year does not preclude a PM from disputing "diligent enforcement" in a subsequent year. If the other preconditions to an NPM Adjustment exist for a given year, an NPM Adjustment would apply, absent the protection of the Settling State "diligently enforcing" its Qualifying Statute. The State has enacted the Model Statute, which is a Qualifying Statute. No provision of the MSA, however, attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement.

The State's Attorney General's office maintains that the State has been and is diligently enforcing its Qualifying Statute. Furthermore, the MSA does not explicitly state which party bears the burden of proving or disproving whether a Settling State has diligently enforced its Qualifying Statute, or whether any diligent enforcement dispute would be resolved in state courts or through arbitration. However, regarding the 2003 NPM Adjustment dispute, the State's MSA court has determined that the 2003 NPM Adjustment dispute was to be determined by a panel of arbitrators, and such panel of arbitrators has determined that, when contested, a state bears the burden of proving its diligence. The State subsequently resolved its 2003 NPM Adjustment dispute, together with its 2004 to 2012 NPM Adjustment disputes, when it participated in the NPM Adjustment Settlement Term Sheet.

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

The Collection Methodology and Bond Redemption Assumptions for the Series B and C Bonds do not include any NPM Adjustments (other than certain 2014 to 2017 PM credit amounts and transition year adjustment amounts projected pursuant to the NPM Adjustment Stipulated Partial Settlement and Award) or withholdings or Disputed Payments Account deposits relating to PM claims of entitlement to NPM Adjustments, based on the fact that the State participated in the NPM Adjustment Stipulated Partial Settlement and Award and on the assumptions that the State has and will diligently enforce its Qualifying Statute and that such Qualifying Statute is not held to be unenforceable. If the assumptions are not realized and future NPM Adjustments, withholdings or Disputed Payments are taken against MSA payments to the State, it could have a material adverse effect on the payments by PMs under the MSA, and could have a material adverse effect on the amount and/or timing of Pledged TSRs and Additional Pledged TSRs available to the Corporation. See "SUMMARY OF PROJECTED OPTIONAL REDEMPTION SCHEDULE."

<u>Settlement of 1999 through 2002 NPM Adjustment Claims</u>. In June 2003, the OPMs, certain SPMs and the Settling States settled all NPM Adjustment claims for the payment years 1999 through 2002, subject, however, under limited circumstances, to the reinstatement of a PM's right to an NPM Adjustment for the payment years 2001 and 2002. In connection therewith, such PMs and the Settling States agreed prospectively that PMs claiming an NPM Adjustment for any year will not make such a deposit into the Disputed Payments Account or withhold payment with respect thereto unless and until the selected economic consultants determine that the disadvantages of the MSA were a significant factor contributing to the market share loss giving rise to the alleged NPM Adjustment. If the selected economic consultants make such a "significant factor" determination regarding a year for which one or more PMs have claimed an NPM Adjustment, such PMs may, in fact, either make a deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment. As discussed below under "Ongoing 2004 through 2012 NPM Adjustment Claims," the Settling States have since agreed that no "significant factor" determination will be necessary for certain years. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT —Adjustments to Payments."

<u>2003 through 2012 NPM Adjustment Claims Generally</u>. Pursuant to the provisions of the MSA, domestic tobacco product manufacturers have participated in proceedings regarding the 2003 NPM Adjustment, results of

which were released on September 11, 2013, as discussed below. In addition, PMs have disputed payments attributable to sales years 2004 through 2012 which could lead to offsets against the Pledged TSRs and Additional Pledged TSRs paid in future years. According to NAAG, one or more of the PMs are disputing or have disputed the calculations of some Annual Payments and Strategic Contribution Fund Payments totaling over $8.5 billion for the sales years 2003 through 2012 (payment years 2006 through 2015 for the OPMs and payment years 2004 through 2013 for the SPMs) as part of the NPM Adjustment. A discussion of the State's settlement of claims regarding the 2003 through 2012 NPM Adjustments appears below under "*—NPM Adjustment Settlement and Award*" and a discussion of certain states arbitration and the decisions of the Arbitration Panel with respect to the 2003 NPM Adjustment appears below under "*2003 NPM Adjustment Claims; Arbitration Results*."

As part of the NPM Adjustment proceedings, an independent economic consulting firm jointly selected by the MSA parties or otherwise selected pursuant to the MSA's provisions is required to determine whether the disadvantages of the MSA were a "significant factor" contributing to the participating manufacturers' collective loss of market share for the year in question. If the firm determines that the disadvantages of the MSA were such a "significant factor," each Settling State may avoid a downward adjustment to its share of the PMs' annual payments for that year by establishing that it diligently enforced its Qualifying Statute during the entirety of that year. Any potential downward adjustment would then be reallocated to any states that do not establish such diligent enforcement. According to the Form 10-K of Altria (Philip Morris's parent company) filed with the SEC for the year ended December 31, 2013, an independent economic consulting firm determined that the disadvantages of the MSA were such a significant factor for each of the years 2003-2006. Following the firm's determination for 2006, the OPMs and the states agreed that the states would not contest that the disadvantages of the MSA were a significant factor contributing to the participating manufacturers' collective loss of market share for the years 2007-2012. This agreement has become effective for 2007-2011 and will become effective for 2012 on February 1, 2015. According to Reynolds American, as of December 31, 2013, 47 of the 48 courts that had addressed the question whether the dispute concerning the 2003 NPM Adjustment (discussed below) is arbitrable had ruled that arbitration is required under the MSA.

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

<u>2003 NPM Adjustment Claims; Arbitration Results</u>. 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, 38 Settling States filed declaratory judgment actions in state courts seeking a declaration that such Settling States diligently enforced their Qualifying Statutes during 2003. The OPMs and SPMs responded to these actions by filing motions to compel arbitration in accordance with the terms of the MSA, including motions to compel arbitration in 11 states and territories that did not file declaratory judgment actions. Courts in all but one of the 46 MSA states and the District of Columbia and Puerto Rico have ruled that the question of whether a state diligently enforced its Qualifying Statute during 2003 is subject to arbitration. The Montana state courts have ruled that the diligent enforcement claims of that state must be litigated in state court, rather than in arbitration. In June 2012, following the denial of the OPMs' petition to the U.S. Supreme Court for a writ of certiorari, the PMs and Montana entered into a consent decree pursuant to which Montana will not be subject to the 2003 NPM Adjustment.

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

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

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

The Arbitration Panel's decision relating to New York 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."

On September 24, 2013, the Pennsylvania Attorney General's office filed a motion with the Arbitration Panel to amend the Arbitration Panel's final award in which it determined that Pennsylvania did not diligently enforce its Qualifying Statute in 2003. The Arbitration Panel denied the motion on October 3, 2013. On November 4, 2013, Pennsylvania filed a motion in the Court of Common Pleas of Philadelphia County to vacate the Arbitration Panel's final award in which it determined that Pennsylvania did not diligently enforce its Qualifying Statute in 2003. In addition, on December 4, 2013, the Indiana Attorney General filed an appeal of the Arbitration Panel's determination with respect to Indiana's non-diligent enforcement in the Marion County Superior Court. It is not known when the amounts withheld by the PMs or deposited into the Disputed Payments Account pursuant to the 2003 NPM Adjustment will be paid out by the MSA Escrow Agent. Pennsylvania supplemented this motion with a memorandum of law on December 13, 2013. The PMs filed an opposition to Pennsylvania's motion on February 11, 2014. A hearing will be held on Pennsylvania's motion to vacate on March 7, 2014.

The Arbitration Panel found that five other states did not diligently enforce their respective Qualifying Statutes in sales year 2003, and all five of those states have filed a motion to contest the decision. On November 18, 2013, the Maryland Attorney General filed a petition in the Circuit Court for Baltimore City to vacate the Arbitration Panel's final award finding Maryland non-diligent in its enforcement. The PMs opposed this motion on December 16, 2013, and a hearing was held on February 19, 2014. On December 4, 2013, the Indiana Attorney General filed an appeal of the Arbitration Panel's determination with respect to Indiana's non-diligent enforcement in the Marion County Superior Court. On December 10, 2013, Missouri Attorney General filed a motion in the Circuit Court for the City of St. Louis to vacate the Arbitration Panel's award finding the state non-diligent in 2003. On January 3, 2014, the PMs objected to Missouri's proposed briefing schedule, and they have not yet filed an opposition. Also on December 10, 2013, Kentucky's Attorney General filed a motion in the Circuit Court of Franklin County to vacate the Arbitration Panel's award finding that it did not diligently enforce its Qualifying Statute in 2003. The PMs opposed this motion on February 18, 2014. Finally, also on December 10, 2013, New Mexico's Attorney General filed a motion in the Santa Fe County Court to vacate the Arbitration Panel's award finding it non-diligent in 2003, and the state filed a supplemental memorandum of law on December 20, 2013. The PMs filed their opposition to this motion on January 21, 2014.

All of these motions are currently pending. It is not known when the amounts withheld by the PMs or deposited into the Disputed Payments Account pursuant to the 2003 NPM Adjustment will be paid out by the MSA Escrow Agent, though some of the contesting states have requested that their respective court make a decision on the motion by April 15, 2014.

<u>Ongoing 2004 Through 2012 NPM Adjustment Claims</u>. An independent economic consulting firm, jointly selected by the MSA parties, determined that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for sales years 2004 and 2005 (as well as 2003, as discussed above). A different independent economic consulting firm, jointly selected by the MSA parties, determined that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for the sales year 2006. Following the firm's determination for 2006, the OPMs and the Settling States agreed that the Settling States would not contest that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for the sales years 2007, 2008 and 2009. Accordingly, the OPMs and the Settling States have agreed that no "significant factor" determination by an independent economic consulting firm will be necessary with respect to the PMs' collective loss of market share for the sales years 2007, 2008 and 2009 (the "significant factor agreement"). This agreement became effective for sales years 2007, 2008 and 2009 on February 1, 2010, 2011 and 2012, respectively. The OPMs and the Settling States have agreed to extend the significant factor agreement to apply to the PMs' collective loss of market share for sales years 2010, 2011 and 2012. This agreement became effective for sales year 2010 on February 1, 2013 and for sales year 2011 on February 1, 2014 and will become effective for sales year 2012 on February 1, 2015. Proceedings with respect to diligent enforcement claims for the sales years 2004 through 2012 have not yet been scheduled.

Altria, Philip Morris's parent company, has indicated in its Form 10-K filed with the SEC for the year ended December 31, 2013 that Philip Morris's approximate share of disputed NPM Adjustments for sales years 2003 to 2012 is $2.261 billion (plus an asserted claim for interest on such moneys at the prime rate, but not reflecting the partial liability reduction for the 2003 NPM Adjustment pursuant to the agreement regarding arbitration or the NPM Adjustment Settlement Term Sheet described below). Philip Morris further reports that it has made its full MSA payment due in each year from 2006 to 2010 to the Settling States (subject to a right to recoup the NPM Adjustment amount in the form of a credit against future MSA payments), even though it had the right to deduct the disputed amounts of the 2003 - 2007 NPM Adjustments, as described above, from such MSA payments. Philip Morris paid its share of the amount of the disputed 2008, 2009 and 2010 NPM Adjustments into the Disputed Payments Account in connection with its MSA payments due in 2011, 2012 and 2013, respectively.

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

Reynolds American, Reynolds Tobacco's parent company, has reported in its Form 10-K filed with the SEC for the fiscal year ended December 31, 2013 that Reynolds Tobacco has disputed a total of approximately $4.7

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

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

As a participant in the NPM Adjustment Stipulated Partial Settlement and Award, the State received its allocable share of moneys released from the Disputed Payment Account in April 2013.

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

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OPM and SPM Maximum Potential NPM Adjustment Amounts
Sales Years 2003-2012 (Payment Years 2004-2013)[1]

Sale Year for which NPM Adjustment was calculated	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
MSA Payment Year for which NPM Adjustment was calculated	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
MSA Payment Year by which deduction for NPM Adjustment may be asserted by OPMs[2]	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Potential OPM NPM Adjustment*	$1,061,158,548	$1,061,288,734	$702,715,077	$646,394,781	$702,104,158[3]	$821,644,318[3]	'79,388,450[3]	$779,818,190[3]	$663,895,464[3]	$715,833,950[3]
Potential SPM NPM Adjustment*	86,407,516	76,107,191	50,630,561	53,949,637	47,254,505[3]	66,765,407[3]	68,573,096[3]	63,143,527[3]	50,767,997[3]	53,091,832[3]
Total*	**$1,147,566,065**	**$1,137,395,925**	**$753,345,638**	**$700,344,418**	**$749,358,662**	**$888,409,725**	**47,961,547**	**$842,961,718**	**$714,663,460**	**$768,925,782**

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

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

Philip Morris has reported its expectation of receiving, outside of the amount covered by the NPM Adjustment Settlement Term Sheet discussed below, its share of any adjustments for 2003 - 2007 in the form of a credit against future MSA payments and its share of any adjustment for 2008 - 2010 in the form of a withdrawal from the Disputed Payments Account or a combination of a credit against future MSA payments and a withdrawal from the Disputed Payments Account. Any adjustments made in the form of a credit against future MSA payments could lead to material reductions in the Pledged TSRs and Additional Pledged TSRs. However, Altria, Philip Morris's parent company, noted in its Form 10-K filed with the SEC for the year ended December 31, 2013 that there is no certainty that the PMs would ultimately receive any adjustment from the Term Sheet Non-Signatories (as defined below) as a result of the NPM Adjustment proceedings described herein.

Altria has further stated in its Form 10-K filed with the SEC for the year ended December 31, 2013 that it continues to reserve all rights regarding the NPM Adjustments with respect to the Term Sheet Non-Signatories and intends to continue to pursue vigorously the disputed NPM Adjustments for sales years 2004 - 2012 against the Term Sheet Non-Signatories States. No proceedings to determine state diligent enforcement claims for the years 2004 through 2012 have yet been scheduled. Philip Morris believes that the MSA requires state claims of diligent enforcement for 2004 - 2012 to be determined in a national arbitration, although a number of Term Sheet Non-Signatories filed motions in their state courts contending, or have reserved rights to contend, that such claims for those years are to be determined either in separate arbitrations for each state or in state court on a state-by-state basis.

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

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

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

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

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

Pursuant to the NPM Adjustment Settlement Term Sheet, including as implemented in April 2013 following the NPM Adjustment Stipulated Partial Settlement and Award, the OPMs and certain SPMs have received certain reductions in 2013 and will receive reductions to future MSA payments to reflect a percentage of the Term Sheet Signatories' aggregate share of the OPMs' and certain SPMs' aggregate 2003 through 2012 NPM Adjustment claims. The amount of such percentages is dependent on the number of jurisdictions that eventually join the final settlement. According to a Form 10-K filed with the SEC by Altria (the parent company of Philip Morris) for the year ended December 31, 2013, the OPMs have agreed that, subject to certain conditions, Philip Morris will receive approximately 28% of the reductions, Reynolds Tobacco will receive approximately 60% of the reductions, and Lorillard will receive approximately 12% of the reductions. In its Form 10-K filed with the SEC for the year ended December 31, 2013, Philip Morris reported that, based on the Term Sheet Signatories as of April 15, 2013, Philip Morris received all of its reduction under the NPM Adjustment Settlement Term Sheet through a credit of approximately $483 million against its MSA payment made in April 2013. Philip Morris also reports that it expects to receive an additional credit of $36 million to be applied to its MSA payment obligation in April 2014 as a result of the two additional states joining the NPM Adjustment Settlement Term Sheet after the date of the 2013 MSA payment. In its Form 10-K filed with the SEC for the fiscal year ended December 31, 2013, Reynolds Tobacco reported that, based on the jurisdictions bound by the NPM Adjustment Settlement Term Sheet, Reynolds Tobacco will receive approximately $1.1 billion as credits with respect to their NPM Adjustment claims for the period from 2003 through 2012, to be applied against annual payments under the MSA over a five-year period, which commenced with the April 2013 MSA payment. In its Form 10-K filed with the SEC for the fiscal year ended December 31, 2013, Lorillard reported that it expects to receive credits over five years of approximately $220 million on its outstanding claims, with $165 million having occurred in April 2013 and the remainder occurring over the following four years.

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

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

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

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

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

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

On September 11, 2013, as described above, the Arbitration Panel released its decisions with respect to fifteen of the Term Sheet Non-Signatories regarding the 2003 NPM Adjustment. The arbitration process will continue with respect to sales years 2004 through 2012 for the Term Sheet Non-Signatories. The OPMs have previously reported that they continue to reserve all rights regarding the NPM Adjustment with respect to the Term Sheet Non-Signatories and pursue the disputed NPM Adjustments against the Term Sheet Non-Signatories. Altria has stated in its Form 10-K filed with the SEC for the year ended December 31, 2013 that, Philip Morris continues to reserve all rights regarding the NPM Adjustments with respect to the Term Sheet Non-Signatories and intends to continue to pursue vigorously the disputed NPM Adjustments for sales years 2004 – 2012 against the Term Sheet Non-Signatories. As noted above, proceedings with respect to diligent enforcement claims for the sales years 2004 through 2012 have not yet been scheduled. It is possible that other states could enter into settlements with regard to the NPM Adjustments sales years 2004 and beyond.

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

Several states have disputed the NPM Adjustment Settlement Term Sheet and Stipulated Partial Settlement and Award.

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

Numerous motions have been filed by the Term Sheet Non-Signatory States to vacate the Partial Settlement and Award. One of these states—Colorado (State v. R.J. Reynolds Tobacco Co., Case No 1997CV3432)—has received a substantive decision on its motion. On February 11, 2014, the District Court for the City and County of Denver denied Colorado's Motion to Vacate the Partial Settlement and Award. In addition, Idaho's motion in the District Court of the Fourth Judicial District of the State of Idaho (State v. Philip Morris, Inc., Case No. CV-OC-1997-03239D) was denied for procedural reasons. Motions are still pending in a number of the other Term Sheet Non-Signatory states including Connecticut (State v. Philip Morris Inc., UWY-CV-96-0148414-S), Illinois (People of the State of Illinois v. Philip Morris, Inc., No. 96 L 13146), Indiana (State v. Philip Morris Tobacco Co., No. 49D07-9702-CT-0236), Massachusetts (Commonwealth of Massachusetts v. Philip Morris, No. 95-7378), New York (State v. Philip Morris, 400361/1997), North Dakota (State v. Philip Morris, Inc., No. 98-3778), Ohio (State v. R.J. Reynolds Tobacco Co., No. 97 CVH 050 5114), Oregon (State v. Philip Morris USA, Inc., No. 0604-04252), and South Carolina (State v. Brown & Williamson Tobacco Corp., 97CP4001686) to vacate and/or modify the NPM Adjustment Stipulated Partial Settlement and Award. Connecticut and South Carolina subsequently became Term Sheet Signatories in May 2013.

Moreover, all six states that were found by the Arbitration Panel to have not diligently enforced their Qualifying Statutes in 2003 have filed motions to vacate the Partial Settlement and Award: Indiana on June 7, 2013 (as described in the above paragraph), Pennsylvania (Commonwealth v. Philip Morris, Inc., No. 2443) on December 13, 2013, Kentucky (Commonwealth v. Brown and Williamson Tobacco Corp., No. 98-CI-01579) on December 10, 2013, Maryland (State v. Philip Morris, Inc., No. 24-C-96122017) on November 18, 2013, Missouri (State v. American Tobacco Co., Inc., No. 22972-01465) on December 10, 2013, and New Mexico (State v. Philip Morris, USA, Inc., No. D-101-CV-1997-01235) on November 22, 2013. The PMs have filed oppositions to these motions in Pennsylvania, Kentucky, Maryland, and New Mexico (with an opposition to Missouri's motion expected in March). A hearing was held on Maryland's motion to vacate the Partial Settlement and Award on February 19, 2014, and a hearing will be held on Pennsylvania's motion to vacate the Partial Settlement and Award on March 7, 2014. The Pennsylvania motion does not seek to vacate the Term Sheet or the entire Partial Award. Rather, it seeks only to vacate the reallocation determination within the Partial Award "as it relates to Pennsylvania."

In addition, two states, Colorado (State v. R.J. Reynolds Tobacco Co., Case No 1997CV3432) and Ohio (State v. R.J. Reynolds Tobacco Co., Case No. 97CVH-05-5114) filed for preliminary injunctions. These motions for preliminary injunctions against the implementation of the NPM Adjustment Stipulated Partial Settlement and Award in connection with the April 2013 MSA payment were denied, and the MSA Auditor carried out such implementation over the objections of the Term Sheet Non-Signatories. The outcomes of the pending claims filed by the Term Sheet Non-Signatories cannot be predicted. No assurance can be given that other challenges to the NPM Adjustment Stipulated Partial Settlement and Award will not be commenced in other MSA courts.

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

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

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

California, Kentucky and Iowa have had disputes and have filed suit against Bekenton USA, Inc. ("**Bekenton**"), to among other things, compel Bekenton to comply with its full payment obligations under the MSA. In June 2005, the State of California filed an application in San Diego County Superior Court seeking an enforcement order against Bekenton. Bekenton was allowed by the court to file a suit that argued, among other things, that the State of California breached the "Most Favored Nation" ("**MFN**") provisions of the MSA by allowing three other SPMs to join the MSA under more favorable terms, and that it was entitled to similar relief under another clause of the MSA (the "**Relief Clause**"), which requires that if any PM is relieved of a payment obligation, such relief becomes applicable to all of the PMs. In a November 2005 tentative ruling (which subsequently became a final order on March 15, 2006), the court denied Bekenton's MFN claim and its motion to file suit under the Relief Clause. In 2005, Bekenton also filed for bankruptcy relief. In the Kentucky case, Bekenton failed to make its full MSA payment of approximately $7.7 million in April 2005, and, instead, paid only $198,000, less than 3% of the total payment due. The Commonwealth of Kentucky commenced an action against Bekenton in which Bekenton claimed that under the Relief Clause it was entitled to reduce its payment. In April 2006, the court dismissed Bekenton's claim for a reduction, holding that the Relief Clause was not applicable since the agreement with another PM did not relieve the PM of any payment obligations. In the Iowa case, the State of Iowa sought to de-list Bekenton as a PM for failing to comply with the MSA payment provisions and to prohibit Bekenton from doing business in Iowa for failing to comply with the escrow payment provisions of the Iowa Qualifying Statute. In August 2005, an Iowa state court enjoined Iowa from "de-listing" Bekenton, permitting Bekenton to continue selling cigarettes in Iowa. The court found that the MSA itself provides procedures for the resolution of disputes regarding MSA payments and that such procedures should be followed in this case.

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

Other Disputes Related to MSA Payments

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

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

Forty-three jurisdictions (including the State) entered into arbitration involving these two disputes. In an award dated January 21, 2013, the Arbitration Panel held that (i) the MSA Auditor is to use the market share for Liggett Group LLC (an SPM) on a net basis, but increase that calculation by a specified factor to avoid unfairness given the gross basis used for Liggett Group LLC in the MSA Auditor’s March 30, 2000 calculation, and (ii) the MSA Auditor is to use the 0.0325 ounce conversion method for purposes of roll-your-own tobacco. Altria reported in its Form 10-K filed with the SEC for the year ended December 31, 2013 that it is unclear precisely which past and future MSA payments may be affected by this ruling.

CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY

For a description of the domestic tobacco industry please see the publicly available documents of the tobacco companies and their parent companies, publicly available analyses of the tobacco industry and other public sources. Certain of those companies file annual, quarterly and certain other reports with the Securities and Exchange Commission (the “**SEC**”). Such reports are available on the SEC’s website (www.sec.gov) and upon request from the Office of Public Reference of the SEC, 450 5th Street, NW, Room 1300, Washington, D.C. 20549-0102 (phone: (202) 942-8090; fax: (202) 628-9001; e-mail: publicinfo@sec.gov). Prospective investors in the Series B and C Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series B and C Bonds is consistent with their investment objectives.

SUMMARY OF THE IHS GLOBAL REPORT

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

General

IHS Global Inc. (“**IHS Global**”), formerly known as DRI•WEFA, Inc., has prepared a report dated March 6, 2014 on the consumption of cigarettes in the United States from 2014 through 2041 entitled, “*A Forecast of U.S. Cigarette Consumption (2014-2041) for the Tobacco Settlement Financing Corporation”* (“**IHS Global Report**”). IHS Global is an internationally recognized econometric and consulting firm of over 325 economists in more than 31 countries. IHS Global is a privately held company, which is a provider of financial, economic and market research information.

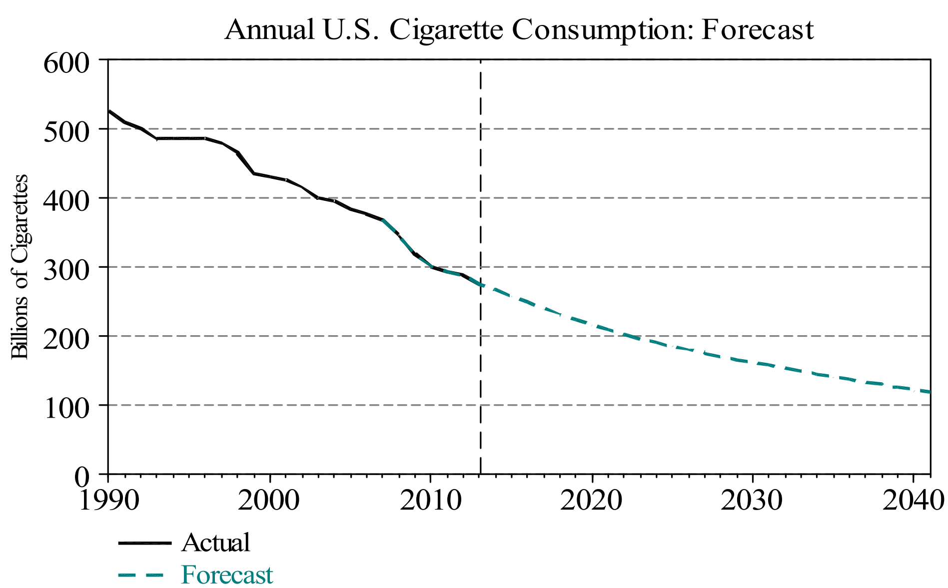
IHS Global has developed a cigarette consumption model based on historical United States data between 1965 and 2013. IHS Global constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building this cigarette consumption model (real cigarette prices, the level of real disposable income per capita, the impact of workplace smoking restrictions first instituted widely in the 1980s, the stricter restrictions on smoking in public places instituted over the last decade, and the trend over time in individual behavior and preferences), IHS Global employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The multivariate regression analysis showed: (i) long run price elasticity of demand of -0.33; (ii) income elasticity of demand of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.4% per year holding other recognized significant factors constant.

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 2014 through 2041 (the "**IHS Global Forecast**"). The IHS Global Forecast indicates that the total United States cigarette consumption in 2041 will be 118 billion cigarettes (or 119 billion including roll-your-own tobacco equivalents), a 57% decline from the 2013 level. Coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2003 to an annual rate of 3.0%. The decline moderated for the next four years, through 2007, averaging 2.3%. The rate of decline accelerated dramatically beginning in 2008, with a 3.8% decline for that year (including roll-your-own equivalents to cigarettes as defined by the MSA at 0.0325 ounces of loose tobacco per cigarette), 9.1% in 2009, and 6.4% in 2010 before finally decelerating to 2.7% in 2011 and 2.0% in 2012. In 2013 the decline sharpened to greater than 4%. 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. From 2013 through 2041 the average annual rate of decline is projected to be 3.0%. Total consumption of cigarettes in the United States is projected to fall from 290 billion in 2012 to 277 billion in 2013, 269 billion in 2014, and to 118 billion by 2041, as set forth in the following table. The IHS Global Report states that IHS Global believes the assumptions on which the IHS Global Forecast is based are reasonable.

IHS Global Forecast of Cigarette Consumption

Year	Consumption including Roll-Your-Own (billions)	Year	Consumption including Roll-Your-Own (billions)
2009	325.0	2026	181.2
2010	304.1	2027	176.4
2011	296.0	2028	171.7
2012	290.1	2029	167.1
2013	276.7	2030	162.6
2014	268.7	2031	158.3
2015	259.5	2032	154.0
2016	250.4	2033	149.8
2017	241.5	2034	145.7
2018	232.8	2035	141.6
2019	224.7	2036	137.6
2020	217.2	2037	133.8
2021	210.0	2038	130.0
2022	203.4	2039	126.2
2023	197.3	2040	122.5
2024	191.6	2041	119.0
2025	186.3		

The graph below illustrates total actual and projected cigarette consumption in the United States:



Comparison with Prior IHS Global Forecasts

In January 2007 IHS Global (then Global Insight) presented a similar study, "*A Forecast of U.S. Cigarette Consumption (2011-2041) for the Tobacco Settlement Financing Corporation*." The current forecast differs from IHS Global's forecast in 2008. That report projected consumption in 2041 of 199 billion cigarettes, reflecting an average decline rate of 1.8%. The current forecast projects an average decline rate of 3.0% through 2041, to an annual consumption level of 118 billion sticks. The new forecast was developed with consideration of the large federal tax increase on 2009 and of the negative effects of the proliferation on smoking ban legislation across the United States.

There was a confluence of factors which led to the dramatically reduced consumption through 2009. First, indoor smoking bans spread rapidly across the country in the latter half of the decade. IHS Global now estimates that their impact on decreased smoking and cigarette consumption was approximately 6 billion sticks in 2009. Second, the latter months of 2008 saw a very deep recession. IHS Global's model projects that, given the lower realized levels of household income in 2009, consumption was negatively impacted by about 8 billion sticks. Third, the increase in the federal excise tax to $1.01 per pack, effective April 1, 2009, decreased cigarette demand by about 10 billion in 2009 according to IHS Global's model of price elasticity. Fourth, the acceleration of state excise tax increases similarly reduced consumption by a further 4 billion.

Over the longer term, IHS Global's model includes estimates of the negative impact of indoor smoking bans, which IHS Global anticipates 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. IHS Global also assumes 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.

Historical Cigarette Consumption

The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco, Firearms and Explosives) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980s, 1990s and 2000s, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2003 and 275 billion in 2013. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.

The following table sets forth United States domestic cigarette consumption for the sixteen years ended December 31, 2013. The data in this table vary from statistics on cigarette shipments in the United States. While the IHS Global Report is based on consumption, payments made under the MSA are computed based in part on shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

U.S. Cigarette Consumption

Year Ended December 31	Consumption (Billions of Cigarettes)	Percentage Change
2013	275	-4.61%
2012	288	-1.87
2011	293	-2.48
2010	301	-5.62
2009	319	-8.08
2008	348	-4.35
2007	368	-2.28
2006	377	-1.93
2005	384	-2.69
2004	395	-1.28
2003	400	-3.66
2002	415	-2.35
2001	425	-1.16
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13

Factors Affecting Cigarette Consumption

Most empirical studies have found a common set of variables that are relevant in building a model of cigarette demand. These conventional analyses usually evaluate one or more of the following factors: (i) general population growth, (ii) price increases, (iii) changes in disposable income, (iv) youth consumption, (v) 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. Since 1964 there has been a significant decline in United States adult per capita cigarette consumption. The 1964 Surgeon General's health warning and numerous subsequent health warnings, together with the increased health awareness of the population over the past 30 years, may have contributed to decreases in cigarette consumption levels. If, as assumed by IHS Global, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. IHS Global's analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables, which are difficult to quantify.

SUMMARY OF COLLECTION METHODOLOGY AND BOND REDEMPTION ASSUMPTIONS

Introduction

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

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

Collection Methodology

In applying the IHS Global Forecast, it was assumed that United States cigarette consumption was equal to the number of cigarettes shipped in and to the United States, the District of Columbia and Puerto Rico, which is the number that is applied to determine the Volume Adjustment. The IHS Global Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time. The IHS Global Forecast for United States cigarette consumption is set forth herein under "SUMMARY OF THE IHS GLOBAL REPORT." See the copy of the IHS Global Report attached hereto as APPENDIX A for a discussion of the assumptions underlying the projections of cigarette consumption contained therein.

Annual Payments and Strategic Contribution Fund Payments

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

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

Volume Adjustment. Next, the Annual Payments and Strategic Contribution Fund Payments calculated for each year after the application of the Inflation Adjustment were adjusted for the Volume Adjustment by applying the IHS Global Forecast for United States cigarette consumption to the OPM shipments as reported to MSAI. No add back or benefit was assumed from any Income Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – *Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

Previously-Settled States Reduction. Next, the Annual Payments calculated for each year after application of the Inflation Adjustment and the Volume Adjustment were reduced by the Previously-Settled States Reduction which applies only to the Annual Payments owed by the OPMs. The Previously-Settled State Reduction does not apply to Strategic Contribution Fund Payments. The Previously-Settled States Reduction is as follows for each year of the following period:

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

2013 through 2017	12.2373756%
2018 and after	11.0666667%

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

NPM Adjustment. The NPM Adjustment has applied to Annual Payments in each year since 2006. However, the Collection Methodology includes an assumption that the State has diligently enforced and will diligently enforce a Qualifying Statute that is not held to be unenforceable. Therefore, the NPM Adjustment is assumed not to apply to Annual Payments and Strategic Contribution Fund Payments throughout the period forecasted in the IHS Global Report (other than certain 2014-2017 PM Credit amounts and transition year adjustment amounts projected pursuant to the NPM Adjustment Stipulated Partial Settlement and Award described below under "–Adjustments to Payments Under the NPM Adjustment Settlement Term Sheet.)" For a discussion of the State's Qualifying Statute (which is a Model Statute), see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Relating to Model/Qualifying Statutes."

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

Litigating Releasing Parties Offset. The Collection Methodology includes an assumption that the Litigating Releasing Parties Offset will not apply.

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

Subsequent Participating Manufacturers. The Collection Methodology treats the SPMs as a single manufacturer having executed the MSA on or prior to February 22, 1997 for purposes of calculating Annual Payments and Strategic Contribution Fund Payments under Section IX(i) of the MSA. Further, the Market Share of the SPMs is determined assuming 0.09 ounces of roll-your-own tobacco constitute an individual Cigarette and is assumed to remain constant at 9.11% throughout the forecast period. Because the SPM Market Share exceeds the Base Share, the SPMs are assumed to make Annual Payments and Strategic Contribution Fund Payments in each year in the same manner as the OPMs but assuming a Market Share equal to (y) the SPM Market Share (9.11%) less the Base Share (3.539%) divided by (z) the aggregate Market Share of the OPMs based on measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate (84.81%).

Allocation Percentage for the State of New Jersey Under the MSA. The amounts of Annual Payments and Strategic Contribution Fund Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled State Reduction (applicable only to Annual Payments) for each year were multiplied by the Allocation Percentage for the State (3.8669963% for Annual Payments and 2.8469526% for Strategic Contribution Fund Payments under the MSA) in order to determine the amount of Annual Payments and Strategic Contribution Fund Payments to be made by the PMs in each year to be allocated to the State.

Additional Pledged TSRs. The amounts of Annual Payments and Strategic Contribution Fund Payments in each year to be allocated to the State under the MSA calculated as described in the preceding paragraph, was multiplied by 15.99% as per the Series 2007-1B Pledge Agreement and by 7.75% as per the Series 2007-1C Pledge Agreement.

Miscellaneous. The Collection Methodology further assumes that no Lump Sum Payment or Partial Lump Sum Payment is received.

Adjustments to Payments Under the NPM Adjustment Settlement Term Sheet

Continued implementation of the terms of the NPM Adjustment Term Sheet, while not assured, has been assumed for purposes of projecting Additional Pledged TSRs for 2017.

Release of Amounts in the Disputed Payments Account. The NPM Adjustment Stipulated Partial Settlement and Award orders the MSA Auditor to release certain amounts plus accumulated earnings thereon from the Disputed Payments Account to the Term Sheet Signatories either in connection with the April 15, 2013 MSA payment or, at a Term Sheet Signatory's direction, to defer such release to a later date or dates (the "2013 DPA Release"). The State elected to receive and received its entire allocable amount of the 2013 DPA Release with is April 15, 2013 MSA payment. No further amounts are expected to be received by the State.

Credits to PM MSA Payments. The NPM Adjustment Stipulated Partial Settlement and Award orders the MSA Auditor to apply credits to the PMs' MSA payments due in April 2013 through and including April 2017 (the "**PM Credit**"). The PM Credit is subject to verification by the MSA Auditor and assumes, inter alia, that no additional Settling States become Term Sheet Signatories. Based on directions submitted to the MSA Auditor by the Term Sheet Signatories on March 22, 2013 regarding implementation of the NPM Adjustment Settlement Term Sheet and for purposes of projecting the PM Credit applied against the State's 2017 MSA payment, it is assumed that: (i) the PM Credit consists of $1,647,485,391.92 ($1,573,474,445.05 and $74,010,946.87 of OPMs' and SPMs' Annual Payments, respectively) attributable to Annual Payments and $74,931,401.15 ($71,418,073.85 and $3,513,327.30 of OPMs' and SPMs' Strategic Contribution Fund Payments, respectively) attributable to Strategic Contribution Fund Payments; (ii) the OPMs' credit for the April 2013 payment was $786,737,222.53 attributable to Annual Payments and $35,709,036.93 attributable to Strategic Contribution Fund Payments; (iii) the SPMs' credit for the April 2013 payment was $29,819,896.01 attributable to Annual Payments and $1,405,718.59 attributable to Strategic Contribution Fund Payments; (iv) the balance of the PM Credit will be credited against the OPMs' MSA payments due in April 2014 through and including April 2017 in equal installments and against the SPMs' MSA payments due in April 2014 through and including April 2016 in equal annual installments (collectively, the "**2014-2017 PM Credits**"); (v) no interest will be paid on the 2014-2017 PM Credits; (vi) 9.20791442% of the PM Credits attributable to Annual Payments are attributable to the State; and (vii) 8.85418798% of the PM Credits attributable to Strategic Contribution Fund Payments are attributable to the State. The portion of the State's MSA payment in 2017 is projected to be reduced by $18,110,522.54 attributable to Annual Payments and $790,436.31 attributable to Strategic Contribution Fund Payments.

NPM Adjustments. The NPM Adjustment Stipulated Partial Settlement and Award also directs the MSA Auditor to implement certain provisions of the NPM Adjustment Settlement Term Sheet as they relate to future years' NPM Adjustments, including the method by which NPM Adjustments are determined. With respect to the NPM Adjustment provisions set forth in Section III.B of the NPM Adjustment Settlement Term Sheet, the projections assume that the State will comply with the safe harbor provision of Section III.B.3 in sales year 2013 and thereafter and, therefore, that no related NPM Adjustments will apply to the State's Annual Payments and Strategic Contribution Fund Payments throughout the period forecasted in the Tobacco Consumption Report. With respect to the NPM Adjustment provisions set forth in Section III.C of the NPM Adjustment Settlement Term Sheet, the projections assume that the State will diligently enforce a Qualifying Statute that is not held to be unenforceable. Therefore, the NPM Adjustment set forth in Section III.C of the NPM Adjustment Settlement Term Sheet is assumed not to apply to Annual Payments and Strategic Contribution Fund Payments throughout the period forecasted in the Tobacco Consumption Report. See "APPENDIX H—NPM ADJUSTMENT STIPULATED PARTIAL SETTLEMENT AND AWARD AND SETTLEMENT TERM SHEET."

The following tables show the projection of Annual Payments and Strategic Contribution Fund Payments to be received by the Series 2007-1B Pledge Agreement Trustee and the Series 2007-1C Pledge Agreement Trustee through the year 2041, calculated in accordance with the Collection Methodology.

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Projection of Annual Payments to be Received by the Series 2007-1B Pledge Agreement Trustee

Payment Year	IHS Global Insight Consumption Forecast(1)	Estimated OPM Consumption(1)	Base Annual Payments ($)	Inflation Adjustment ($)	Volume Adjustment ($)	Previously Settled States Reduction ($)	Subtotal ($)	Corporation's Allocation(2)	OPM Annual Payments to Trustee ($)	SPM Annual Payments to Trustee ($)	PM Credits(3) ($)	Total Annual Payments to Trustee ($)
2017	250,428,657,945	211,915,234,640	8,139,000,000	6,006,870,935	(7,686,702,092)	(790,432,752)	5,668,736,090	0.61833271%	35,051,649	2,623,523	(2,895,873)	34,779,300
2018	241,451,142,745	204,318,371,502	9,000,000,000	7,111,589,400	(9,007,027,873)	(786,238,145)	6,318,323,382	0.61833271%	39,068,260	2,885,663		41,953,923
2019	232,840,560,705	197,032,010,874	9,000,000,000	7,594,937,100	(9,526,364,899)	(782,255,326)	6,286,316,875	0.61833271%	38,870,353	2,871,045		41,741,398
2020	224,703,161,242	190,146,062,074	9,000,000,000	8,092,785,600	(10,054,654,945)	(778,886,461)	6,259,244,194	0.61833271%	38,702,954	2,858,681		41,561,635
2021	217,152,072,853	183,756,255,569	9,000,000,000	8,605,569,600	(10,588,072,139)	(776,603,055)	6,240,894,406	0.61833271%	38,589,491	2,850,300		41,439,791
2022	210,025,900,084	177,726,016,910	9,000,000,000	9,133,736,400	(11,131,010,864)	(774,968,295)	6,227,757,241	0.61833271%	38,508,260	2,844,300		41,352,560
2023	203,428,257,530	172,143,025,804	9,000,000,000	9,677,748,600	(11,679,785,913)	(774,441,206)	6,223,521,481	0.61833271%	38,482,069	2,842,366		41,324,435
2024	197,292,637,888	166,951,003,107	9,000,000,000	10,238,081,400	(12,235,973,102)	(774,899,987)	6,227,208,311	0.61833271%	38,504,866	2,844,049		41,348,915
2025	191,608,356,870	162,140,907,667	9,000,000,000	10,815,223,500	(12,799,426,881)	(776,414,828)	6,239,381,790	0.61833271%	38,580,138	2,849,609		41,429,748
2026	186,289,265,359	157,639,839,240	9,000,000,000	11,409,679,800	(13,372,680,786)	(778,761,227)	6,258,237,787	0.61833271%	38,696,731	2,858,221		41,554,952
2027	181,248,336,498	153,374,154,828	9,000,000,000	12,021,970,500	(13,958,616,002)	(781,677,900)	6,281,676,598	0.61833271%	38,841,661	2,868,926		41,710,587
2028	176,416,934,178	149,285,773,870	9,000,000,000	12,652,629,300	(14,559,761,783)	(784,944,008)	6,307,923,510	0.61833271%	39,003,954	2,880,913		41,884,867
2029	171,718,931,853	145,310,277,323	9,000,000,000	13,302,207,900	(15,179,226,597)	(788,276,600)	6,334,704,703	0.61833271%	39,169,551	2,893,144		42,062,696
2030	167,121,606,420	141,419,974,569	9,000,000,000	13,971,274,200	(15,818,723,699)	(791,548,924)	6,361,001,576	0.61833271%	39,332,153	2,905,155		42,237,308
2031	162,636,862,662	137,624,939,553	9,000,000,000	14,660,412,300	(16,478,285,095)	(794,822,080)	6,387,305,125	0.61833271%	39,494,797	2,917,168		42,411,965
2032	158,276,170,689	133,934,878,399	9,000,000,000	15,370,224,300	(17,157,912,386)	(798,162,521)	6,414,149,393	0.61833271%	39,660,784	2,929,428		42,590,212
2033	154,034,908,895	130,345,880,256	9,000,000,000	16,101,331,200	(17,858,260,610)	(801,566,481)	6,441,504,109	0.61833271%	39,829,927	2,941,921		42,771,848
2034	149,800,370,196	126,762,571,263	9,000,000,000	16,854,371,100	(18,584,884,407)	(804,489,863)	6,464,996,830	0.61833271%	39,975,190	2,952,651		42,927,841
2035	145,652,476,955	123,252,582,524	9,000,000,000	17,630,001,900	(19,335,010,183)	(807,312,419)	6,487,679,298	0.61833271%	40,115,443	2,963,010		43,078,453
2036	141,608,835,326	119,830,812,541	9,000,000,000	18,428,902,200	(20,108,432,106)	(810,132,026)	6,510,338,068	0.61833271%	40,255,550	2,973,359		43,228,908
2037	137,641,224,265	116,473,380,385	9,000,000,000	19,251,769,500	(20,907,112,885)	(812,808,668)	6,531,847,948	0.61833271%	40,388,552	2,983,182		43,371,735
2038	133,761,288,567	113,190,139,998	9,000,000,000	20,099,322,900	(21,731,168,909)	(815,409,044)	6,552,744,947	0.61833271%	40,517,765	2,992,726		43,510,492
2039	129,968,683,738	109,980,799,866	9,000,000,000	20,972,302,200	(22,581,287,850)	(817,938,924)	6,573,075,427	0.61833271%	40,643,475	3,002,012		43,645,487
2040	126,209,896,404	106,800,076,436	9,000,000,000	21,871,471,500	(23,461,036,189)	(820,088,177)	6,590,347,135	0.61833271%	40,750,272	3,009,900		43,760,172
2041	122,529,907,424	103,686,032,962	9,000,000,000	22,797,615,600	(24,368,877,647)	(822,113,669)	6,606,624,284	0.61833271%	40,850,919	3,017,334		43,868,253

(1) Consumption amounts are for the previous sales year.
(2) The State of New Jersey is entitled to 3.8669963% of the Annual Payments under the MSA. The Series 2007-1B Additional Pledged TSRs constitute 15.99% of the tobacco settlement revenues.
(3) 15.99% of the PM Credits attributable to Annual Payments to the State.

Projection of Strategic Contribution Fund Payments and Total Payments to be Received by the Series 2007-1B Pledge Agreement Trustee

Payment Year	IHS Global Insight Consumption Forecast(1)	Estimated OPM Consumption(1)	Base Strategic Contribution Fund Payments ($)	Inflation Adjustment ($)	Volume Adjustment ($)	Subtotal ($)	Corporation's Allocation(2)	OPM Strategic Contribution Fund Payments to Trustee ($)	SPM Strategic Contribution Fund Payments to Trustee ($)	PM Credits(3) ($)	Total Strategic Contribution Fund Payments to Trustee ($)	Total Annual Payments to Trustee ($)	Total Payments to Trustee ($)
2017	250,428,657,945	211,915,234,640	861,000,000	635,448,566	(813,152,783)	683,295,782	0.45522772%	3,110,552	204,326	(126,391)	3,188,487	34,779,300	37,967,787
2018	241,451,142,745	204,318,371,502										41,953,923	41,953,923
2019	232,840,560,705	197,032,010,874										41,741,398	41,741,398
2020	224,703,161,242	190,146,062,074										41,561,635	41,561,635
2021	217,152,072,853	183,756,255,569										41,439,791	41,439,791
2022	210,025,900,084	177,726,016,910										41,352,560	41,352,560
2023	203,428,257,530	172,143,025,804										41,324,435	41,324,435
2024	197,292,637,888	166,951,003,107										41,348,915	41,348,915
2025	191,608,356,870	162,140,907,667										41,429,748	41,429,748
2026	186,289,265,359	157,639,839,240										41,554,952	41,554,952
2027	181,248,336,498	153,374,154,828										41,710,587	41,710,587
2028	176,416,934,178	149,285,773,870										41,884,867	41,884,867
2029	171,718,931,853	145,310,277,323										42,062,696	42,062,696
2030	167,121,606,420	141,419,974,569										42,237,308	42,237,308
2031	162,636,862,662	137,624,939,553										42,411,965	42,411,965
2032	158,276,170,689	133,934,878,399										42,590,212	42,590,212
2033	154,034,908,895	130,345,880,256										42,771,848	42,771,848
2034	149,800,370,196	126,762,571,263										42,927,841	42,927,841
2035	145,652,476,955	123,252,582,524										43,078,453	43,078,453
2036	141,608,835,326	119,830,812,541										43,228,908	43,228,908
2037	137,641,224,265	116,473,380,385										43,371,735	43,371,735
2038	133,761,288,567	113,190,139,998										43,510,492	43,510,492
2039	129,968,683,738	109,980,799,866										43,645,487	43,645,487
2040	126,209,896,404	106,800,076,436										43,760,172	43,760,172
2041	122,529,907,424	103,686,032,962										43,868,253	43,868,253

(1) Consumption amounts are for the previous sales year.
(2) The State of New Jersey is entitled to 2.8469526% of the Strategic Contribution Fund Payments under the MSA. The Series 2007-1B Additional Pledged TSRs constitute 15.99% of the tobacco settlement revenues.
(3) 15.99% of the PM Credits attributable to Strategic Contribution Fund Payments to the State.

Projection of Annual Payments to be Received by the Series 2007-1C Pledge Agreement Trustee

Payment Year	IHS Global Insight Consumption Forecast(1)	Estimated OPM Consumption(1)	Base Annual Payments ($)	Inflation Adjustment ($)	Volume Adjustment ($)	Previously Settled States Reduction ($)	Subtotal ($)	Corporation's Allocation(2)	OPM Annual Payments to Trustee ($)	SPM Annual Payments to Trustee ($)	PM Credits(3) ($)	Total Annual Payments to Trustee ($)
2017	250,428,657,945	211,915,234,640	8,139,000,000	6,006,870,935	(7,686,702,092)	(790,432,752)	5,668,736,090	0.29969221%	16,988,761	1,271,564	(1,403,565)	16,856,759
2018	241,451,142,745	204,318,371,502	9,000,000,000	7,111,589,400	(9,007,027,873)	(786,238,145)	6,318,323,382	0.29969221%	18,935,523	1,398,617		20,334,140
2019	232,840,560,705	197,032,010,874	9,000,000,000	7,594,937,100	(9,526,364,899)	(782,255,326)	6,286,316,875	0.29969221%	18,839,602	1,391,532		20,231,134
2020	224,703,161,242	190,146,062,074	9,000,000,000	8,092,785,600	(10,054,654,945)	(778,886,461)	6,259,244,194	0.29969221%	18,758,467	1,385,539		20,144,007
2021	217,152,072,853	183,756,255,569	9,000,000,000	8,605,569,600	(10,588,072,139)	(776,603,055)	6,240,894,406	0.29969221%	18,703,475	1,381,478		20,084,952
2022	210,025,900,084	177,726,016,910	9,000,000,000	9,133,736,400	(11,131,010,864)	(774,968,295)	6,227,757,241	0.29969221%	18,664,104	1,378,569		20,042,673
2023	203,428,257,530	172,143,025,804	9,000,000,000	9,677,748,600	(11,679,785,913)	(774,441,206)	6,223,521,481	0.29969221%	18,651,409	1,377,632		20,029,041
2024	197,292,637,888	166,951,003,107	9,000,000,000	10,238,081,400	(12,235,973,102)	(774,899,987)	6,227,208,311	0.29969221%	18,662,458	1,378,448		20,040,906
2025	191,608,356,870	162,140,907,667	9,000,000,000	10,815,223,500	(12,799,426,881)	(776,414,828)	6,239,381,790	0.29969221%	18,698,941	1,381,143		20,080,084
2026	186,289,265,359	157,639,839,240	9,000,000,000	11,409,679,800	(13,372,680,786)	(778,761,227)	6,258,237,787	0.29969221%	18,755,451	1,385,317		20,140,768
2027	181,248,336,498	153,374,154,828	9,000,000,000	12,021,970,500	(13,958,616,002)	(781,677,900)	6,281,676,598	0.29969221%	18,825,696	1,390,505		20,216,201
2028	176,416,934,178	149,285,773,870	9,000,000,000	12,652,629,300	(14,559,761,783)	(784,944,008)	6,307,923,510	0.29969221%	18,904,356	1,396,315		20,300,671
2029	171,718,931,853	145,310,277,323	9,000,000,000	13,302,207,900	(15,179,226,597)	(788,276,600)	6,334,704,703	0.29969221%	18,984,617	1,402,243		20,386,860
2030	167,121,606,420	141,419,974,569	9,000,000,000	13,971,274,200	(15,818,723,699)	(791,548,924)	6,361,001,576	0.29969221%	19,063,426	1,408,064		20,471,491
2031	162,636,862,662	137,624,939,553	9,000,000,000	14,660,412,300	(16,478,285,095)	(794,822,080)	6,387,305,125	0.29969221%	19,142,256	1,413,887		20,556,143
2032	158,276,170,689	133,934,878,399	9,000,000,000	15,370,224,300	(17,157,912,386)	(798,162,521)	6,414,149,393	0.29969221%	19,222,706	1,419,829		20,642,535
2033	154,034,908,895	130,345,880,256	9,000,000,000	16,101,331,200	(17,858,260,610)	(801,566,481)	6,441,504,109	0.29969221%	19,304,686	1,425,884		20,730,570
2034	149,800,370,196	126,762,571,263	9,000,000,000	16,854,371,100	(18,584,884,407)	(804,489,863)	6,464,996,830	0.29969221%	19,375,092	1,431,085		20,806,177
2035	145,652,476,955	123,252,582,524	9,000,000,000	17,630,001,900	(19,335,010,183)	(807,312,419)	6,487,679,298	0.29969221%	19,443,070	1,436,106		20,879,175
2036	141,608,835,326	119,830,812,541	9,000,000,000	18,428,902,200	(20,108,432,106)	(810,132,026)	6,510,338,068	0.29969221%	19,510,976	1,441,121		20,952,098
2037	137,641,224,265	116,473,380,385	9,000,000,000	19,251,769,500	(20,907,112,885)	(812,808,668)	6,531,847,948	0.29969221%	19,575,440	1,445,883		21,021,322
2038	133,761,288,567	113,190,139,998	9,000,000,000	20,099,322,900	(21,731,168,909)	(815,409,044)	6,552,744,947	0.29969221%	19,638,066	1,450,508		21,088,575
2039	129,968,683,738	109,980,799,866	9,000,000,000	20,972,302,200	(22,581,287,850)	(817,938,924)	6,573,075,427	0.29969221%	19,698,995	1,455,009		21,154,004
2040	126,209,896,404	106,800,076,436	9,000,000,000	21,871,471,500	(23,461,036,189)	(820,088,177)	6,590,347,135	0.29969221%	19,750,757	1,458,832		21,209,589
2041	122,529,907,424	103,686,032,962	9,000,000,000	22,797,615,600	(24,368,877,647)	(822,113,669)	6,606,624,284	0.29969221%	19,799,539	1,462,435		21,261,974

(1) Consumption amounts are for the previous sales year.
(2) The State of New Jersey is entitled to 3.8669963% of the Annual Payments under the MSA. The Series 2007-1C Additional Pledged TSRs constitute 7.75% of the tobacco settlement revenues.
(3) 7.75% of the PM Credits attributable to Annual Payments to the State.

Projection of Strategic Contribution Fund Payments and Total Payments to be Received by the Series 2007-1C Pledge Agreement Trustee

Payment Year	IHS Global Insight Consumption Forecast[(1)]	Estimated OPM Consumption[(1)]	Base Strategic Contribution Fund Payments ($)	Inflation Adjustment ($)	Volume Adjustment ($)	Subtotal ($)	Corporation's Allocation[(2)]	OPM Strategic Contribution Fund Payments to Trustee ($)	SPM Strategic Contribution Fund Payments to Trustee ($)	PM Credits[(3)] ($)	Total Strategic Contribution Fund Payments to Trustee ($)	Total Annual Payments to Trustee ($)	Total Payments to Trustee ($)
2017	250,428,657,945	211,915,234,640	861,000,000	635,448,566	(813,152,783)	683,295,782	0.22063883%	1,507,616	99,032	(61,259)	1,545,389	16,856,759	18,402,148
2018	241,451,142,745	204,318,371,502										20,334,140	20,334,140
2019	232,840,560,705	197,032,010,874										20,231,134	20,231,134
2020	224,703,161,242	190,146,062,074										20,144,007	20,144,007
2021	217,152,072,853	183,756,255,569										20,084,952	20,084,952
2022	210,025,900,084	177,726,016,910										20,042,673	20,042,673
2023	203,428,257,530	172,143,025,804										20,029,041	20,029,041
2024	197,292,637,888	166,951,003,107										20,040,906	20,040,906
2025	191,608,356,870	162,140,907,667										20,080,084	20,080,084
2026	186,289,265,359	157,639,839,240										20,140,768	20,140,768
2027	181,248,336,498	153,374,154,828										20,216,201	20,216,201
2028	176,416,934,178	149,285,773,870										20,300,671	20,300,671
2029	171,718,931,853	145,310,277,323										20,386,860	20,386,860
2030	167,121,606,420	141,419,974,569										20,471,491	20,471,491
2031	162,636,862,662	137,624,939,553										20,556,143	20,556,143
2032	158,276,170,689	133,934,878,399										20,642,535	20,642,535
2033	154,034,908,895	130,345,880,256										20,730,570	20,730,570
2034	149,800,370,196	126,762,571,263										20,806,177	20,806,177
2035	145,652,476,955	123,252,582,524										20,879,175	20,879,175
2036	141,608,835,326	119,830,812,541										20,952,098	20,952,098
2037	137,641,224,265	116,473,380,385										21,021,322	21,021,322
2038	133,761,288,567	113,190,139,998										21,088,575	21,088,575
2039	129,968,683,738	109,980,799,866										21,154,004	21,154,004
2040	126,209,896,404	106,800,076,436										21,209,589	21,209,589
2041	122,529,907,424	103,686,032,962										21,261,974	21,261,974

(1) Consumption amounts are for the previous sales year.
(2) The State of New Jersey is entitled to 2.8469526% of the Strategic Contribution Fund Payments under the MSA. The Series 2007-1C Additional Pledged TSRs constitute 7.75% of the tobacco settlement revenues.
(3) 7.75% of the PM Credits attributable to Strategic Contribution Fund Payments to the State.

Bond Redemption Assumptions

Issue Size. The Series 2007-1B Bonds were issued with an aggregate maturity amount of $855,000,000 and the Series 2007-1C Bonds were issued with an aggregate maturity amount of $425,850,000. All of the Series B and C Bonds remain outstanding as of March 7, 2014 and are assumed to remain outstanding until June 1, 2017.

Optional Redemption. The Series B and C Bonds are subject to optional redemption in minimum increments of $5,000 of maturity value beginning on June 1, 2017 and on each June 1 thereafter at 100% of their respective Accreted Values.

Senior Liquidity Reserve Account. The Senior Liquidity Reserve Account is held for the sole benefit of the Series 2007-1A Bonds and is not available to pay debt service on or the optional redemption price of the Series B and C Bonds.

Interest Earnings. The Collection Methodology assumes that the Series 2007-1B Pledge Agreement Trustee and the Series 2007-1C Pledge Agreement Trustee will receive ten days after April 15 its entitlement of the Annual Payments owed by the PMs in payment year 2017 and each year thereafter. It is further assumed that the Series 2007-1B Pledge Agreement Trustee and the Series 2007-1C Pledge Agreement Trustee will receive ten days after April 15 its entitlement of the Strategic Contribution Fund Payments owed by the PMs in payment year 2017. Interest earnings are assumed at 0% per annum on the Annual Payments and Strategic Contribution Fund Payments from the date of receipt by the Indenture Trustee until the applicable Distribution Date. No interest earnings have been assumed on the Annual Payments and Strategic Contribution Fund Payments prior to the time they are received by the applicable Pledge Agreement Trustee.

Operating Expense Assumptions. Operating expenses of the Authority are funded from Pledged TSRs. No operating or other expenses will be paid from the Additional Pledged TSRs.

Issuance Date. The Series B and C Bonds were issued on January 29, 2007.

Interest Rates and Accreted Values. On their issuance date, the Series 2007-1B Bonds had an approximate yield to maturity of 5.65%. On their issuance date, the Series 2007-1C Bonds had an approximate yield to maturity of 5.80%. Tables of Accreted Values for the Series B and C Bonds are included herein in "APPENDIX I - TABLES OF ACCRETED VALUES".

No assurance can be given that actual cigarette consumption in the United States during the term of the Series B and C Bonds will be as assumed, or that the other assumptions underlying the Collection Methodology, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Collection Methodology, the amount of Additional Pledged TSRs available to the Corporation to pay the optional redemption prices of the Series B and C Bonds could be adversely affected. See "RISK FACTORS" herein.

CONTINUING DISCLOSURE

"Prior to the execution and delivery of the Pledge Agreements, the Corporation and The Bank of New York Mellon, as dissemination agent (the "**Dissemination Agent**"), will enter into a Supplemental Continuing Disclosure Undertaking for the benefit of the owners and beneficial holders of the Series B and C Bonds pursuant to which the Corporation will agree to provide, together with the Corporation's Annual Report required to be provided pursuant to the Continuing Disclosure Agreement, certain annual information pertaining to the Additional Pledged TSRs and the Series B and C Bonds. The obligation of the Corporation to provide such supplemental information shall terminate upon the defeasance, prior redemption or payment in full of all of the Series B and C Bonds. The information contained in the 2007 Offering Circular under the heading "CONTINUING DISCLOSURE" and in "APPENDIX C – CONTINUING DISCLOSURE AGREEMENT" is incorporated herein by reference. The Corporation is currently in compliance with its undertakings contained in the continuing disclosure agreement, which was executed and delivered in connection with the issuance of the Series 2007-1A Bonds and the Series B and C Bonds.

LITIGATION

There is no litigation pending or threatened in any court (either in State or federal court) to restrain or enjoin the execution or delivery of the Pledge Agreements or questioning the creation, organization or existence of the Corporation, the validity or enforceability of the Act, the transfer of the Pledged TSRs and Additional Pledged TSRs by the State to the Corporation, the Pledge Agreements, the proceedings for the authorization, execution, authentication and delivery of the Pledge Agreements or the validity of the Pledge Agreements as "ancillary facilities" under the Act.

TAX MATTERS

Federal Income Tax

Series B and C Bonds owned by those Bondholders who have paid a portion of the Series 2007-1B Bond Enhancement Premium or the Series 2007-1C Bond Enhancement Premium ("**Identified Bondholders**") are treated solely for federal income tax purposes as new debt instruments received by such Identified Bondholders on the date of execution and delivery of the Pledge Agreements by the Corporation and receipt by the Corporation of the Bond Enhancement Premium (the "**Effective Date**") in an exchange to which Section 1001 of the Internal Revenue Code of 1986, as amended (the "**Code**") applies. Such Series B and C Bonds are referred to in this Section as the "**Reissued Bonds**." Series B and C Bonds owned by other Bondholders are referred to in this Section as the "**Non-Reissued Bonds**." IDENTIFIED BONDHOLDERS MAY RECOGNIZE TAXABLE GAIN OR LOSS IN CONNECTION WITH THE EXECUTION AND DELIVERY OF THE PLEDGE AGREEMENTS AND SHOULD CONSULT WITH THEIR TAX ADVISORS IN ORDER TO UNDERSTAND THE TAX CONSEQUENCES OF THE EXECUTION AND DELIVERY OF THE PLEDGE AGREEMENTS.

Applicable Federal tax law provides that interest on obligations such as the Series B and C Bonds is not included in gross income for Federal income tax purposes only if certain requirements are met. These requirements include, but are not limited to, requirements relating to use and expenditure of proceeds, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on investments of gross proceeds of the Series B and C Bonds be rebated to the Federal government. Noncompliance with such requirements may cause Original Issue Discount (as defined and further described below) on the Series B and C Bonds to become subject to Federal income taxation retroactive (a) in the case of the Reissued Bonds, to the Effective Date, and (b) in the case of the Non-Reissued Bonds, to their date of original issuance, in both cases regardless of the date on which such noncompliance occurs or is discovered. The Corporation has covenanted in the Indenture, and the State and the Corporation have covenanted in the Tax Agreement executed in connection with the original issuance of the Series B&C Bonds (the "**2007 Tax Certificate**") and will in the Tax Certificate (the "**Tax Certificate**") which will be executed by the Corporation and the State in connection with the execution and delivery of the Pledge Agreements, that they shall do and perform all acts permitted by law that are necessary or desirable to assure that Original Issue Discount on the Series B and C Bonds will be and will remain excluded from gross income for Federal income tax purposes. The Tax Certificate will contain certain provisions relating to compliance with the requirements of the Code, including certain representations and covenants in that regard by the State and the Corporation.

In the opinion of Special Counsel, pursuant to the applicable provisions of the Code and related rulings, regulations and judicial decisions, and assuming continued compliance by the Corporation and the State with the applicable provisions of the Indenture, the 2007 Tax Certificate and the Tax Certificate, Original Issue Discount on the Series B and C Bonds is not included in the gross income of the owners thereof for Federal income tax purposes pursuant to the Code and is not an item of tax preference to be included in calculating alternative minimum taxable income under the Code for purposes of the alternative minimum tax imposed with respect to individuals and corporations. Original Issue Discount on the Series B and C Bonds held by corporate taxpayers is included in the relevant income computation for calculation of the Federal alternative minimum tax imposed on corporations as a result of the inclusion of Original Issue Discount on the Series B and C Bonds in "adjusted current earnings."

Special Counsel is further of the opinion that the difference between (a) the Accreted Value at maturity of the Series B and C Bonds of each maturity, and (b) their respective "issue prices" within the meaning of the Code constitutes original issue discount ("**Original Issue Discount**") which is excluded from gross income for Federal income tax purposes. The respective issue prices of the Reissued Bonds will be determined by the Corporation including based on the fair market value on the date of issue of such Reissued Bonds that are treated as traded on an established market in accordance with the applicable provisions of the Code and regulations, and such determination will be posted on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access System within ninety (90) days after the Effective Date. Such determination will be binding on the holders of the Reissued Bonds unless such holder determines and reports a different fair market value for the Reissued Bonds in accordance with the Code and regulations. The respective issue prices of the Non-Reissued Bonds are the initial offering prices to the public (excluding bond houses, brokers or similar persons or organizations acting in the capacity of underwriters or wholesalers) at which prices a substantial amount of such Non-Reissued Bonds of the same maturity was sold upon original issuance of the Non-Reissued Bonds. Further, such original issue discount accrues actuarially on a constant interest rate basis over the term of each Series B and C Bond. The basis (i) of each Reissued Bond held by the Identified Bondholders on the Effective Date, and (ii) of each Non-Reissued Bond acquired upon original issuance, will be increased by the amount of such accrued original issue discount. Under Section 171(a)(2) of the Code, no deduction is allowed for the amortizable bond premium (determined in accordance with Section 171(b) of the Code) on tax-exempt bonds. Under Section 1016(a)(5) of the Code, however, an adjustment must be made to the owner's basis in such bond to the extent of any amortizable bond premium that is disallowable as a deduction under Section 171(a)(2) of the Code.

The opinion of Special Counsel is issued as of the Effective Date, and Special Counsel assumes no obligation to update, revise or supplement its opinion to reflect any facts or circumstances that may come to the attention of Special Counsel after the date of its opinion, or any changes in law or interpretations thereof that may occur after the date of such opinion, or for any reason whatsoever. Special Counsel also expresses no opinion on the effect of any action taken after the Effective Date or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for federal income tax purposes of the Original Issue Discount on the Series B and C Bonds.

Certain Federal Tax Consequences Relating to Series B and C Bonds

Although Original Issue Discount on the Series B and C Bonds is excluded from gross income for Federal income tax purposes, the accrual or receipt of Original Issue Discount on the Series B and C Bonds may otherwise affect the Federal income tax liability of the recipient. The nature and extent of these other tax consequences will depend upon the recipient's particular tax status or other items of income or deduction. Special Counsel expresses no opinion regarding any such consequences. Identified Bondholders and other holders or purchasers of the Series B and C Bonds, corporations (including S corporations and foreign corporations operating branches in the United States), property or casualty insurance companies, banks, thrifts or other financial institutions, certain recipients of Social Security benefits and individuals who may be eligible for the earned income tax credit under Section 32 of the Code are advised to consult their own tax advisors as to the tax consequences of purchasing or holding the Series B and C Bonds.

There can be no assurance that legislation will not be introduced or enacted after the issuance and delivery of the Series B and C Bonds so as to affect adversely the exclusion from gross income for Federal income tax purposes of Original Issue Discount on the Series B and C Bonds. For example, the House Ways and Means Committee Chair recently released draft legislation. This draft legislation would subject Original Issue Discount on the Bonds to federal income tax at an effective rate of 10% or more for individuals, trusts or estates in the highest income tax bracket. 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 Bonds.Each Identified Bondholder and other holder or purchaser of Series B and C Bonds should consult his or her own advisor regarding any pending or proposed Federal tax legislation and any changes in the status thereof.

New Jersey Gross Income Tax

In the opinion of Special Counsel, interest on and any gain realized on the sale of the Series B and C Bonds is not includable in gross income under the existing New Jersey Gross Income Tax Act.

ALL IDENTIFIED BONDHOLDERS AND OTHER HOLDERS OR PURCHASERS OF THE SERIES B AND C BONDS SHOULD CONSULT WITH THEIR TAX ADVISORS IN ORDER TO UNDERSTAND THE IMPLICATIONS OF THE CODE.

RATINGS

Upon execution of the Pledge Agreements, S&P is expected to upgrade its existing ratings on each of the Series B and C Bonds to "A-".

There is no assurance that any rating assigned to the Series B and C Bonds will continue for any given period of time or that such rating will not be revised downward, suspended or withdrawn entirely by S&P. Any such downward revision, suspension or withdrawal of a rating may have an adverse effect on the availability of a market for or the market price of the Series B and C Bonds.

ENHANCEMENT AGREEMENT

The Enhancement Agent has agreed, subject to certain conditions contained in the Enhancement Agreement with the Corporation to pay to the Corporation the Bond Enhancement Premium but only from funds received by the Enhancement Agent from the Identified Bondholders. The Enhancement Agent will be paid a fee by the Corporation for its services rendered in connection with structuring the bond enhancement transaction and negotiating and delivering the Bond Enhancement Premium.

LEGAL INVESTMENTS

The information contained in the 2007 Offering Circular under the heading "LEGAL INVESTMENTS" is incorporated herein by reference.

LEGAL MATTERS

DeCotiis, FitzPatrick & Cole, LLP, Teaneck, New Jersey, as Special Counsel to the Corporation, will render its opinion with respect to the validity of the Pledge Agreements and certain tax matters in substantially the form set forth in APPENDIX B hereto.

Certain legal matters will be passed upon for the Corporation and the State by the State's Attorney General, and for the Enhancement Agent by Orrick, Herrington & Sutcliffe, LLP, New York, New York, as Enhancement Agent Counsel.

OTHER PARTIES

Financial Advisor

Acacia Financial Group, Inc. has served as Financial Advisor (the "**Financial Advisor**") to the Corporation in connection with the Enhancement Agreement. The Financial Advisor's fee for services rendered is contingent upon the effectiveness of the Enhancement Agreement.

IHS Global

IHS Global has been retained as an independent econometric expert. The IHS Global Report attached as APPENDIX A hereto is included herein in reliance on IHS Global as experts in such matters. IHS Global's fees for acting as the independent econometric consultant are not contingent upon the effectiveness of the Pledge Agreements. The IHS Global Report should be read in its entirety.

TOBACCO SETTLEMENT FINANCING CORPORATION

By: /s/ Andrew Sidamon-Eristoff
President

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APPENDIX A

IHS GLOBAL REPORT

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A Forecast of U.S. Cigarette Consumption (2014-2041) for The Tobacco Settlement Financing Corporation

Submitted to:

The Tobacco Settlement Financing Corporation

Prepared by:

IHS Global Inc.

James Diffley
Senior Director

IHS Global Inc.
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March 6, 2014

Executive Summary

IHS Global Insight has developed a cigarette consumption model based on historical U.S. data between 1965 and 2013. This econometric model, coupled with our long term forecast of the U.S. economy, has been used to project total U.S. cigarette consumption from 2014 through 2041. Our forecast indicates that total consumption in 2041 will be 118 billion cigarettes (or 119 billion including roll-your-own tobacco equivalents), a 57% decline from the 2013 level. From 2013 through 2041 the average annual rate of decline is projected to be 3.0%.

Our model was constructed based on widely accepted economic principles and IHS Global Insight's considerable experience in building econometric forecasting models. A review of the economic research literature indicates that our model is consistent with the prevalent consensus among economists concerning cigarette demand. We considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking amongst underage youth, and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After extensive analysis, we found the following variables to be effective in building an empirical model of adult per capita cigarette consumption: real cigarette prices, real per capita disposable personal income, the impact of workplace smoking restrictions first instituted widely in the 1980s, the stricter restrictions on smoking in public places instituted over the last decade, and the trend over time in individual behavior and preferences. This forecast is based on reasonable assumptions regarding the future paths of these factors.

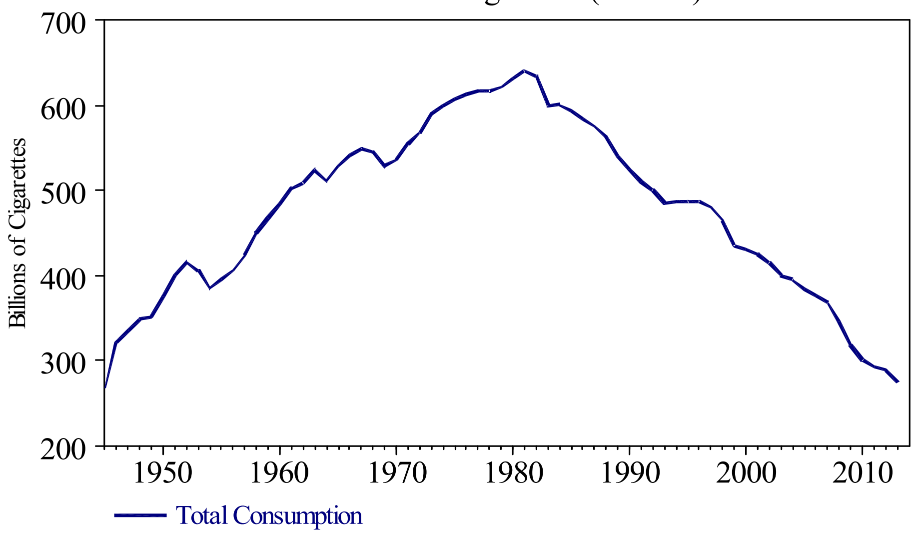
Disclaimer

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

Cigarette Use in the United States

People have used tobacco products for centuries. Tobacco was first brought to Europe from America in the late 15th century and became America's major cash crop in the 17th and 18th centuries[1]. Prior to 1900, tobacco was most frequently used in pipes, cigars, and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable U.S. consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico, and other U.S. possessions, and small tax-exempt categories[2] as reported by the Bureau of Alcohol, Tobacco, Firearms, and Explosives. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion cigarettes in 1900 to a peak of 640 billion in 1981[3]. Consumption declined in the 1980s, 1990s, and 2000s, reaching a level of 465 billion cigarettes in 1998 and decreased to less than 400 billion cigarettes in 2003[4] and 275 billion in 2013[5]. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.

Historical U.S. Cigarette Consumption: 1945-2013
Number of Cigarettes (Billions)



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

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

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

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

[5] *Source*: US Tobacco and Tax Bureau, MSAI

While the historical trend in consumption prior to 1981 was increasing, there was a decline in cigarette consumption of 9.8% during the Great Depression between 1931 and 1932. Notwithstanding, this steep decline, consumption rapidly increased after 1932, exceeding previous levels by 1934. Following the release of the Surgeon General's Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.2% between 1965 and 1981. Between 1981 and 1990, however, U.S. cigarette consumption declined at an average annual rate of 2.2%. From 1990 to 1998, the average annual rate of decline in cigarette consumption was 1.5%; but for 1998 the decline increased to 3.1% and increased further to 6.5% for 1999. These declines are correlated with large price increases in 1998 and 1999 following the Master Settlement Agreement ("MSA") and previously settled states agreements. In 2000 and 2001, the rate of decline moderated, to 1.2%. In the early part of the decade, coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2003 to an annual rate of 3.0%. The decline moderated for the next four years, through 2007, averaging 2.3%.

The rate of decline accelerated dramatically beginning in 2008, with a 3.8% decline in the number of cigarettes (including roll-your-own equivalents to cigarettes as defined by the MSA at 0.0325 ounces of loose tobacco per cigarette) for that year, 9.1% in 2009, and 6.4% in 2010 before finally decelerating to 2.7% in 2011 and 2.0% in 2012. In 2013 the decline sharpened to greater than 4%. This decline has been attributed by the industry to a weak economy, the rapid increase in usage of electronic cigarettes, and to an unfavorable comparison with a surprisingly strong 2012.

The following table sets forth United States domestic cigarette consumption, with and without roll-your-own equivalents, for the fifteen years ended December 31, 2013[6]. The data in this table vary from statistics on cigarette shipments in the United States. While this Report is based on consumption, payments made under the MSA dated November 23, 1998 between certain cigarette manufacturers and certain settling states are computed based in part on shipments in or to the fifty United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

[6] *Source:* National Association of Attorneys General, USDA-ERS; 2004, 2005, 2006, estimates by IHS Global Insight. USDA estimates for 2004, 2005, and 2006 diverge significantly from estimates based on independent data from the industry and from the US Tobacco and Tax Bureau. In 2004, the manufacturers report domestic shipments of 394.5 billion, and the TTB reports a total of 397.7 billion. These contrast with a USDA estimate of 388 billion. In 2005, the manufacturers report 381.7 billion, TTB reports 381.1 billion, and USDA 376 billion. In 2006, the manufacturers report 372.5 billion, TTB reports 380.9 billion, and USDA 372 billion. The USDA has discontinued this service, publishing its final report on October 24, 2007. For 2007 TTB reports 361.6 billion, while the manufacturers report 357.2 billion.

U.S. Cigarette Consumption

Year Ended December 31,	Consumption (Billions of Cigarettes)	Percentage Change	Consumption (Billions of Cigarettes with roll-your-own equivalents)	Percentage Change
2013	275	-4.61	277	-4.61
2012	288	-1.87	290	-1.98
2011	293	-2.48	296	-2.67
2010	301	-5.62	304	-6.45
2009	319	-8.08	325	-9.14
2008	348	-4.35	358	-3.79
2007	368	-2.28	372	-4.97
2006	377	-1.93	391	0.26
2005	384	-2.69	390	-3.51
2004	395	-1.28	404	0.09
2003	400	-3.66	404	-3.30
2002	415	-2.35	418	-2.68
2001	425	-1.16	429	-1.51
2000	430	-1.15	436	-1.30
1999	435	-6.45	442	
1998	465	-3.13		

There was a confluence of factors which led to the dramatically reduced consumption through 2009. First, indoor smoking bans spread rapidly across the country in the latter half of the decade. We now estimate that their impact on decreased smoking and cigarette consumption was approximately 6 billion sticks in 2009. Second, the latter months of 2008 saw a very deep recession. Our model projects that, given the lower realized levels of household income in 2009, consumption was negatively impacted by about 8 billion sticks. Third, the increase in the federal excise tax to $1.01 per pack, effective April 1, 2009 decreased cigarette demand by about 10 billion in 2009 according to our model of price elasticity. Fourth, the acceleration, prompted by the recession, of state excise tax increases similarly reduced consumption by a further 4 billion.

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according to MSAI, the three leading manufacturers accounted for 85.6% of U.S. shipments in 2013. According to the National Association of Attorneys General, the three leading manufacturers accounted for 84.5% of U.S. shipments in 2012, 84.5% in 2011, and 83.6% in 2010. These top companies are Philip Morris USA, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. These companies commanded 47.3%, 23.4%, and 14.9%, respectively of the domestic market in 2013[7]. The market share of the leading manufacturers has declined from over 96% in 1998 due to inroads by smaller manufacturers and importers following the MSA and other state settlement agreements.

The United States government has raised revenue through tobacco taxes since the Civil War. Although the federal excise taxes have risen through the years, excise taxes as a percentage of total federal revenue had fallen from 3.4% in 1950 to approximately 0.4% prior to the 2009 federal excise tax increase. In fiscal year 2012, the federal government received $15.7 billion in excise tax revenue from tobacco sales. In addition, state governments also raised significant revenues, $17.1 billion in 2012 from excise taxes. Cigarettes constitute the majority of these sales, which also include cigars and other tobacco products.

Survey of the Economic Literature on Smoking

Many organizations have conducted studies on U.S. cigarette consumption. These studies have utilized a variety of methods to estimate levels of smoking, including interviews and/or written questionnaires. Although these studies have tended to produce varying estimates of consumption levels due to a number of factors—including different survey methods and different definitions of smoking—taken together such studies provide a general approximation of consumption levels and trends. Set forth below is a brief summary of some of the more recent studies on cigarette consumption levels.

Incidence of Smoking

Approximately 42.1 million American adults were current smokers in 2012, representing approximately 18.1% of the population age 18 and older, a decline from 19.3% in 2010, according to a Centers for Disease Control and Prevention ("CDC") study[8] released in 2012. The CDC has, in December 2013, released preliminary results that the smoking rate for adults fell to 17.4% for January to June 2013. This survey defines "current smokers" as those persons who have smoked at least 100 cigarettes in their lifetime and who smoked every day or some days at the time of the survey. Although the percentage of adults who smoke (incidence) declined from 42.4% in 1965 to 25.5% in 1990 and 24.1% in 1998, the incidence rate has declined relatively slowly since 1998. The decline

[7] IHS Global Insight calculation based on industry shipments data.

[8] *Source*: CDC. Morbidity and Mortality Weekly Report. "Current Cigarette Smoking Among Adults – United States, 2005-2012".January, 2014.

had accelerated between 2002, when the incidence rate was 22.5%, to 2004, when the incidence rate dropped to 20.9%, though it remained as high as 20.6% in 2009. The 2014 report also indicated that the percentage of smokers who smoked less than 30 cigarettes per day had declined from 12.6% to 7.0% since 2005.

The CDC, in November 2011, released the results of a study of quitting smoking[9]. It found that, in 2010, 68.8% of smokers wanted to stop smoking, 52.4% had made a quit attempt in the past year, 6.2% had recently quit, 48.3% had been advised by a health professional to quit, and 31.7% had used counseling and/or medications when they tried to quit. In January 2014 the CDC released further results indicating the quit rates had increased to 52.9% for attempts made in the past year.

A recent trend, likely influenced by extensive indoor smoking bans in the U.S., is growing numbers of "light smokers", those who smoke just a few cigarettes per day. Thus the decline in the overall prevalence of smoking has slowed while the rate of decline of the volume of cigarettes consumed has accelerated. In a similar fashion electronic cigarettes have replaced cigarette consumption in locations subject to indoor smoking bans.

Youth Smoking

Certain studies have focused in whole or in part on youth cigarette consumption. Surveys of youth typically define a "current smoker" as a person who has smoked a cigarette on one or more of the 30 days preceding the survey. The CDC's Youth Risk Behavior Survey ("YRBS") estimated that from 1991 to 1999 incidence among high school students (grades 9 through 12) rose from 27.5% to 34.8%, representing an increase of 26.5%. By 2003, incidence had fallen to 21.9%, a decline of 37.1% over four years. The rate of decline has continued, though at a slower pace. By 2011, the prevalence was 18.1%.[10]

According to the Monitoring the Future Study, a school-based study of cigarette consumption and drug use conducted by the Institute for Social Research at the University of Michigan, smoking incidence over the prior 30 days among eighth, tenth, and twelfth graders were lower in 2013 than in 2012, continuing trends that began in 1996. Smoking incidence in all grades is well below where it was in 1991, having fallen below that mark in 2001 for eighth graders and in 2002 for tenth and twelfth graders.

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

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

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

The 2011 National Survey on Drug Use and Health (formerly called National Household Survey on Drug Abuse) conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services ("SAMHSA") estimated that approximately 68.2 million Americans age 12 and older were current cigarette smokers (defined by this survey to mean they had smoked cigarettes at least once during the 30 days prior to the interview). The survey found that an estimated 7.8% of youths age 12 to 17 were current cigarette smokers in 2011, down from 8.4% in 2010 and 13.0% in 2002.

The CDC reported on November 15, 2013 that the National Youth Tobacco Survey found that in 2012 the prevalence of tobacco product use among middle and high school students was 6.7% and 23.3%, respectively. These rates decreased from 2011 when they were 7.5% and 24.3%, respectively.

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These surveys all indicate that youth smoking, which had increased during the 1990s following two decades of decline, is again decreasing. In most of the nation the minimum legal age to purchase cigarettes is 18. In 2013 New York City increased that age to 21. A similar proposal to raise the smoking age has also been introduced in the Colorado, New York State, New Jersey, and Vermont legislatures, in the Council of the District of Columbia, and in Suffolk County, New York. Four states Alabama, Alaska, New Jersey, and Utah, and three New York counties currently set the minimum age at 19.

Price Elasticity of Cigarette Demand

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

Two studies published by the National Bureau of Economic Research examine the price elasticity of youth smoking. In their study on youth smoking in the United States, Gruber and Zinman estimate an elasticity of smoking participation (defined as smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to 1997.[11] That is, a 1% increase in cigarette prices would result in a decrease of 0.67% in the number of those seniors who smoked. The study's findings state that the drop in

[11] *Source*: Gruber, Jonathon and Zinman, Jonathon. "Youth Smoking in the U.S.:Evidence and Implications". Working Paper No. W7780. National Bureau of Economic Research. 2000.

cigarette prices in the early 1990's can explain 26% of the upward trend in youth smoking during the same period. The study also found that price has little effect on the smoking habits of younger teens (8th grade through 11th grade), but that youth access restrictions have a significant impact on limiting the extent to which younger teens smoke. Tauras and Chaloupka also found an inverse relationship between price and cigarette consumption among high school seniors.[12] The price elasticity of cessation for males averaged 1.12 and for females averaged 1.19 in this study. These estimates imply that a 1% increase in the real price of cigarettes will result in an increase in the probability of smoking cessation for high school senior males and females of 1.12% and 1.19%, respectively. A study utilizing more recent data, from 1975 to 2003, by Grossman, estimated an elasticity of smoking participation of just -0.12.[13] Nevertheless it concludes that price increases subsequent to the 1998 MSA explain almost the entire 12% drop in youth smoking over that time.

In another study, Czart et al. (2001) looked at several factors which they felt could influence smoking among college students. These factors included price, school policies regarding tobacco use on campus, parental education levels, student income, student marital status, sorority/fraternity membership, and state policies regarding smoking. The authors considered two ways in which smoking behavior could be affected: (1) smoking participation; and (2) the amount of cigarettes consumed per smoker. The results of the study suggest that, (1) the average estimated price elasticity of smoking participation is –0.26, and (2), the average conditional demand elasticity is –0.62. These results indicate that a 1% increase in cigarette prices, will reduce smoking participation among college students by 0.26% and will reduce the level of smoking among current college students by 0.62%.[14]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[15] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least one to five cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticities of initiation are –0.27 for any smoking, -0.81 for smoking at least one to five cigarettes, and –0.96 for smoking at least one-half pack of cigarettes. These results above indicate that a 10% increase in the price of cigarettes will decrease the probability of smoking initiation between approximately 3% and 10% depending on how initiation is defined. In a related study, Powell et al. (2003) estimated a price elasticity of youth smoking participation of

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

–0.46, implying that a 1% increase in price leads to a 0.46% reduction in smoking participation.[16]

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

Nicotine Replacement Products

Nicotine replacement products, such as Nicorette Gum and Nicoderm patches, are used to aid those who are attempting to quit smoking. Before 1996, these products were only available with a doctor's prescription. Currently, they are available as over-the-counter products. Many researchers now recommend that those trying to quit smoking use a variety of these methods in combination.

One study, by Hu et al., examines the effects of nicotine replacement products on cigarette consumption in the United States.[17] One of the results of the study found that, "a 0.076% reduction in cigarette consumption is associated with the availability of nicotine patches after 1992." In 2002, the Food and Drug Administration ("FDA") approved the Commit lozenge for over-the-counter sale. This product is similar to the gum and patch nicotine replacement products. NicoBloc, a liquid applied to cigarettes which blocks tar and nicotine from being inhaled, is another cessation product on the market since 2003. Zyban is a non-nicotine drug that has been available since 2000. It has been shown to be effective when combined with intensive behavioral support.[18]

In 2006, the FDA approved varenicline, a Pfizer product marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. Tests indicate that it is more effective as a cessation aid than Zyban. Pfizer introduced Chantix with a novel marketing program, GETQUIT, an integrated consumer support system which emphasizes personalized treatment advice with regular phone and e-mail contact. The drug debuted with strong sales in 2007, but suffered a reversal the following year due to safety concerns. It has since seen increased sales and marketing success. Free & Clear, a provider of tobacco treatment services, reported in June 2008, that Chantix has achieved higher average quit rates than Zyban, patches, gum, and lozenges. Though Pfizer reported additional positive results in 2009, the FDA required that Pfizer update the Chantix label with the most restrictive, "Black Box", safety labeling describing the risks. But the FDA does conclude: "The Agency continues to believe that the drug's benefits outweigh the risks and the current warnings in the Chantix label are appropriate." These warnings include changes in behavior, hostility, agitation, depressed mood, and suicidal thoughts or actions, as well as serious skin reactions and heart and blood vessel

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

[17] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. Summer 2000. http:\\tc.bmjjournals.com.

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

problems. Nevertheless the FDA said on October 24, 2011 that it will continue to evaluate the risk of mood changes and other psychiatric events associated with its use. In March 2013, researchers at the University of Texas M.D. Anderson Cancer Center reported a better quitting experience with varenicline than other treatments. In September 2013 researchers in a Pfizer sponsored study concluded that the drug does help some patients with depression or mood disorders to quit smoking without worsening symptoms of depression or anxiety. Also, in October 2013 researchers at the University of Bristol reported in the British Medical Journal that cessation drugs do not increase suicide risk.

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

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

Several new drugs may also appear on the market in the near future. In 2005, Cytos Biotechnology AG announced the successful completion of Phase II testing of a virus-based vaccine, genetically engineered to attract an immune system response against nicotine and its effects. In 2007 the company entered into a partnership with Novartis to commercialize the drug, NIC002, but a subsequent Phase II trial was unsuccessful. Novartis though has continued study and commenced a new Phase II trial in November 2011. In 2011 the FDA cleared an Investigational New Drug Application to conduct a Phase II-B trial of X-22, a smoking cessation kit of very low nicotine cigarettes made by the 22nd Century Group. In 2012, a team from Weill Cornell Medical College reported the development of an anti-nicotine vaccine using a genetically engineered virus. The vaccine was successful in test with mice, though it will take several years before it can be tested in humans. It is expected that products such as these and others will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. Our forecast includes a strong negative trend in smoking rates which incorporates the influence of these factors.

Further aiding sales of these products is the decision by 45 state Medicaid programs to offer cessation benefits to Medicaid beneficiaries. And at least ten states (California, Colorado, Maryland, New Jersey, New Mexico, New York, North Dakota, Oregon, Rhode Island, and Vermont) have established minimum standards for private insurance coverage of cessation products and services. Most recently, in October 2010, Medicare coverage was expanded to provide cessation counseling to seniors without tobacco-related disease.

Electronic Cigarettes

Electronic cigarettes have also gained in popularity in recent years. NJOY, Vapor, Logic, and Blu, are marketing and advertising extensively across the US. Sales in 2013 have been estimated to be as much as $1.5 billion, and increasing rapidly. The CDC in

February 2013 reported survey results that indicate 6.2% of the adult population, and 21% of smokers, had tried e-cigarettes at some time. These were roughly double estimates in 2010. Lorillard acquired Blu Ecigs in 2012, Reynolds has tested an e-cigarette, Vuse, and Altria announced in 2013 that it would introduce a product later in the year.

They are, on one hand, alternatives to cigarettes as smokers cope with indoor bans, but also cessation devices whose nicotine content can be controlled. In 2010 the U.S. Court of Appeals for the District of Columbia Circuit ruled that the FDA could not regulate electronic cigarettes as a drug, rather it must regulate them as tobacco products. It is unclear what actions the FDA may take towards electronic cigarettes in the future. Their role though in smoking, and smoking cessation, is ambiguous. On the one hand they can be used as a cessation device weaning a smoker away from cigarettes. In this case, as a substitute for cigarettes, they result in lower cigarette consumption. On the other hand, they can, in the presence of indoor smoking bans, allow smokers to maintain a nicotine habit or addiction, offsetting some of the ban's effectiveness in reducing smoking and consumption of cigarettes. In this case electronic cigarettes are complements to cigarettes. Indoor smoking restrictions have reduced the consumption of cigarettes and created a demand for electronic cigarettes. But electronic cigarettes themselves do not further reduce consumption except to the extent that they are substitutes for cigarette usage. Nevertheless, a 2013 study in the United Kingdom found that 76% of e-cigarette users said they started using their devices to replace cigarettes entirely. And results of a trial in Italy, published by the journal Plos One in June 2013, found that 8.7% of electronic cigarette users stopped smoking cigarettes. In September 2013, The Lancet published a New Zealand study which concluded that smoking cessation attempts using e-cigarettes were at least as effective as those using nicotine patches. (In a sample the quit rate after six months with e-cigarettes was 7.3%, versus 5.8% with patches).

The American Legacy Foundation conducted a 2013 survey which found, as part of the 41% of smokers who intended to quit smoking in 2014, 12% planned to switch to e-cigs. A Centers for Disease Control and Prevention study published in the November 15th issue of Morbidity and Mortality Weekly Report says that according to data from the National Youth Tobacco Survey of middle school and high school students in the US, e-cig use among middle school students increased from 0.6% in 2011 to 1.1% in 2012. Among high school students the prevalence increased from 1.5% in 2011 to 2.8% in 2012. In October 2013 a study at the University of Oklahoma Health Science Center concluded that e-cigarettes do not appear to entice teens to try smoking tobacco.

For the consumer, e-cigs are a less expensive alternative as they are not taxed as cigarettes. (Minnesota has imposed a 95% tax on the wholesale cost however.) A cartridge and battery for an electronic cigarette would cost less than half as much as an equivalent pack of cigarettes in a average tax state.

Researchers have reported several safety concerns with the products, including concerns on the variability in delivered nicotine content. The U.S. Department of Transportation is proposing a ban on electronic cigarettes on all flights to and from the U.S., a prohibition already enacted by Amtrak on its trains. The states of North Dakota, New Jersey, and Utah prohibit e-cigarette use in workplaces, restaurants, and bars. Arkansas, Colorado, Delaware, New Hampshire, Oklahoma, and Oregon restrict e-cig use at state workplaces and school grounds. And there are, based on data from the ANRF, e-cigarette restrictions at indoor smokefree venues in 108 localities in the US. In January 2014, Chicago, IL extended its public places smoking ban to include e-cigs, and the City Council in Los Angeles, CA is considering a similar measure. A South Dakota Senate Committee on February 24th sent to the full Senate a bill that would classify e-cigs containing nicotine as tobacco products that cannot be sold to or used by anyone aged below 18. In September 2013 forty state attorneys general sent a letter to the Food and Drug Administration (FDA) urging the agency to regulate electronic cigarettes in the same way it regulates tobacco products.

In August 2013 the Consumer Advocates for Smoke-free Alternatives Association released a study it funded by the Drexel University School of Public Health. It found that chemicals in electronic cigarettes (e-cigarettes) pose no health concern for users or bystanders.

Workplace Restrictions

In their 1996 study on the effect of workplace smoking bans on cigarette consumption, Evans, Farrelly, and Montgomery found that between 1986 and 1993 smoking participation rates among workers fell 2.6% more than non-workers.[19] Their results suggest that workplace smoking bans reduce smoking prevalence by five percentage points and reduce consumption by smokers nearly 10%. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day a smoker spent working in a smoking restricted environment, the greater the decline in the quantity of cigarettes that smoker consumed.

Factors Affecting Cigarette Consumption

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

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

Price Elasticity of Demand. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5. Based on Global Insight's multivariate regression analysis using U.S. data from 1965 to 2012, the long-run price elasticity of consumption for the entire population is -0.33; a 1.0% increase in the price of cigarettes decreases consumption by 0.33%.

In 1998, the average price of a pack of cigarettes in the U.S. in nominal terms was $2.20. This increased to $2.88 per pack in 1999, representing a nominal growth in the price of cigarettes of 30.9% from 1998. During 1999, consumption declined by 6.45%. This was primarily due to a $0.45 per pack increase in November 1998 which was intended to offset the costs of the MSA and agreements with previously settled states.

Over the next several years the cigarette manufacturers continued to increase wholesale prices, and state excise taxes rose dramatically across the nation. By 2008 the weighted average state excise tax was $1.23 per pack and cigarette prices averaged $5 per pack.

The 2008-2009 recession and its stress on state budget revenues prompted acceleration in excise tax increases, as sixteen states increased taxes, resulting in an average tax of $1.34 at the end of 2009. In 2010, Hawaii, New Mexico, New York, South Carolina, Utah, and Washington, raised taxes. In 2011, excise tax increases went into effect in Connecticut, again in Hawaii, and in Vermont. In 2012, Illinois, by $1.00 per pack, and Rhode Island, by $0.04 per pack, raised cigarette excise taxes.

In 2013, Cook County, Illinois increased its cigarette excise tax by $1.00 per pack, and in November Chicago increased its excise tax by $0.50 to push city, county, and state taxes in Chicago to $7.17 per pack. Also in 2013, cigarette excise tax increases were enacted in Minnesota, by $1.60 per pack, Massachusetts, by $1.00 per pack, Oregon, by $0.13 per pack effective January 1, 2014, and in New Hampshire, by $0.10 per pack. The average state tax rate is currently $1.53. Puerto Rico also enacted plans to increase its excise taxes over the next two years. A group in California is backing a 2014 ballot initiative to add $1.00 per pack to the state excise tax. A similar ballot initiative was unsuccessful at the polls in 2012. Nevertheless, in May 2013, two California Senate committees recommended a bill to raise the state excise by $1.95 per pack. In November 2013 New York City passed an ordinance that set a minimum retail price of a pack of cigarettes at $10.50, and prohibited the use of coupons and promotions to discount that price. Tobacco companies and retail trade groups asked a Federal court in January to block the law.

The federal excise tax had remained constant, at $0.39 per pack, from 2002 until 2009 when the U.S. Congress adopted legislation which raised the tax by $0.62, to $1.01, effective April 1, 2009. As a result the total state and federal excise tax now equals $2.47 on average in the U.S. In 2011 a U.S. senate bill was sponsored by 14 Democrats and would have raised the excise tax to $2.01 per pack, but it was not successful. On January 22, 2013 Senator Tom Harkin introduced legislation, the Healthy Lifestyles and Prevention America Act, which would double the Federal excise tax on cigarettes and roll-your-own tobacco and increase the tax on smokeless tobacco products. President

Obama's 2015 federal budget proposal includes an increase in the Federal Excise Tax to $1.95 per pack, and indexes the rate to inflation.

Purchases of roll-your-own cigarette tobacco were discouraged by 2009 legislation, as its excise tax was raised substantially. But the excise tax changes also had the effect of encouraging the use of pipe tobacco, combined with the availability of roll-your-own machines to circumvent the higher excise taxes. Legislation introduced by Senator Richard Durbin on January 31, 2013, the Tobacco Tax Equity Act, would similarly equalize Federal excise tax rates on all tobacco products.

During much of the period following the MSA, the major manufacturers refrained from wholesale price increases, and also actively pursued extensive promotional and dealer and retailer discounting programs which served to hold down retail prices. They did this in part due to the state tax increases, but primarily to maintain their market share from its erosion by a deep discount segment which grew rapidly following the MSA. The major manufacturers were finally successful in stemming the increase in the deep discount market share, which stabilized in 2004. The major manufacturers have raised prices or reduced discounts and promotions in each year since 2004. The average price, including excise taxes in January 2014 was $7.36 per pack.

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Over the longer term our forecast expects price increases to continue to exceed the general rate of inflation due to increases in the manufacturers' prices as well as further increases in excise taxes. In December 2012 R.J. Reynolds and Philip Morris USA announced list price increases of 6 cents per pack. This followed June increases of 6 cents, and of 8 cents per pack by Lorillard. In June 2013 Philip Morris USA reduced promotional allowances on Marlboro and L&M cigarettes by 6 cents per pack. And on November 25, Philip Morris USA announced that on December 1, 2013 it would reduce promotional allowances and raise prices by seven cents per pack.

Premium brands are typically $0.50 to $1.00 more expensive per pack than discount brands, allowing a margin for consumers to switch to less costly discount brands in the event of price increases. The increasing availability of cigarette outlets on Indian reservations, where some sales are typically exempt from taxes, provides another opportunity for consumers to reduce the cost of smoking. Similarly, Internet sales of cigarettes grew rapidly, though credit card companies and shippers including the U.S. Postal Service have now put significant restrictions on shipping of cigarettes, and the federal government has enacted the Prevent All Cigarette Trafficking ("PACT") Act which requires the collection of all applicable taxes on Internet and mail-order cigarette shipments. Under the MSA volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped. The availability of lower price alternatives lessens the negative impact of price increases on cigarette volume, but it may negatively impact MSA receipts.

Changes in Disposable Income. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found cigarette consumption in the United States increases as disposable income increases.[20] However, a few studies found cigarette consumption decreases as disposable income increases.[21] Based on our multivariate regression analysis the income elasticity of consumption is 0.27; a 1.0% increase in real disposable income per capita increases per capita cigarette consumption by 0.27%. In normal periods of economic growth this factor contributes a positive impact to cigarette demand, offsetting some of the negative impacts previously discussed. However, with the recession of 2008-2009 this factor also impacted cigarette demand and consumption in a negative way.

Youth Consumption. The number of teenagers who smoke is another likely determinant of future adult consumption. While this variable has been largely ignored in empirical studies of cigarette consumption,[22] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[23] One study examines the effects of youth smoking on future adult smoking.[24] The study found that between 25% and 50% of any increase or decrease in youth smoking would persist into adulthood. According to the study, several factors may alter future correlation between youth and adult smoking: there are better means for quitting smoking than in the past, and there are more workplace bans in effect that those who are currently in their teen years will face as they age.

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

In 2012, the Surgeon General issued a report, "Preventing Tobacco Use among Youth and Young Adults". Among its major conclusions were, 1) that prevention efforts must focus on both adolescents and young adults, 2) that advertising and promotional activities by tobacco companies have been shown to cause the onset and continuation of smoking among youth, 3) that after years of steady progress, declines in tobacco use by the young have slowed, and 4) that coordinated, multi-component interventions that combine mass media campaigns, price increases, school-based programs, and community wide smoke-free policies and norms are effective in reducing tobacco use. Also in 2012 the CDC produced a mass-media advertising campaign featuring graphic descriptions of the adverse health effects of smoking. In August 2012 the CDC declared the campaign a major success, as the agency concluded that the ads helped to double the amount of calls to their telephone quit line. A new CDC campaign, with graphic adverse health images began in March 2013, and in September 2013 the CDC announced survey results which concluded that cessation attempts increased from 31.1% to 34.8% of smokers who had seen the graphic ads, which the CDC extrapolated to 100,000 sustained quitters,

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[20] Ippolito, et al.; Fuji.
[21] Wasserman, et al.; Townsend et al.
[22] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.
[23] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."
[24] *Source*: Gruber, Jonathon and Zinman, Jonathon. "Youth Smoking in the U.S.:Evidence and Implications". Working Paper No. W7780, National Bureau of Economic Research, 2000.

approximately 0.25% of US smokers. In November 2013 the journal Tobacco Control published research from the University of Illinois at Chicago which concluded that the FDA has underestimated the impact of graphic labels. Examining the experience in Canada the researchers concluded that graphic warning labels reduced smoking rates in Canada by 3% to 5%.

Trend Over Time. Since 1964 there has been a significant decline in adult per capita cigarette consumption. The Surgeon General's health warning (1964) and numerous subsequent health warnings, together with the increased health awareness of the population over the past thirty years, may have contributed to decreases in cigarette consumption levels. If, as we assume, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. Our analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables, which are difficult to quantify.

Health Warnings. Categorical variables also have been used to capture the effect of different time periods on cigarette consumption. For example, some researchers have identified the United States Surgeon General's Report in 1964 and subsequent mandatory health warnings on cigarette packages as turning points in public attitudes and knowledge of the health effects of smoking. The Cigarette Labeling and Advertising Act of 1965 required a health warning to be placed on all cigarette packages sold in the United States beginning January 1, 1966. The Public Health Smoking Act of 1969 required all cigarette packages sold in the United States to carry an updated version of the warning, stating that it was a Surgeon General's warning, beginning November 1, 1970. The Comprehensive Smoking Education Act of 1984 led to even more specific health warnings on cigarette packages. The Family Smoking Prevention and Tobacco Control Act ("FSPTCA") requires that cigarette packages have larger and more visible graphic health warnings. Regulations that were to go into effect in September 2012 mandated that a series of nine graphic health warnings must appear on the upper portion of the front and rear panels of each cigarette package and comprise at least the top 50 percent of these panels. Five manufacturers challenged the implementation of these new warnings on First Amendment grounds, and on November 7, 2011 a federal judge issued a preliminary injunction blocking the FDA requirement. The judge ruled that the labels were not factual, but rather, "…calculated to provoke the viewer to quit…." In 2012 a federal judge in Washington blocked the new requirement, while an appeals court in Ohio ruled to uphold parts of the Act. In March 2013 the Attorney General decided not to ask the U.S. Supreme Court to review the case. Instead the FDA announced on March 19, 2013 that it would undertake research to support new rulemaking. On April 22, 2013 the Supreme Court upheld the provisions of the 2009 law, allowing the FDA to develop and implement new graphic warning labels.

At least six states, Alabama, Georgia, Idaho, Kentucky, South Carolina, and West Virginia, charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. Several large corporations, including

Meijer Inc., Gannett Co., American Financial Group Inc., Bank One, JP Morgan Chase, PepsiCo Inc., Northwest Airlines, Safeway, Tribune Co., and Whirlpool, are now charging smokers higher premiums.

Smoking Bans in Public Places. Beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. In September 2003 Alabama joined the other 49 states and the District of Columbia in requiring smoke-free indoor air to some degree or in some public places.[25]

The most comprehensive bans, extending to restaurants and bars, have been enacted since 1998 in 39 states and a number of large cities. Restrictions to all workplaces, restaurants, and bars cover 49.1% of the U.S, according to the American Nonsmokers' Rights Foundation ("ANRF"). In 2012 North Dakota became the most recent state to adopt these bans in public places.

The ANRF documents clean indoor air ordinances by local governments throughout the U.S. As of January 2, 2013, there were 3,964 municipalities with indoor smoking restrictions. Of these, 867 local governments required non-hospitality workplaces to be 100% smoke-free while 901 governments required 100% smoke-free conditions in restaurants, and 771 required the same for bars. The number of such ordinances has grown rapidly in the past two decades. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars.[26]

Based on the regression analysis using data from 1965 to 2013, the restrictions on workplace smoking that proliferated in the 1980s appear to have an independent effect on per capita cigarette consumption. We estimate that the restrictions instituted beginning in the late 1970s have reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. Bauer, et al. estimates that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[27] Research in Canada, by the Ontario Tobacco Research Unit, concludes that consumption drops in workplaces where smoking is banned, by almost five cigarettes per person per day. Tauras, in a study based on a large survey of smokers, found that the more restrictive smoke-free air laws decrease average smoking, but have little influence on prevalence.[28] The study predicts that moving from no smoking restrictions at all to the most restrictive bans reduces average smoking from 5% to 8%.

The extension of the indoor bans to restaurants and bars in the last decade began largely in the Northeast and did not appear, in our econometric analysis, to have a significant independent impact on smoking there. However, with data available from later in the

[25] *Source*: American Lung Association. "State Legislated Actions on Tobacco Issues". 2002.
[26] *Source:* American Nonsmokers' Rights Foundation. http://www.no-smoke.org. July 2013.
[27] Bauer, Hyland, Li, Steger, and Cummings. "A Longitudinal Assessment of the Impact of Smoke-Free Worksite Policies on Tobacco Use". American Journal of Public Health. June 2005
[28] Tauras, John A. "Smoke-Free Air Laws, Cigarette Prices, and Adult Cigarette Demand" Economic Inquiry, April 2006.

decade across a wider geography, econometric analysis reveals that the bans did have a significant impact and we have added a variable quantifying the effect in our consumption model.

The first extensive outdoor smoking restrictions were instituted in March 2006 in Calabasas, California. The cities of Los Angeles and Oakland, Contra Costa County, and the California municipalities of Belmont, Beverly Hills, Campbell, Concord, Dublin, El Cajon, Emeryville, Hayward, Loma Linda, Santa Cruz, Santa Monica, and Walnut Creek have also established extensive outdoor restrictions, as have Davis County and the City of Murray in Utah. In 2007, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. They are now among 143 municipalities which have banned smoking on beaches, and 707 who have banned smoking in municipal parks. In 2011 the New York City Council approved a bill to ban smoking in all city parks, beaches and pedestrian plazas. That ban went into effect on May 23, 2011. According to ANRF, as of January 2014, 901 municipalities prohibit smoking in city parks, and 170 municipalities mandate smoke-free city beaches. In January 2014 a smoking ban went into effect in Boston's parks, and on Hawaii's beaches.

Additional restrictions are being placed in residential units as well. First, many hotels, including the Marriott, Sheraton, and Westin chains have adopted completely smoke-free room standards. And multi-family residential buildings have been increasingly subject to restrictions, beginning in 2008 in the California cities of Belmont and Calabasas, which have approved ordinances which restrict smoking anywhere in the city except for single-family detached homes. Alameda, Oakland, Pasadena, Santa Monica, and Thousand Oaks are among eight other California cities with such extensive bans. In September 2011 Sonoma County imposed a similar ban, effective June 2012. In August 2011 the California Legislature passed legislation enabling landlords to ban smoking in residential rental units. In June 2012, the Towbes Group of Santa Barbara became the largest apartment portfolio, with 2,000 units, to impose a smoking ban. In April 2013 California Assembly Bill 746 was defeated; it would have prohibited smoking in, and within 20 feet of entrances of, condominiums, duplexes, and apartment units throughout the state. A similar bill has also been introduced in Massachusetts.

New York City's first non-smoking apartment building opened in late 2009. Many landlords and condominium associations in California, and in New York City, have also established smoke-free apartment policies. Most recently Related Companies, which manages 40,000 rental units, announced a ban on smoking for all new tenants. In July 2011 the San Antonio Housing Authority announced a ban, effective in January 2012, on smoking in its 6,175 rental units. Similar bans went into effect in 2012 for public housing in Boston and Minneapolis.

New Jersey has prohibited smoking in college dormitories since 2005. At least 1,182 colleges nationwide now prohibit smoking everywhere on campus. In 2013 the California and Louisiana state college and university systems have banned tobacco use, joining Arkansas and Oklahoma with no-smoking restrictions at public colleges and universities, and Iowa, which prohibits smoking at all colleges and universities. Twenty-one states have banned smoking, indoors and outdoors, at state prisons. Arkansas, California, Louisiana, Maine, Puerto Rico, Texas, and Rockland County, NY now prohibit smoking in a car where there are children present, and similar legislation has been proposed in Illinois, Maryland, New York, Ohio, Oregon, Utah, Vermont, Virginia, and other states.

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

Smokeless Tobacco Products. Unlike electronic cigarettes, smokeless tobacco products have been available for centuries. As cigarette consumption expanded in the last century, the use of smokeless products declined. Chewing tobacco and snuff are the most significant components. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and potentially spit-free. Chewing tobacco and dry snuff consumption had been declining in the U.S. into this century, but moist snuff consumption has increased at an annual rate of more than 5% since 2002. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST (purchased by Altria in 2009), was the largest producer of moist smokeless tobacco, and explicitly targeted adult smoker conversion in its growth strategy over the last decade. As with e-cigarettes, the leading cigarette manufacturers soon themselves added smokeless products, responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. Philip Morris USA now markets Marlboro Snus which has experienced sales growth of over 6% annually into 2012, and Reynolds American has enjoyed similar gains with one of its smokeless products, Camel Snus.

In 2011, according to SAMHSA's National Survey on Drug Use & Health, 3.2% of adults used smokeless tobacco products. And young adults were twice as likely to use smokeless products. A Massachusetts survey in 2011 found that 29% of male smokers aged 18-24 in snus test markets had tried snus products.

Advocates of the use of snuff as part of a harm reduction strategy point to Sweden, where "snus", a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men.[29] The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. A May 2008 study using data from the 2000 National Health Interview Survey reports that U.S. men who used smokeless tobacco as a smoking cessation method achieved significantly higher quit rates than those who used other cessation aids.[30] A 2010 study concluded however that young males who used smokeless tobacco products were more likely to be concurrent smokers.[31] Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[32] and the American Medical Association[33] (AMA) both conclude that nicotine is an addictive drug that produces dependence. The American Psychiatric Association has determined that cigarette smoking causes nicotine dependence in smokers and nicotine withdrawal in those who stop smoking. The American Medical Association Council on Scientific Affairs found that one-third to one-half of all people who experiment with smoking become smokers.

Regulation. Since June 22, 2009 when President Obama signed the FSPTCA, the FDA has had broad authority over the sale, distribution, and advertising of tobacco products. Such legislation significantly restricts tobacco marketing and sales to youth, requires the disclosure of cigarette ingredients, bigger and bolder health warnings, and bans labels thought to be deceptive, such as "light", and "low-tar" from cigarettes.

A significant issue before the FDA is the role of menthol cigarettes. It has been argued that menthol flavoring serves as an inducement to youth smoking and that its prevalence is especially high among minority groups, raising a call for a ban on its manufacture and sale. The FDA has established a working group to study the issue. Menthol cigarette sales represent approximately 30% of total cigarette sales. Moreover, menthol smoking rates have increased among young adults during the past decade. In September 2012 the American Journal of Public Health published the first peer-reviewed data on menthol smokers. It reported the results of a national survey of those smokers showing that nearly 40% of menthol smokers say they would quit smoking if menthol cigarettes were no longer available. While an outright ban would no doubt prompt a significant number of these smokers to switch to other brands, any significant amount of quitting as a result

[29] Foulds, Ramstrom, Burke, and Fagerstrom. "Effect of Smokeless Tobacco (Snus) on Smoking and Public Health in Sweden". Tobacco Control. Vol. 12, 2003.
[30] Rodu and Phillips, "Switching to Smokeless Tobacco as a Smoking Cessation Method: Evidence form the 2000 National Health Interview Survey". Harm Reduction Journal. 23 May 2008.
[31] Tomar, Alpert, and Connolly, "Patterns of Dual Use of Cigarettes and Smokeless Tobacco among US Males: Findings from National Surveys". Tobacco Control. 11 December 2009.
[32] *Source:* Surgeon General's 1988 Report, "The Health Consequences of Smoking – Nicotine Addiction".
[33] *Source*: Council on Scientific Affairs, "Reducing the Addictiveness of Cigarettes," Report to the AMA House of Delegates, June 1998.

would have a large negative effect on total consumption and sales. This survey suggests that the effect might be as large as a 12% reduction in cigarette consumption.

The FDA, in July 2013, released its review, "Preliminary Scientific Evaluation of the Possible Public Health Effects of Menthol Versus Nonmenthol Cigarettes". It concluded that menthol in cigarettes is likely to be associated with, first, altered physiological responses to tobacco smoke, second, increased dependence, third, reduced success in smoking cessation, and fourth, increased smoking initiation by youth. Though the report did not constitute a decision about regulatory action, the FDA did conclude that it is likely that menthol cigarettes pose a public health risk above that seen with nonmenthol cigarettes. In August 2013 the American Academy of Family Physicians advocated a menthol ban in an open letter to the Food and Drug Administration. And in November 2013 twenty-five state attorneys general asked U.S. public health regulators to ban menthol cigarettes.

In 2011 the FDA's Tobacco Products Scientific Advisory Committee ("TPSAC") determined that menthol use is most prevalent among younger smokers, and among African Americans. It concludes that the availability of menthol cigarettes more likely than not: 1.) increases experimentation and regular smoking, 2.) increases the likelihood and degree of addiction in youth smokers and, 3.) results in lower likelihood of smoking cessation success in African Americans. TPSAC continues to study the issue in 2014. The FDA submitted a draft report of its independent review of research related to the effects of menthol in cigarettes on public health, if any, to an external peer review panel in July 2011, adding that after peer review, the results and the preliminary scientific assessment will be available for public comment in the Federal Register. In addition TPSAC has initiated discussions on the nature and impact of dissolvable tobacco products on public health.

Whether FDA regulation will result in a significantly faster rate of decline of smoking in the U.S. cannot be determined at this time. But it clearly does have that potential if regulators take an aggressive and effective approach towards that goal. One of the most profound actions it is empowered to take is to mandate the reduction of nicotine levels in cigarettes. It will surely study the issue, perhaps opting to phase out nicotine, the addictive factor in cigarettes over some time period. The smaller manufacturers believe, on the other hand, that FDA regulation will strengthen the role of the major producers, as it raises costs of compliance and narrows price gaps of discount cigarettes. In October 2011, the FDA and the U.S. National Institutes of Health announced a national study of the effects of new tobacco regulation on smokers. The study will examine, by following more than 40,000 smokers, susceptibility to tobacco use, use patterns, resulting health problems, and will evaluate how regulations affect tobacco-related attitudes and behaviors. In January 2013 a state legislator in Oregon took an unprecedented step in cigarette regulation by introducing a bill which would make nicotine a controlled substance, requiring a doctor's prescription.

Research has indicated, and our model incorporates, a negative impact on cigarette consumption due to tobacco tax increases, and a negative trend decline in levels of smoking since the Surgeon General's 1964 warning, subsequent anti-smoking initiatives, and regulations which restrict smoking. Our model and forecast acknowledges the efficacy of these activities in reducing smoking and assumes that the effectiveness of such anti-smoking efforts will continue. For instance, in 2001, Canada required cigarette labels to include large graphic depictions of adverse health consequences of smoking. Recent research suggests that these warnings have some effectiveness, as one-fifth of the participants in a survey reported smoking less as a result of the labels.[34] More recent survey research has found that smokers were more likely to say they wanted to quit after having seen such graphic images. As the prevalence of smoking declines, it is likely that the achievement of further declines will require either a greater level of spending, or more effective programs. This is the common economic principle of diminishing returns**.**

An Empirical Model of Cigarette Consumption

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

1) the real price of cigarettes
2) the level of real disposable income per capita
3) the impact of restrictions on smoking in public places
4) the trend over time in individual behavior and preferences

We used the tools of standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the U.S. Then, using that relationship, along with IHS Global Insight's standard population growth forecast, we projected actual cigarette consumption (in billions of cigarettes) out to 2041. It should also be noted that since our entire dataset incorporates the effect of the Surgeon General's health warning (1964), the impact of that variable too is accounted for in the forecast. Similarly the effect of nicotine dependence is incorporated into our entire dataset and influences the trend decline.

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

Using U.S. data from 1965 through 2013 on the variables described above, we developed the following regression equation.

log (per capita consumption) = 54.1

- 0.024 * trend

- 0.223 * log (cigarette price)

- 0.104 * log (cigarette price last year)

+ 0.274 * log (per capita disposable income)

- 0.001 * percentage of U.S. with strong indoor smoking ban

- 0.002 * percentage of U.S. with strong indoor smoking ban last year.

This model has an R-square in excess of 0.99, meaning that it explains more than 99 percent of the variation in U.S. adult per capita cigarette consumption over the 1965 to 2012 period. In terms of explanatory power this indicates a very strong model with a high level of statistical significance.

According to the regression equation specified above, cigarette consumption per capita (CPC) displays a trend decline of 2.4% per year. The trend reflects the impact of a systematic change in the underlying data that is **not** explained by the included explanatory variables. In the case of cigarette consumption, the systematic change is in public attitudes toward smoking. The trend may also reflect the cumulative impact of health warnings, advertising restrictions, and other variables which are statistically insignificant when viewed in isolation. Some of the impact of the availability of e-cigarettes may be captured here, though it is also captured in the indoor smoking ban terms. This trend, primarily due to an increase in the health-conscious proportion of the population averse to smoking, would by itself account for 90.3% of the variation in consumption. This coefficient is estimated such that a statistical confidence interval of 95% for its value is from 0.0195 to 0.0269 (1.95% to 2.69%). This implies that there is a probability of 5% that the trend rate of decline is outside this range.

Forecast Assumptions

Our forecast is based on assumptions regarding the future path of the explanatory variables in the regression equation. Projections of U.S. population and real per capita personal disposable income are standard IHS Global Insight forecasts. Annual population growth is projected to average 0.7%, and real per capita personal disposable income is projected to increase over the long term at just over 2.1% per year.

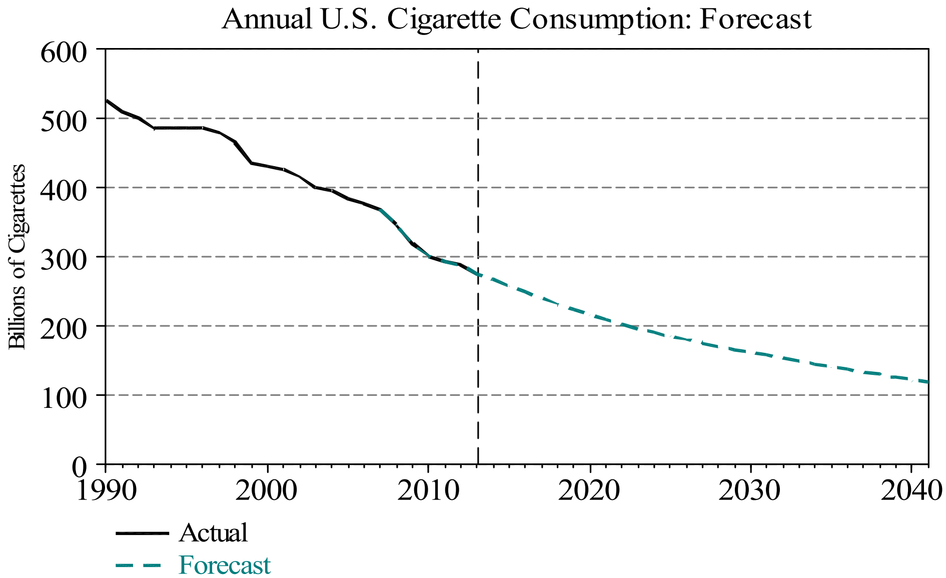
The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the MSA and other state settlement agreements and subsequent excise tax increases. Cigarette prices increased dramatically in November 1998, as manufacturers raised prices by $0.45 per pack. Subsequent increases by the manufacturers and numerous federal and state hikes in excise taxes brought prices to an average of $3.84 per pack in 2004, to $4.04 in 2005, to $4.18 in 2006, $4.47 in 2007, $4.75 in 2008, and to $5.99 in 2009, $6.62 in 2010, $6.85 in 2011,$7.00 in 2012, and $7.19 in 2013 following federal and state tax increases. Our forecast assumptions have incorporated price increases in excess of general inflation to offset excise and other taxes. Relative to other goods, cigarette prices will rise by an average of 1.9% per year over the long term. The average real increase over the 30 years ending 1998 was 1.48% per year.

President Obama's 2015 federal budget proposal includes an increase in the Federal Excise Tax to $1.95 per pack. Our model predicts that, if enacted, the tax increase would reduce cigarette consumption by an additional 4.6%, resulting in a total decline of approximately 8% in the first year after enactment.

In addition, we assume that the prevalence of indoor and outdoor restrictions on smoking will continue to increase. It is assumed that by 2020 100% of states and municipalities will completely restrict smoking in workplaces, restaurants and bars. At the same time, outdoor and residential restrictions will proliferate over this, and the following decades. These bans are assumed to be as effective in reducing smoking as the indoor bans.

Forecast of Cigarette Consumption

The graph below illustrates total actual and projected cigarette consumption in the United States.



In addition to the expected trend decline in cigarette consumption, the sharp upward shock to cigarette prices in late 1998 and 1999 contributed to a 6.5% reduction in consumption in 1999. The rate of decline moderated considerably in the following years, averaging 2.1% from 1999 to 2007, before accelerating sharply in 2008.

The economic downturn in the US in 2008 turned into the deepest since the 1930s, with sharply negative effects on household disposable income. At the same time a rapid increase in gasoline and energy prices significantly reduced the discretionary spending of consumers. In addition, cigarette price increases continued, the federal excise tax was raised dramatically, and indoor smoking bans continued to proliferate. Consumption fell by nearly 4% in 2008 and by over 9% in 2009. Cigarette shipment declines moderated after 2010, and in 2012 the rate of decline was slightly less than 2%. (Roll-your-own tobacco had represented as much as 3% of tobacco volume under the MSA, but has declined in volume by over 70% since 2008, after federal excise taxes were substantially increased.)

In 2013, shipments reported by MSAI were 4.6% lower than a year ago. Through November the TTB reports shipments 4.5% lower than the comparable period in 2012.

Weak per capita disposable income growth was responsible for part of the decline. In addition the manufacturers report that wholesale inventories declined by 1.4 billion sticks during the year. For 2014 we project a consumption decline of 3.4%, as economic growth accelerates. The decline in wholesale shipments of cigarettes will be somewhat less however, 2.9%, as inventories are expected to be rebuilt by 1.4 billion sticks to offset the 2013 decline.

Over the longer term our model includes estimates of the negative impact of indoor smoking bans, which we anticipate will ultimately be enacted in all states. For instance, in 2011 legislation to establish indoor bans in Texas and Louisiana made significant advances before being defeated. We also assume that stringent restrictions on smoking will continue to be enacted, including their gradual extension to outdoor public places, as well as to private indoor residential spaces such as in multi-family housing.

From 2013 through 2041 the average annual rate of decline is projected to be 3.0%.

Forecast U.S. Consumption of Cigarettes

	Total Consumption	Decline Rate	Consumption including Roll-Your-Own	Decline Rate
	(billions)	*(%)*	*(billions)*	*(%)*
2009	318.7	-8.1%	325.0	-9.1%
2010	300.8	-5.6%	304.1	-6.4%
2011	293.3	-2.5%	296.0	-2.7%
2012	287.9	-1.9%	290.1	-2.0%
2013	274.6	-4.6%	276.7	-4.6%
		FORECAST		
2014	266.6	-2.9%	268.7	-2.9%
2015	257.5	-3.4%	259.5	-3.4%
2016	248.5	-3.5%	250.4	-3.5%
2017	239.6	-3.6%	241.5	-3.6%
2018	231.1	-3.6%	232.8	-3.6%
2019	223.0	-3.5%	224.7	-3.5%
2020	215.5	-3.4%	217.2	-3.4%
2021	208.4	-3.3%	210.0	-3.3%
2022	201.9	-3.1%	203.4	-3.1%
2023	195.8	-3.0%	197.3	-3.0%
2024	190.1	-2.9%	191.6	-2.9%
2025	184.9	-2.8%	186.3	-2.8%
2026	179.9	-2.7%	181.2	-2.7%
2027	175.1	-2.7%	176.4	-2.7%
2028	170.4	-2.7%	171.7	-2.7%
2029	165.8	-2.7%	167.1	-2.7%
2030	161.4	-2.7%	162.6	-2.7%
2031	157.1	-2.7%	158.3	-2.7%
2032	152.9	-2.7%	154.0	-2.7%
2033	148.6	-2.7%	149.8	-2.7%
2034	144.5	-2.8%	145.7	-2.8%
2035	140.5	-2.8%	141.6	-2.8%
2036	136.6	-2.8%	137.6	-2.8%
2037	132.7	-2.8%	133.8	-2.8%
2038	129.0	-2.8%	130.0	-2.8%
2039	125.2	-2.9%	126.2	-2.9%
2040	121.6	-2.9%	122.5	-2.9%
2041	118.1	-2.9%	119.0	-2.9%

Comparison With Prior Forecasts

In January 2007 IHS Global, then Global Insight presented a similar study, "A Forecast of U.S. Cigarette Consumption (2011-2041) for the Tobacco Settlement Financing Corporation." That report projected consumption in 2041 of 199.4 billion cigarettes, reflecting an average decline rate of 1.8%. The current forecast projects an average decline rate of 3.0% through 2041, to an annual consumption level of 118.1 billion sticks. The new forecast was developed with consideration of the large federal tax increase in 2009 and of the negative effects of the proliferation on smoking ban legislation across the US.

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APPENDIX B

FORM OF OPINION OF
SPECIAL COUNSEL TO THE CORPORATION

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[UPON EXECUTION AND DELIVERY OF THE PLEDGE AGREEMENTS, DECOTIIS, FITZPATRICK & COLE, LLP IS EXPECTED TO RENDER ITS APPROVING LEGAL OPINION IN SUBSTANTIALLY THE FOLLOWING FORM]

[Closing Date]

Tobacco Settlement Financing Corporation
Trenton, New Jersey

Ladies and Gentlemen:

We have acted as Special Counsel to the Tobacco Settlement Financing Corporation (the "Corporation"), a public body corporate and politic and an instrumentality of the State of New Jersey (the “State”) exercising public and essential governmental functions, established in, but not of, the Department of the Treasury, and created by and existing under the Tobacco Settlement Financing Corporation Act, constituting Chapter 32 of the Laws of 2002 of the State (the "Act"). This opinion is rendered in connection with the execution and delivery by the Corporation of (i) the Series 2007-1B Pledge Agreement (the “Series 2007-1B Pledge Agreement”), dated as of March 1, 2014, by and between the Corporation and The Bank of New York Mellon, as Series 2007-1B Pledge Agreement Trustee (the “Series 2007-1B Pledge Agreement Trustee”), relating to the Corporation’s Tobacco Settlement Asset-Backed Bonds, Series 2007-1B First Subordinate Capital Appreciation Bonds (the “Series 2007-1B Bonds”), and (ii) the Series 2007-1C Pledge Agreement (the “Series 2007-1C Pledge Agreement” and, together with the Series 2007-1B Pledge Agreement, the “Pledge Agreements”), dated as of March 1, 2014, by and between the Corporation and The Bank of New York Mellon, as Series 2007-1C Pledge Agreement Trustee (the “Series 2007-1C Pledge Agreement Trustee” and, together with the Series 2007-1B Pledge Agreement Trustee, the “Pledge Agreement Trustees”), relating to the Corporation’s Series 2007-1C Second Subordinate Capital Appreciation Bonds (the “Series 2007-1C Bonds” and together with the Series 2007-1B Bonds, the “Series B and C Bonds”). Capitalized terms used but not defined in this opinion shall have the meanings given to them in the Pledge Agreements or in the Trust Indenture and the Series 2007-1 Supplement, both dated as of January 1, 2007 (collectively, the "Indenture"), by and between the Corporation and The Bank of New York Mellon, as trustee (the "Bond Trustee") pursuant to which the Series B and C Bonds were issued.

The Pledge Agreements are authorized, executed and delivered pursuant to the Act and pursuant to a resolution of the Corporation adopted March 5, 2014 (the "Authorizing Resolution"). Pursuant to the Series 2007-1B Pledge Agreement, the Corporation will pledge 15.99% of the TSRs owned by the Corporation and received by The Bank of New York Mellon, as depository agent (the “Depository Agent”) on and after July 1, 2016 (the “Series 2007-1B Additional Pledged TSRs”) to the Series 2007-1B Bonds to be applied to the optional redemption of the Series 2007-1B Bonds on June 1, 2017 and on each June 1 thereafter until the Series 2007-1B Bonds have been Fully Paid. Pursuant to the Series 2007-1C Pledge Agreement, the Corporation will pledge 7.75% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "Series 2007-1C Additional Pledged TSRs" and collectively with the Series 2007-1B Additional Pledged TSRs, the "Additional Pledged TSRs") to the Series 2007-1C Bonds to be applied to the optional redemption of the Series 2007-1C Bonds on June 1, 2017 and on each June 1 thereafter until the Series 2007-1C Bonds have been Fully Paid.

We have examined the Constitution and laws of the State including, but not limited to, the Act, and a record of proceedings relating to the execution and delivery of the Pledge Agreements. We have also examined executed counterpart originals or copies, certified or otherwise identified to our satisfaction, of the Pledge Agreements, the Amended and Restated Depository Trust Agreement (the "Amended and Restated Depository Trust Agreement"), dated as of March 1, 2014, by and among the State, the Corporation, The Bank of New York Mellon, as Depository Agent (the "Depository Agent"), the Pledge Agreement Trustees and the Bond Trustee, the Assignment Agreement (the "Assignment Agreement") dated as of March 1, 2014, by and between the State and the Corporation, the Second Amended and Restated Residual Certificate, executed by the Corporation (the "Second Amended and Restated Residual Certificate"), dated March 7, 2014, executed by the Corporation and the State and authenticated by the Bond Trustee, and the Supplemental Continuing Disclosure Undertaking (the "Supplemental Disclosure Undertaking" and together with the Pledge Agreements, the Amended and Restated Depository Trust Agreement, the Assignment Agreement, and the Second Amended and Restated Residual Certificate, the "Enhancement Documents"), dated as of March 1, 2014, by and between the Corporation and the Bond Trustee, and such matters of law and other documents, instruments, certifications and agreements as we have deemed necessary or appropriate.

In our examination, we have assumed the legal capacity of all natural persons, the genuineness of all signatures, the authenticity of all documents tendered to us as originals and the conformity to original documents of all documents submitted to us as certified, conformed or photostatic copies.

In rendering the opinion set forth in Section 7 hereof, we have also relied, to the extent we have deemed such reliance proper, on certain representations, certifications of fact, and statements of expectations made by the Corporation and the State with respect to the Series B and C Bonds and the use of the proceeds thereof.

Subject to the foregoing and the limitations set forth below, we are of the opinion that:

1. The Corporation is duly created and established and validly exists under the Act as a public body corporate and politic and an instrumentality of the State exercising public and essential governmental functions, established in, but not of, the Department of the Treasury, with the right and lawful authority and power to enter into the Enhancement Documents.

2. The Authorizing Resolution has been duly and lawfully adopted by the Corporation and is in full force and effect.

3. Each Pledge Agreement constitutes an "ancillary facility" within the meaning of the Act, and each Pledge Agreement creates a valid pledge of, and first-priority lien on, the

Series 2007-1B Additional Pledged Property or Series 2007-1C Additional Pledged Property, as applicable, pledged thereunder (including, without limitation, the Series 2007-1B Additional Pledged TSRs or the Series 2007-1C Additional Pledged TSRs, as applicable). Pursuant to the Act, the lien of such pledge and security interest is valid and binding as against all parties asserting or having claims of any kind in tort, contract or otherwise against the Corporation, irrespective of whether such parties have notice thereof. We direct to your attention that the Pledge Agreements and the Additional Pledged TSRs pledged thereunder are not subject to the lien of the Indenture.

4. The claims of the Series 2007-1B Pledge Agreement Trustee and the Series 2007-1C Pledge Agreement Trustee upon fifteen and ninety-nine one hundredths percent (15.99%) and seven and seventy-five one hundredths percent (7.75%), respectively, of the "state's tobacco receipts" (as defined in the Act), as Series 2007-1B Additional Pledged TSRs and Series 2007-1C Additional Pledged TSRs, respectively, is valid and enforceable.

5. In accordance with the Act, the Pledge Agreements are not a debt or liability of the State or any agency or instrumentality thereof (other than the Corporation as set forth in the Pledge Agreements and the Act), either legal, moral or otherwise, and nothing contained in the Pledge Agreements, the Authorizing Resolution or the Act shall be construed to authorize the Corporation to incur any indebtedness on behalf of or in any way to obligate the State or any political subdivision thereof.

6. Each of the Enhancement Documents has been duly authorized, executed and delivered by the Corporation and, assuming the due authorization, execution and delivery thereof by the other respective parties thereto, constitutes a valid and legally binding agreement of the Corporation enforceable against the Corporation in accordance with its respective terms.

7. The Series B and C Bonds owned by those Bondholders who have paid a portion of the Series 2007-1B Bond Enhancement Premium or the Series 2007-1C Bond Enhancement Premium ("Identified Bondholders") are treated solely for federal income tax purposes as new debt instruments received by such Identified Bondholders on the date of execution and delivery of the Pledge Agreements by the Corporation and receipt by the Corporation of the Bond Enhancement Premium (the "Effective Date") in an exchange to which Section 1001 of the Internal Revenue Code of 1986, as amended (the "Code"), applies. Such Series B and C Bonds are referred to in this paragraph 7 as the "Reissued Bonds." Series B and C Bonds owned by other Bondholders are referred to in this paragraph 7 as the "Non-Reissued Bonds."

The Corporation and the State have covenanted to comply with any continuing requirements that may be necessary to preserve the exclusion from gross income for purposes of federal income taxation of Original Issue Discount (as defined and described below) on the Series B and C Bonds under the Code. Failure to comply with certain requirements of the Code could cause Original Issue Discount on the Series B and C Bonds to be includable in gross income for federal income tax purposes retroactive (a) in the case of the Reissued Bonds, to the Effective Date, and (b) in the case of the Non-Reissued Bonds, to their date of original issuance, in both cases regardless of the date on which such noncompliance occurs or is discovered. In our opinion, assuming continuing compliance by the Corporation and the State with its covenants, under current law, Original Issue Discount on the Series B and C Bonds is not includable in the gross income of the owners thereof for federal income tax purposes and is not an item of tax preference to be included in calculating alternative minimum taxable income under the Code for purposes of the alternative minimum tax imposed with respect to individuals and corporations. Original Issue Discount on the Series B and C Bonds held by corporate taxpayers is included in the relevant income computation for calculation of the federal alternative minimum tax imposed on corporations as a result of the inclusion of Original Issue Discount on the Reissued Bonds in "adjusted current earnings."

We are further of the opinion that the difference between (a) the Accreted Value at maturity of the Series B and C Bonds of each maturity, and (b) their respective “issue prices” within the meaning of the Code constitutes original issue discount (“Original Issue Discount”) which is excluded from gross income for federal income tax purposes. The respective issue prices of the Reissued Bonds are required to be determined as of the Effective Date in accordance with the applicable provisions of the Code and regulations. The respective issue prices of the Non-Reissued Bonds are the initial offering prices to the public (excluding bond houses, brokers or similar persons or organizations acting in the capacity of underwriters or wholesalers) at which prices a substantial amount of such Non-Reissued Bonds of the same maturity was sold upon original issuance of the Non-Reissued Bonds. Further, such Original Issue Discount accrues actuarially on a constant interest rate basis over the term of each Series B and C Bond. The basis (i) of each Reissued Bond held by the Identified Bondholders on the Effective Date, and (ii) of each Non-Reissued Bond acquired upon original issuance, will be increased by the amount of such accrued Original Issue Discount.

No opinion is expressed, however, as to the extent the accrual or receipt of Original Issue Discount on the Series B and C Bonds may otherwise affect the federal income tax liability of or other consequences to the recipients thereof, which will depend on each recipient's particular tax status and other items of income or deduction.

8. Under existing law, interest on and any gain realized on the sale of any Series B and C Bonds is not includable in gross income under the New Jersey Gross Income Tax Act.

Except as stated above, we express no opinion as to any federal, state, local or foreign tax consequences of the ownership or disposition of the Reissued Bonds.

The opinions expressed above with respect to the enforceability of the Pledge Agreements and the other Enhancement Documents are qualified to the extent that we express no opinion as to the effect of, or restrictions or limitations imposed by or resulting from, bankruptcy, insolvency, moratorium, reorganization or other laws, judicial decisions and principles of equity affecting creditors’ rights generally and judicial discretion, and the valid exercise of the sovereign police powers of the State and of the United States of America, and we express no opinion as to the availability of any particular remedy.

This opinion is issued as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any facts or circumstances that may come to our attention after the date of this opinion, or any changes in law or interpretations thereof that may occur after the date of this opinion, or for any reason whatsoever. We also express no opinion on the effect of any action taken after the date hereof or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for federal income tax purposes of interest on the Series B and C Bonds.

This opinion is rendered on the basis of the laws of the State of New Jersey and the applicable laws of the United States of America, as enacted and construed on the date hereof, and we express no opinion as to the laws of any other jurisdiction.

This opinion is furnished to you by us solely for your benefit and may not be used or quoted, in whole or in part, to others nor relied upon by others, without our express prior written consent. Notwithstanding anything to the contrary contained herein, the undersigned acknowledges that this opinion is a government record subject to release under the Open Public Records Act (N.J.S.A. 47:1A 1 et seq.).

Very truly yours,

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APPENDIX C

FORM OF PLEDGE AGREEMENTS

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PLEDGE AGREEMENT

by and between

TOBACCO SETTLEMENT FINANCING CORPORATION

and

THE BANK OF NEW YORK MELLON,
as Series 2007-1B Pledge Agreement Trustee,

Dated as of March 1, 2014

Securing

Tobacco Settlement Asset-Backed Bonds
Series 2007-1B First Subordinate Capital Appreciation Bonds
(Turbo Term Bonds)

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EXHIBIT A – FORM OF OMNIBUS REDEMPTION NOTICE

EXHIBIT B – FORM OF SUPPLEMENTAL REDEMPTION NOTICE

THIS PLEDGE AGREEMENT, dated as of March 1, 2014, (the "Agreement") by and between the TOBACCO SETTLEMENT FINANCING CORPORATION, a body corporate and politic and an instrumentality of The State of New Jersey (the "Corporation"), and THE BANK OF NEW YORK MELLON, a New York State banking corporation organized and existing under the laws of the State of New York and authorized to accept and execute trusts of the character herein set forth under and by virtue of the laws of the State of New Jersey, as Series 2007-1B Pledge Agreement Trustee (the "Trustee").

W I T N E S S E T H:

WHEREAS, the Corporation is a body corporate and politic and an instrumentality of the State of New Jersey (the "State") established in, but not of, the Department of the Treasury exercising public and essential government functions, established pursuant to the Tobacco Settlement Financing Corporation Act, constituting Chapter 32 of the Laws of 2002 of the State (the "Act"); and

WHEREAS, pursuant to a Trust Indenture, as supplemented by a Series 2007 Supplement, both dated as of January 1, 2007 (collectively, the "Indenture"), by and between the Corporation and The Bank of New York Mellon, as trustee (the "Bond Trustee"), the Corporation issued its $3,622,208,081.50 Tobacco Settlement Asset-Backed Bonds, Series 2007-1 (the "Series 2007 Bonds"), consisting of (i) its $3,436,225,000.00 Series 2007-1A Senior Current Interest Serial Bonds and Series 2007-1A Senior Current Interest Turbo Term Bonds (collectively, the "Series 2007-1A Bonds"), (ii) its $126,198,000.00 Series 2007-1B First Subordinate Capital Appreciation Bonds (Turbo Term Bonds) (the "Series 2007-1B Bonds"), and (iii) its $59,785,081.50 Series 2007-1C Second Subordinate Capital Appreciation Bonds (Turbo Term Bonds) (the "Series 2007-1C Bonds"); and

WHEREAS, the Series 2007 Bonds were issued in order to refund the Corporation's then outstanding Tobacco Settlement Asset-Backed Bonds, Series 2002 and Tobacco Settlement Asset-Backed Bonds, Series 2003; and

WHEREAS, the Series 2007 Bonds are secured by and payable from, among other things, all of the Corporation's right, title and interest in the "Pledged TSRs", consisting of 76.26% of the TSRs received by the State under the MSA; and

WHEREAS, the 23.74% of the TSRs owned by the Corporation that are not Pledged TSRs (the "2007 Unpledged TSRs") are not pledged to the payment of the Series 2007 Bonds pursuant to the Indenture and are currently paid upon receipt from time to time to the State as owner of the Residual Certificate; and

WHEREAS, in consideration of the payment of a premium in the aggregate amount of $46,506,899.25 (the "Series 2007-1B Enhancement Premium") by certain holders of the Series 2007-1B Bonds (the "Identified Series 2007-1B Bondholders"), and in order to provide for the early redemption of the Series 2007-1B Bonds in accordance with the terms and provisions of thereof and of this Pledge Agreement, the Corporation has determined to pledge a portion of the 2007 Unpledged TSRs, constituting 15.99% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "Series 2007-1B Additional Pledged TSRs") to the payment of all of the Series 2007-1B Bonds, and to apply the Series 2007-1B Additional Pledged TSRs to the optional redemption of the Series 2007-1B Bonds in accordance with their terms, all subject to the terms and conditions set forth in this Pledge Agreement; and

WHEREAS, the Series 2007-1B Additional Pledged TSRs and the other Series 2007-1B Additional Property (as hereinafter defined) are being pledged exclusively to the Series 2007-1B Bonds pursuant to the Act and pursuant to this Pledge Agreement, and the Series 2007-1B Additional Pledged TSRs and the other Series 2007-1B Additional Property are not Collateral within the meaning of the Indenture and are not subject to the lien of the Indenture; and

WHEREAS, all of the original terms of the Series 2007-1B Bonds will remain exactly the same, notwithstanding execution and delivery of this Pledge Agreement; and

WHEREAS, simultaneously with the execution and delivery of this Pledge Agreement, the Corporation and the Series 2007-1C Pledge Agreement Trustee are entering into the Series 2007-1C Pledge Agreement pursuant to which the Corporation is pledging the Series 2007-1C Additional Pledged TSRs to the payment of the Series 2007-1C Bonds in accordance with the provisions of the Series 2007-1C Pledge Agreement.

NOW THEREFORE, in consideration of the foregoing and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to legally bound, the Corporation and the Trustee hereby agree as follows:

ARTICLE I
DEFINITIONS AND INTERPRETATION

Section 1.01 Definitions. Capitalized terms used but not defined in this Pledge Agreement shall have the meanings given to them in the Indenture. In addition, the following words and terms shall, unless the context otherwise requires, have the following meanings:

“Act” shall have the meaning given to such term in the recitals to this Pledge Agreement.

“Amended and Restated Depository Trust Agreement” means the Amended and Restated Depository Trust Agreement, dated as of March 1, 2014, by and among the Corporation, the State, the Depository Agent, the Bond Trustee, the Trustee and the Series 2007-1C Trustee.

“Applicable Series 2007-1B Bonds to be Redeemed” means, with respect to each Optional Redemption Date, the lesser of (a) Series 2007-1B Bonds in an Aggregate Accreted Value (determined as of such Optional Redemption Date) equal to the maximum amount of Series 2007-1B Bonds that can be redeemed in Authorized Denominations from the balance on deposit in the Series 2007-1B Additional Pledged TSRs Account on the May 1 immediately preceding such Optional Redemption Date, or (b) all of the Series 2007-1B Bonds Outstanding as of such Optional Redemption Date.

“Bond Trustee” means The Bank of New York Mellon, Woodland Park, New Jersey, acting as Trustee under the Indenture, and its successors and assigns thereunder.

“Identified Series 2007-1B Bondholders” shall have the meaning given to such term in the recitals to this Pledge Agreement.

“Depository Agent” means The Bank of New York Mellon, Woodland Park, New Jersey, acting as Depository Agent under the Amended and Restated Depository Agreement, and its successors and assigns thereunder.

"Fully Paid" shall have the meaning given to such term in Section 2.03(b) of the Indenture.

"Omnibus Redemption Notice" means the Omnibus Redemption Notice, in the form attached to this Pledge Agreement as Exhibit A, to be provided by the Corporation to the Bond Trustee in accordance with Section 3.02(a), setting forth the Corporation's election to call the Applicable Series 2007-1B Bonds to be Redeemed for optional redemption on each Optional Redemption Date in accordance with the terms of the Indenture and directing the Bond Trustee to call the Applicable Series 2007-1B Bonds to be Redeemed on each Optional Redemption Date in an aggregate Accreted Value as set forth in the Supplemental Redemption Notice to be provided by the Trustee, in the name of the Corporation, to the Bond Trustee, all as set forth in Section 3.02(b).

"Optional Redemption Date" means June 1, 2017 and each June 1 thereafter until all of the Series 2007-1B Bonds have been Fully Paid.

"Pledged TSRs" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Second Amended and Restated Residual Certificate" means the Second Amended and Restated Residual Certificate, dated March 7, 2014, executed by the Corporation and authenticated by the Bond Trustee, which, from and after its execution and delivery, shall constitute the Residual Certificate described in the Indenture.

"Series 2007 Bonds" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Series 2007-1B Additional Pledged Property" shall have the meaning given to such term in Section 2.01(a).

"Series 2007-1B Additional Pledged TSRs" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Series 2007-1B Additional Pledged TSRs Account" shall have the meaning given to such term in Section 3.01(a).

"Series 2007-1B Bonds" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Series 2007-1B Bondholders" means the registered owners of the Series 2007-1B Bonds from time to time as shown on the books of the Bond Trustee.

"Series 2007-1B Enhancement Premium" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Series 2007-1C Additional Pledged TSRs" means 2007 Unpledged TSRs in an amount equal to 7.75% of the total amount of TSRs which are being pledged to the payment of the Series 2007-1C Bonds pursuant to and in accordance with the terms of the Series 2007-1C Pledge Agreement.

“Series 2007-1C Bonds” shall have the meaning given to such term in the recitals to this Pledge Agreement.

“Series 2007-1C Pledge Agreement” means the Pledged Agreement, dated as of March 1, 2014, between the Corporation and the Series 2007-1C Pledge Agreement Trustee, pursuant to which the Corporation is pledging the Series 2007-1C Additional Pledged TSRs for the payment of the Series 2007-1C Bonds.

“Series 2007-1C Pledge Agreement Trustee” means The Bank of New York Mellon, Woodland Park, New Jersey, acting as Pledge Agreement Trustee under the Series 2007-1C Pledge Agreement, and its successors and assigns thereunder.

“State” shall have the meaning given to such term in the recitals to this Pledge Agreement.

“Supplemental Redemption Notice” means the Supplemental Redemption Notice, in the form attached to this Pledge Agreement as Exhibit B, to be provided by the Trustee, in the name of the Corporation, to the Bond Trustee pursuant to and as provided in Section 3.02(b).

“Transaction Proceeds Account” means the account so designated and established pursuant to Section 3.04.

“Trustee” means The Bank of New York Mellon, Woodland Park, New Jersey, acting as Pledge Agreement Trustee under this Pledge Agreement, and its successors and assigns hereunder.

“2007 Unpledged TSRs” shall have the meaning given to such term in the recitals to this Pledge Agreement.

Section 1.02 Interpretation. (a) Articles and Sections referred to by number shall mean the corresponding Articles and Sections of this Pledge Agreement.

(b) Words of the masculine gender shall mean and include correlative words of the feminine and neuter genders and words importing the singular number shall mean and include the plural number and vice versa.

(c) The terms “hereby,” “hereof,” “herein,” “hereunder” and any similar terms, as used in this Pledge Agreement, refer to this Pledge Agreement; and the term “date hereof' means on, the term “hereafter” means after, and the term “heretofore” means before, the date of execution and delivery of this Pledge Agreement.

(d) The captions of the Articles and Sections of this Pledge Agreement and any table of contents shall be solely for convenience of reference, and shall not affect the meaning, construction or effect of this Pledge Agreement.

Nothing in this Pledge Agreement expressed or implied is intended or shall be construed to confer upon, or to give to, any person, other than the Corporation, the Trustee and the Series 2007-1B Bondholders any right, remedy or claim under or by reason of this Pledge Agreement or any covenant, condition or stipulation hereof.

If any one or more of the covenants or agreements provided herein on the part of the Corporation or the Trustee to be performed should be contrary to law, then such covenant or covenants or agreement or agreements shall be deemed separable from the remaining covenants and agreements hereof and shall in no way affect the validity of the other provisions of this Pledge Agreement.

Section 1.03 No Liability. (a) Neither the directors nor officers of the Corporation nor any person executing Bonds, Ancillary Contracts, including this Pledge Agreement, Swap Contracts or other obligations of the Corporation shall be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance or execution and delivery thereof.

(b) **THIS AGREEMENT IS AN ANCILLARY FACILITY WITHIN THE MEANING OF THE ACT. THE ACT PROVIDES THAT THE ISSUANCE OF SECURITIES AND THE EXECUTION OF ANY ANCILLARY FACILITY UNDER THE PROVISIONS OF THE ACT SHALL NOT DIRECTLY, OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO PAY ANY AMOUNTS TO THE CORPORATION OR OWNER OF SECURITIES OR BENEFITTED PARTIES OR LEVY OR PLEDGE ANY FORM OF TAXATION WHATSOEVER THEREFOR. THE SECURITIES AND ANY ANCILLARY FACILITY SHALL NOT BE A DEBT OR LIABILITY OF THE STATE OR ANY AGENCY OR INSTRUMENTALITY THEREOF (OTHER THAN THE CORPORATION AS SET FORTH IN THE ACT), EITHER LEGAL, MORAL OR OTHERWISE, AND NOTHING CONTAINED IN THE ACT SHALL BE CONSTRUED TO AUTHORIZE THE CORPORATION TO INCUR ANY INDEBTEDNESS ON BEHALF OF OR IN ANY WAY TO OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF, AND THE SECURITIES AND ANY ANCILLARY FACILITY SHALL CONTAIN ON THE FACE THEREOF OR OTHER PROMINENT PLACE THEREON IN BOLD TYPEFACE A STATEMENT TO THE FOREGOING EFFECT. NO APPROPRIATION OF ANY MONEYS BY THE STATE TO THE CORPORATION IS AUTHORIZED IN THE ACT.**

ARTICLE II
PLEDGE OF SERIES 2007-1B Additional Pledged TSRS

Section 2.01 Pledge of Series 2007-1B Additional Pledged TSRs. (a) In order to further secure and provide a further source of payment for the Series 2007-1B Bonds in accordance with their terms and in accordance with the terms of this Pledge Agreement, the Corporation hereby pledges to the Trustee, and grants to the Trustee a first priority lien and security interest in, all of the Corporation's right, title, and interest, whether now owned or hereafter acquired, in, to, and under: (i) the Series 2007-1B Additional Pledged TSRs, (ii) the Series 2007-1B Additional Pledged TSRs Account, (iii) all money, instruments, investment property, and other property credited to or on deposit in the Series 2007-1B Additional Pledged TSRs Account, and all investment earnings thereon; (iv) all present and future claims, demands, causes and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments, payment intangibles and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing; and (v) all proceeds of the foregoing. The property described in the preceding sentence is referred to herein as the “Series 2007-1B Additional

Pledged Property." The Series 2007-1B Additional Pledged Property does not include any other Pledged TSRs or 2007 Unpledged TSRs, including, without limitation, 2007 Unpledged TSR's received prior to July 1, 2016, and including, without limitation, Series 2007-1C Additional Pledged TSRs, or rights in and to such other TSRs. The Corporation covenants and agrees that it will implement, protect, and defend the security interest and pledge made in this Section 2.01 by all appropriate action for the benefit of the Series 2007-1B Bondholders and any Beneficiary, the cost thereof to be an Operating Expense.

(b) The pledge of the Series 2007-1B Additional Pledged Property shall be valid and binding from the date of execution of this Pledge Agreement, and amounts so pledged and thereafter received shall immediately be subject to the lien of the pledge without any physical delivery thereof or further act, and the lien of such pledge shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Corporation, irrespective of whether such parties have notice thereof, and this Pledge Agreement need not be recorded or filed to perfect such pledge.

(c) The Series 2007-1B Additional Pledged Property is being pledged exclusively to the Series 2007-1B Bonds pursuant to the Act and pursuant to this Pledge Agreement, and the Series 2007-1B Additional Pledged Property is not Collateral within the meaning of the Indenture and is not subject to the lien of the Indenture.

Section 2.02 Payment of Series 2007-1B Bonds; Discharge of Pledge Agreement. Whenever all Series 2007-1B Bonds have been Fully Paid, then this Pledge Agreement and the lien, rights and security interests created by this Pledge Agreement shall terminate and become null and void, and the Corporation and the Trustee shall execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created hereunder. Any funds or other property held by the Trustee and not required for payment or redemption of the Series 2007-1B Bonds shall be distributed to the Corporation, as the registered owner of the Second Amended and Restated Residual Certificate, in accordance with the terms thereof and of the Amended and Restated Depository Trust Agreement.

ARTICLE III
ESTABLISHMENT OF SERIES 2007-1B ADDITIONAL PLEDGED TSRS ACCOUNT; OPTIONAL REDEMPTION OF SERIES 2007-1B BONDS AND APPLICATION OF SERIES 2007-1B ADDITIONAL PLEDGED TSRS; INVESTMENTS

Section 3.01 Establishment of Series 2007-1B Additional Pledged TSRs Account. (a) There is hereby created and established with the Trustee a special and irrevocable trust account designated the "Tobacco Settlement Financing Corporation Series 2007-1B Additional Pledged TSRs Account" (the "Series 2007-1B Additional Pledged TSRs Account") to be held in the custody of the Trustee, separate and apart from all other funds of the Corporation or the Trustee, including, without limitation, the funds and accounts created and held under the Indenture or under the Series 2007-1C Pledge Agreement, in accordance with the terms and provisions hereof. The Series 2007-1B Additional Pledged TSRs Account is to be held by the Trustee as a trust fund for, and is hereby irrevocably pledged to, the payment when due of the Accreted Value of the Series 2007-1B Bonds as provided in this Pledge Agreement. The Series 2007-1B Additional Pledged TSRs Account is not Collateral within the meaning of the Indenture and is not subject to the lien of the Indenture.

(b) Commencing July 1, 2016, the Trustee shall deposit all Series 2007-1B Additional Pledged TSRs received by it from the Depository Agent pursuant to the Amended and Restated Depository Trust Agreement into the Series 2007-1B Additional Pledged TSRs Account.

(c) On each Optional Redemption Date, the Trustee shall withdraw from the Series 2007-1B Additional Pledged TSRs Account and deposit with the Bond Trustee, for application in accordance with Section 5.04(f) of the Indenture, an amount equal to the amount necessary to pay the Accreted Value of the Applicable Series 2007-1B Bonds to be Redeemed on such Optional Redemption Date. In the event that the Trustee and the Bond Trustee shall not be one and the same Person, the Trustee shall make such withdrawal and payment to the Bond Trustee on the Business Day immediately preceding such Optional Redemption Date.

(d) When all of the Series 2007-1B Bonds have been Finally Paid, the balance on deposit in the Series 2007-1B Additional Pledged TSRs Account shall be paid to the Corporation, as the registered owner of the Second Amended and Restated Residual Certificate, in accordance with the terms thereof and of the Amended and Restated Depository Trust Agreement.

Section 3.02 Optional Redemption of Series 2007-1B Bonds. (a) The Corporation hereby exercises its election to call Series 2007-1B Bonds for optional redemption on each Optional Redemption Date in an aggregate Accreted Value equal to the aggregate Accreted Value of the Applicable Series 2007-1B Bonds to be Redeemed on such Optional Redemption Date.

(b) On May 1, 2017 and on each May 1 thereafter, or, if any such May 1 is not a Business Day, on the next preceding Business day, the Trustee shall, and is hereby authorized and directed to, provide the Bond Trustee, in the name of the Corporation, with a Supplemental Redemption Notice setting forth the aggregate Accreted Value of the Applicable Series 2007-1B Bonds to be Redeemed on such Optional Redemption Date.

Section 3.03 Investments. Pending its use under this Pledge Agreement, money in the Series 2007-1B Additional Pledged TSRs Account held by the Trustee may be invested by the Trustee in Eligible Investments maturing or redeemable at the option of the holder on or before each Optional Redemption Date and shall be so invested as directed in a Certificate of an Authorized Officer of the Corporation. In the absence of negligence or bad faith on its part, the Trustee shall not be liable for any losses on investments made at the direction of the Corporation.

3.04 Transaction Proceeds Account. There is hereby established with the Trustee a Transaction Proceeds Account to be held in the custody of the Trustee, separate and apart from all other funds of the Corporation or the Trustee, including, without limitation, the funds and accounts created and held under the Indenture, hereunder or under the Series 2007-1C Pledge Agreement, in accordance with the terms and provisions hereof. Simultaneously with execution and delivery hereof, the Corporation shall cause to be paid to the Trustee, for deposit to the Transaction Proceeds Account, the Series 2007-1B Bond Enhancement Premium. The amount in deposit in the Transaction Proceeds Account shall be disbursed, at the written direction of an Authorized Officer of the Corporation, to (1) make the payment to the State required pursuant to Section 2.01 of the Assignment Agreement, and (2) pay transaction costs relating to the execution and delivery of this Pledge Agreement. Pending such disbursements, the Trustee shall invest the amounts on deposit in the Transaction Proceeds Account in Eligible Investments as directed in writing by an Authorized Officer of the Corporation. For the avoidance of doubt, the Transaction Proceeds Account and amounts on deposit therein shall at all times be the sole property, and held for the sole benefit, of the Corporation and shall not be subject to the pledge and lien of this Pledge Agreement or of the Indenture.

ARTICLE IV
COVENANTS AND REPRESENTATIONS OF THE CORPORATION

Section 4.01 Contract; Obligations to Owners; Representations of the Corporation.

(a) In consideration of the payment of the Series 2007-1B Enhancement Premium by the Identified Series 2007-1B Bondholders, the provisions of this Pledge Agreement shall be a contract of the Corporation with all of the Series 2007-1B Bondholders. The pledge and grant of a security interest made in this Pledge Agreement and the covenants herein set forth to be performed by the Corporation shall be for the equal benefit, protection, and security of the Series 2007-1B Bonds, regardless of the time or times of their maturity, without preference, priority, or distinction of any thereof over any other.

(b) The Corporation covenants to pay when due all sums payable by it under this Pledge Agreement, but only from the Series 2007-1B Additional Pledged Property and subject to the limitations set forth in Section 1.03. The obligation of the Corporation to pay the amounts payable by the Corporation under this Pledge Agreement shall be absolute and unconditional, shall be binding and enforceable in all circumstances whatsoever, and shall not be subject to setoff, recoupment, or counterclaim. This Pledge Agreement constitutes an “ancillary facility” within the meaning of the Act and is entitled to the benefits of the Act.

(c) The Corporation represents that (i) it is duly authorized pursuant to law to execute, deliver, and perform the terms of this Pledge Agreement; (ii) all action on its part required for or relating to the execution and delivery of this Pledge Agreement has been duly taken; (iii) this Pledge Agreement, upon the execution and delivery hereof, shall be a valid and enforceable obligation of the Corporation in accordance with its terms; (iv) it has not heretofore conveyed, assigned, pledged, granted a security interest in, or otherwise disposed of the Series 2007-1B Additional Pledged Property; (v) the execution, delivery, and performance of this Pledge Agreement is not in contravention of law or any agreement, instrument, indenture, or other undertaking to which it is a party or by which it is bound and no other approval, consent, or notice from any governmental agency is required on the part of the Corporation in connection with the execution and delivery of this Pledge Agreement.

(d) This Pledge Agreement creates a valid pledge of the Series 2007-1B Additional Pledged Property in favor of the Trustee as additional security and as an additional source of payment for the Series 2007-1B Bonds, enforceable by the Trustee in accordance with the terms hereof.

Section 4.02 Covenants.

(a) *Protection of Series 2007-1B Additional Pledged Property*. The Corporation shall from time to time authorize, execute or authenticate, deliver and file all documents and instruments, and will take such other action, as is necessary or advisable to: (1) maintain or preserve the lien, pledge and security interest of this Pledge Agreement; (2) perfect or protect the validity of any grant made or to be made by this Pledge Agreement; (3) preserve and defend title to the Series 2007-1B Additional Pledged Property and the rights of the Trustee in the Series 2007-1B Additional Pledged Property against the claims of all Persons and parties, including the challenge by any party to the validity or enforceability of this Pledge Agreement or the Act or the performance by any party hereunder; (4) pay any and all taxes levied or assessed upon all or any part of the Series 2007-1B Additional Pledged Property, if any; or (5) carry out more effectively the purposes of this Pledge Agreement.

(b) *Limitation of Liens*. The Corporation shall not (1) permit the validity or effectiveness of this Pledge Agreement to be impaired, or permit the security interest created by this Pledge Agreement to be amended, hypothecated, subordinated, terminated, or discharged, or permit any Person to be released from any covenants or obligations with respect to the Series 2007-1B Bonds under this Pledge Agreement except as may be expressly permitted hereby, (2) permit any lien, charge, excise, claim, security interest, mortgage, or other encumbrance that ranks prior to or on a parity with the pledge and security interest granted hereby (other than the security interest created by this Pledge Agreement) to be created on or extend to or otherwise arise upon or burden the Series 2007-1B Additional Pledged Property or any part thereof or any interest therein or the proceeds thereof, or (3) permit the security interest created by this Pledge Agreement not to constitute a valid first priority security interest in the Series 2007-1B Additional Pledged Property.

(c) *Payments Restricted*. The Corporation shall not, directly or indirectly, make distributions from the Series 2007-1B Additional Pledged TSRs Account except in accordance with this Pledge Agreement.

ARTICLE V
THE TRUSTEE

Section 5.01 Duties and Obligations. The Trustee agrees to perform all the duties and obligations expressly imposed upon it by this Pledge Agreement, and, except for such duties and obligations, the Trustee shall not have any implied duties.

Section 5.02 Resignation, Removal and Replacement. (a) The Trustee may resign and be discharged of its duties and obligations created by this Pledge Agreement, and may be removed and discharged as Trustee under this Pledge Agreement, upon the same terms and conditions as set forth in Article VII of the Indenture, which terms and conditions are incorporated herein by reference. If the Trustee shall resign or be removed as Trustee under this Pledge Agreement as aforesaid, then, upon appointment of a successor Trustee for such purpose, in the same manner as provided in the Indenture for the appointment of a successor Bond Trustee, which provision in the Indenture is incorporated herein by reference, the said successor Trustee shall become the Trustee hereunder and all the title, rights, duties and obligations of the former Trustee under this Pledge Agreement and with respect to the moneys deposited or to be deposited under this Pledge Agreement shall become those of the successor Trustee, and upon acceptance by such successor Trustee of the trusts created hereunder, all further title, rights, duties and obligations of the former Trustee under this Pledge Agreement shall cease and be discharged, saving rights or liabilities theretofore accrued by the Authority or the former Trustee. No resignation or discharge of the Trustee shall take effect until a successor shall have been appointed and shall have accepted its appointment as Trustee hereunder, and until the Series 2007-1B Additional Pledged TSRs Account shall have been transferred to such successor.

(b) Any entity into which the Trustee may be merged or converted or with which it may be consolidated or any entity resulting from any merger, conversion or consolidation to which it shall be a party or any entity to which all or substantially all of the corporate trust business shall be sold or transferred (including its interest in this Pledge Agreement), shall be the successor to the Trustee without the execution or filing of any paper or the performance of any further act; provided, however, that such company shall be a bank or trust company organized under the laws of any state of the United States or a national banking association and shall be authorized by law to perform all the duties imposed upon it by this Pledge Agreement.

(c) The provisions of Article VII of the Indenture relating to the rights, duties and reimbursements of the Bond Trustee are hereby incorporated in this Pledge Agreement as if set forth in full herein and are hereby made applicable to the Trustee.

ARTICLE VI
MISCELLANEOUS

Section 6.01 Supplements and Amendments. This Pledge Agreement may not be supplemented or amended in any manner adverse to the interests of the Series 2007-1B Bondholders except in accordance with Section 10.01 of the Indenture. In all other respects, this Pledge Agreement may be supplemented or amended by agreement among the parties hereto.

Section 6.02 Notices. Unless otherwise expressly provided, all notices to the Corporation or the Trustee shall be in writing and shall be deemed sufficiently given if sent by registered or certified mail, postage prepaid and return receipt requested, recognized private overnight carrier, shipping charges prepaid and with acknowledgement of delivery, or hand delivered during business hours as follows:

To the Corporation:

Tobacco Settlement Financing Corporation
c/o State of New Jersey, Office of Public Finance
50 West State Street, 5th Floor
P.O. Box 005
Trenton, New Jersey 08625
Attention: Director, Office of Public Finance

To the Trustee and
the Bond Trustee:

The Bank of New York Mellon
Corporate Trust Administration
385 Rifle Camp Road, 3rd Floor
Woodland Park, New Jersey 07424

To S&P:

Standard & Poor's Credit Market Services
55 Water Street, 38th Floor
New York, New York 10041
Attn: Asset Backed Department

or, as to all of the foregoing, to such other address as the addressee shall have indicated by prior Written Notice to the one giving notice.

Any such communication also may be transmitted to the appropriate party by telephone and shall be deemed given or made at the time of such transmission if, and only if, such transmission of notice shall be confirmed by Written Notice as specified above.

Notice hereunder may be waived prospectively or retrospectively by the Person entitled to the notice, but no waiver shall affect any notice requirement as to other Persons.

Section 6.03 Third Party Beneficiaries. This Pledge Agreement is not intended for the benefit of and shall not be construed to create rights in parties other than the Corporation, the Trustee and the Series 2007-1B Bondholders. Except for the Series 2007-1B Bondholders, there are no third party beneficiaries to this Pledge Agreement.

Section 6.04 Successors and Assigns. All covenants and agreements in this Pledge Agreement by the Corporation shall bind its successors and assigns, whether so expressed or not. All agreements of the Trustee in this Pledge Agreement shall bind its successors.

Section 6.05 Governing Law. This Pledge Agreement shall be construed in accordance with and governed by the Constitution and the laws of the State.

Section 6.06 Limitation of Liability. No member, director, officer, or employee of the Corporation shall be individually or personally liable for the payments due under this Pledge Agreement, but nothing contained herein shall relieve any director, officer, or employee of the Corporation from the performance of any official duty provided by any applicable provisions of law or hereby.

Section 6.07 Signatures and Counterparts. This Pledge Agreement and each Supplemental Indenture may be executed and delivered in any number of counterparts, each of which shall be deemed to be an original, but such counterparts together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the Corporation and the Trustee have caused this Pledge Agreement to be executed their duly authorized offices as of the day and year first above written.

TOBACCO SETTLEMENT FINANCING CORPORATION

By___________________________________

Name: Andrew P. Sidamon-Eristoff
Title: President

THE BANK OF NEW YORK MELLON,
as Series 2007-1B Pledge Agreement Trustee

By: ______________________________

Name: David J. O'Brien
Title: Vice President

[SIGNATURE PAGE TO PLEDGE AGREEMENT]

EXHIBIT A
FORM OF OMNIBUS REDEMPTION NOTICE

March 7, 2014

The Bank of New York Mellon, as Trustee
385 Rifle Camp Road, 3rd Fl.
Woodland Park, NJ 07424

Re: Omnibus Notice of Optional Redemption
Tobacco Settlement Financing Corporation
Tobacco Settlement Asset-Backed Bonds, Series 2007-1B
First Subordinate Capital Appreciation Bonds (Turbo Term Bonds)

Ladies and Gentlemen:

Reference is made to the Series 2007-1B Pledge Agreement, dated as of March 1, 2014 (the "Pledge Agreement"), between the Tobacco Settlement Financing Corporation (the "Corporation") and The Bank of New York Mellon, as Series 2007-1B Pledge Agreement Trustee (the "Pledge Agreement Trustee") relating to the above captioned bonds (the "Series 2007-1B Bonds"). Capitalize terms used but not defined in this notice shall have the meaning set forth in the Pledge Agreement or in the hereinafter defined Indenture.

The Series 2007-1B Bonds are issued pursuant to a Trust Indenture (the "Trust Indenture"), as supplemented by a Series 2007 Supplement (the "Series 2007 Supplement" and, together with the Trust Indenture, the "Indenture), both dated as of January 1, 2007, by and between the Corporation and The Bank of New York Mellon, as trustee (the "Bond Trustee"). The Series 2007-1B Bonds are subject to redemption at the option of the Corporation, in whole or in part, on any date on or after June 1, 2017, from any Maturity Date selected by the Corporation in its discretion and on such basis as the Bond Trustee shall deem fair and appropriate, including by lot, within a Maturity Date, in either case at a redemption price equal to 100% of the Accreted Value on the redemption date. Pursuant to Section 3.02 of the Pledge Agreement, the Corporation has exercised its option to call the Series 2007-1B Bonds for optional redemption on June 1, 2017 and on each June 1 thereafter until the Series 2007-1B Bonds have been Fully Paid (each such June 1, on "Optional Redemption Date") in an Aggregate Accreted Value (determined as of such Optional Redemption Date) equal to the maximum amount of Series 2007-1C Bonds that can be redeemed in Authorized Denominations from the balance on deposit in the Series 2007-1C Additional Pledged TSRs Account on the May 1 immediately preceding such Optional Redemption Date, or if such May 1 is not a Business Day, on the next preceding Business Day, or (b) all of the Series 2007-1C Bonds Outstanding as of such Optional Redemption Date (each such amount being referred to herein as the "Applicable Amount").

Pursuant to Section 5.04(f) of the Trust Indenture, the Bond Trustee shall be provided with 30 days prior notice of any optional redemption. Please accept this Omnibus Notice as the notice specified in said Section 5.04(f) and direction of the Corporation to call the Series 2007-1B Bonds for optional redemption in accordance with the provisions of the Indenture and as specified in the Pledge Agreement on each Optional Redemption Date in an amount equal to the Applicable Amount for such Optional Redemption Date. In the event that at any time the

Pledge Agreement Trustee and the Bond Trustee shall not be one and the same Person, the Corporation shall cause the Pledge Agreement Trustee to provide you with a Supplemental Notice of Optional Redemption in the form attached hereto as Exhibit A. The form of redemption notice to be given by the Bond Trustee to the holders of the Series 2007-1B Bonds to be redeemed is attached hereto as Exhibit B.

Very truly yours,

TOBACCO SETTLEMENT FINANCING CORPORATION

By: ______________________________

Andrew P. Sidamon-Eristoff
President

Receipt Acknowledged:

THE BANK OF NEW YORK MELLON

By:______________________________

Name: David J. O'Brien
Title Vice President

Dated: March 7, 2014

EXHIBIT B
FORM OF SUPPLEMENTAL REDEMPTION NOTICE

May 1, 20__

[Bond Trustee]
[Address]
[Address]

Re: Supplemental Notice of Optional Redemption
Tobacco Settlement Financing Corporation
Tobacco Settlement Asset-Backed Bonds, Series 2007-1B
First Subordinate Capital Appreciation Bonds (Turbo Term Bonds)

Ladies and Gentlemen:

Notice is hereby given, on behalf of the Tobacco Settlement Financing Corporation (the "Corporation"), in accordance with Section 3.02 of the Pledge Agreement, dated as of March 1, 2014 (the "Series 2007-1B Pledge Agreement"), by and between the Corporation and The Bank of New York Mellon (the "Series 2007-1B Pledge Agreement Trustee"), to ______________________________, as Bond Trustee under the Trust Indenture, as supplemented by a Series 2007 Supplement, both dated as of January 1, 2007 (the "Indenture"), by and between the Corporation and the Bond Trustee, in connection with the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1B First Subordinate Capital Appreciation Bonds (Turbo Term Bonds) maturing June 1, 2041 (the "Series 2007-1B Bonds"), that $_______________ aggregate Accreted Value of Series 2007-1B Bonds shall be redeemed on June 1, 20__ (the "Redemption Date") in accordance with the terms of the Indenture.

TOBACCO SETTLEMENT FINANCING CORPORATION

By: The Bank of New York Mellon,
as Series 2007-1B Pledge Agreement Trustee

Receipt Acknowledged:

[Bond Trustee]

By:___________________________
Name:
Title

Dated:

PLEDGE AGREEMENT

by and between

TOBACCO SETTLEMENT FINANCING CORPORATION

and

THE BANK OF NEW YORK MELLON,
as Series 2007-1C Pledge Agreement Trustee,

Dated as of March 1, 2014

Securing

Tobacco Settlement Asset-Backed Bonds
Series 2007-1C Second Subordinate Capital Appreciation Bonds
(Turbo Term Bonds)

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EXHIBIT A – FORM OF OMNIBUS REDEMPTION NOTICE
EXHIBIT B – FORM OF SUPPLEMENTAL REDEMPTION NOTICE

THIS PLEDGE AGREEMENT, made and dated as of March 1, 2014, (the "Agreement") by and between the TOBACCO SETTLEMENT FINANCING CORPORATION, a body corporate and politic and an instrumentality of The State of New Jersey (the "Corporation"), and THE BANK OF NEW YORK MELLON, a New York State banking corporation organized and existing under the laws of the State of New York and authorized to accept and execute trusts of the character herein set forth under and by virtue of the laws of the State of New Jersey, as Series 2007-1C Pledge Agreement Trustee (the "Trustee").

W I T N E S S E T H:

WHEREAS, the Corporation is a body corporate and politic and an instrumentality of the State of New Jersey (the "State") established in, but not of, the Department of the Treasury exercising public and essential government functions, established pursuant to the Tobacco Settlement Financing Corporation Act, constituting Chapter 32 of the Laws of 2002 of the State (the "Act"); and

WHEREAS, pursuant to a Trust Indenture, as supplemented by a Series 2007 Supplement, both dated as of January 1, 2007 (collectively, the "Indenture"), by and between the Corporation and The Bank of New York Mellon, as trustee (the "Bond Trustee"), the Corporation issued its $3,622,208,081.50 Tobacco Settlement Asset-Backed Bonds, Series 2007-1 (the "Series 2007 Bonds"), consisting of (i) its $3,436,225,000.00 Series 2007-1A Senior Current Interest Serial Bonds and Series 2007-1A Senior Current Interest Turbo Term Bonds (collectively, the "Series 2007-1A Bonds"), (ii) its $126,198,000.00 Series 2007-1B First Subordinate Capital Appreciation Bonds (Turbo Term Bonds) (the "Series 2007-1B Bonds"), and (iii) its $59,785,081.50 Series 2007-1C Second Subordinate Capital Appreciation Bonds (Turbo Term Bonds) (the "Series 2007-1C Bonds"); and

WHEREAS, the Series 2007 Bonds were issued in order to refund the Corporation's then outstanding Tobacco Settlement Asset-Backed Bonds, Series 2002 and Tobacco Settlement Asset-Backed Bonds, Series 2003; and

WHEREAS, the Series 2007 Bonds are secured by and payable from, among other things, all of the Corporation's right, title and interest in the "Pledged TSRs", consisting of 76.26% of the TSRs received by the State under the MSA; and

WHEREAS, the 23.74% of the TSRs owned by the Corporation that are not Pledged TSRs (the "2007 Unpledged TSRs") are not pledged to the payment of the Series 2007 Bonds pursuant to the Indenture and are currently paid upon receipt from time to time to the State as owner of the Residual Certificate; and

WHEREAS, in consideration of the payment of a premium in the aggregate amount of $50,000,418.00 (the "Series 2007-1C Enhancement Premium") by certain holders of the Series 2007-1C Bonds (the "Identified Series 2007-1C Bondholders"), and in order to provide for the early redemption of the Series 2007-1C Bonds in accordance with the terms and provisions thereof and of this Pledge Agreement, the Corporation has determined to pledge a portion of the 2007 Unpledged TSRs, constituting 7.75% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "Series 2007-1C Additional Pledged TSRs") to the payment of all of the Series 2007-1C Bonds, and to apply the Series 2007-1C Additional Pledged TSRs to the optional redemption of the Series 2007-1C Bonds in accordance with their terms, all subject to the terms and conditions set forth in this Pledge Agreement; and

WHEREAS, the Series 2007-1C Additional Pledged TSRs and the other Series 2007-1C Additional Property (as hereinafter defined) are being pledged exclusively to the Series 2007-1C Bonds pursuant to the Act and pursuant to this Pledge Agreement, and the Series 2007-1C Additional Pledged TSRs and the other Series 2007-1C Additional Property are not Collateral within the meaning of the Indenture and are not subject to the lien of the Indenture; and

WHEREAS, all of the original terms of the Series 2007-1C Bonds will remain exactly the same, notwithstanding execution and delivery of this Pledge Agreement; and

WHEREAS, simultaneously with the execution and delivery of this Pledge Agreement, the Corporation and the Series 2007-1B Pledge Agreement Trustee are entering into the Series 2007-1B Pledge Agreement pursuant to which the Corporation is pledging the Series 2007-1B Additional Pledged TSRs to the payment of the Series 2007-1B Bonds in accordance with the provisions of the Series 2007-1B Pledge Agreement.

NOW THEREFORE, in consideration of the foregoing and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to legally bound, the Corporation and the Trustee hereby agree as follows:

ARTICLE I
DEFINITIONS AND INTERPRETATION

Section 1.01 Definitions. Capitalized terms used but not defined in this Pledge Agreement shall have the meanings given to them in the Indenture. In addition, the following words and terms shall, unless the context otherwise requires, have the following meanings:

"Act" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Amended and Restated Depository Trust Agreement" means the Amended and Restated Depository Trust Agreement, dated as of March 1, 2014, by and among the Corporation, the State, the Depository Agent, the Bond Trustee, the Trustee and the Series 2007-1B Trustee.

"Applicable Series 2007-1C Bonds to be Redeemed" means, with respect to each Optional Redemption Date, the lesser of (a) Series 2007-1C Bonds in an Aggregate Accreted Value (determined as of such Optional Redemption Date) equal to the maximum amount of Series 2007-1C Bonds that can be redeemed in Authorized Denominations from the balance on deposit in the Series 2007-1C Additional Pledged TSRs Account on the May 1 immediately preceding such Optional Redemption Date, or (b) all of the Series 2007-1C Bonds Outstanding as of such Optional Redemption Date.

"Bond Trustee" means The Bank of New York Mellon, Woodland Park, New Jersey, acting as Trustee under the Indenture, and its successors and assigns thereunder.

"Identified Series 2007-1C Bondholders" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Depository Agent" means The Bank of New York Mellon, Woodland Park, New Jersey, acting as Depository Agent under the Amended and Restated Depository Agreement, and its successors and assigns thereunder.

“Fully Paid” shall have the meaning given to such term in Section 2.03(b) of the Indenture.

“Omnibus Redemption Notice” means the Omnibus Redemption Notice, in the form attached to this Pledge Agreement as Exhibit A, to be provided by the Corporation to the Bond Trustee in accordance with Section 3.02(a), setting forth the Corporation’s election to call the Applicable Series 2007-1C Bonds to be Redeemed for optional redemption on each Optional Redemption Date in accordance with the terms of the Indenture and directing the Bond Trustee to call the Applicable Series 2007-1C Bonds to be Redeemed on each Optional Redemption Date in an aggregate Accreted Value as set forth in the Supplemental Redemption Notice to be provided by the Trustee, in the name of the Corporation, to the Bond Trustee, all as set forth in Section 3.02(b).

“Optional Redemption Date” means June 1, 2017 and each June 1 thereafter until all of the Series 2007-1C Bonds have been Fully Paid.

“Pledged TSRs” shall have the meaning given to such term in the recitals to this Pledge Agreement.

“Second Amended and Restated Residual Certificate” means the Second Amended and Restated Residual Certificate, dated March 7, 2014, executed by the Corporation and authenticated by the Bond Trustee, which, from and after its execution and delivery, shall constitute the Residual Certificate described in the Indenture.

“Series 2007 Bonds” shall have the meaning given to such term in the recitals to this Pledge Agreement.

“Series 2007-1B Additional Pledged TSRs” means 2007 Unpledged TSRs in an amount equal to 15.99% of the total amount of TSRs which are being pledged to the payment of the Series 2007-1B Bonds pursuant to and in accordance with the terms of the Series 2007-1B Pledge Agreement.

“Series 2007-1B Bonds” shall have the meaning given to such term in the recitals to this Pledge Agreement.

“Series 2007-1B Pledge Agreement” means the Pledged Agreement, dated as of March 1, 2014, between the Corporation and the Series 2007-1B Pledge Agreement Trustee, pursuant to which the Corporation is pledging the Series 2007-1B Additional Pledged TSRs for the payment of the Series 2007-1B Bonds.

“Series 2007-1B Pledge Agreement Trustee” means The Bank of New York Mellon, Woodland Park, New Jersey, acting as Pledge Agreement Trustee under the Series 2007-1B Pledge Agreement, and its successors and assigns thereunder.

“Series 2007-1C Additional Pledged Property” shall have the meaning given to such term in Section 2.01(a).

“Series 2007-1C Additional Pledged TSRs” shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Series 2007-1C Additional Pledged TSRs Account" shall have the meaning given to such term in Section 3.01(a).

"Series 2007-1C Bonds" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Series 2007-1C Bondholders" means the registered owners of the Series 2007-1C Bonds from time to time as shown on the books of the Bond Trustee.

"Series 2007-1C Enhancement Premium" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"State" shall have the meaning given to such term in the recitals to this Pledge Agreement.

"Supplemental Redemption Notice" means the Supplemental Redemption Notice, in the form attached to this Pledge Agreement as Exhibit B, to be provided by the Trustee, in the name of the Corporation, to the Bond Trustee pursuant to and as provided in Section 3.02(b).

"Transaction Proceeds Account" means the account so designated and established pursuant to Section 3.04.

"Trustee" means The Bank of New York Mellon, Woodland Park, New Jersey, acting as Pledge Agreement Trustee under this Pledge Agreement, and its successors and assigns hereunder.

"2007 Unpledged TSRs" shall have the meaning given to such term in the recitals to this Pledge Agreement.

Section 1.02 Interpretation. (a) Articles and Sections referred to by number shall mean the corresponding Articles and Sections of this Pledge Agreement.

(b) Words of the masculine gender shall mean and include correlative words of the feminine and neuter genders and words importing the singular number shall mean and include the plural number and vice versa.

(c) The terms "hereby," "hereof," "herein," "hereunder" and any similar terms, as used in this Pledge Agreement, refer to this Pledge Agreement; and the term "date hereof' means on, the term "hereafter" means after, and the term "heretofore" means before, the date of execution and delivery of this Pledge Agreement.

(d) The captions of the Articles and Sections of this Pledge Agreement and any table of contents shall be solely for convenience of reference, and shall not affect the meaning, construction or effect of this Pledge Agreement.

Nothing in this Pledge Agreement expressed or implied is intended or shall be construed to confer upon, or to give to, any person, other than the Corporation, the Trustee and the Series 2007-1C Bondholders any right, remedy or claim under or by reason of this Pledge Agreement or any covenant, condition or stipulation hereof.

If any one or more of the covenants or agreements provided herein on the part of the Corporation or the Trustee to be performed should be contrary to law, then such covenant or covenants or agreement or agreements shall be deemed separable from the remaining covenants and agreements hereof and shall in no way affect the validity of the other provisions of this Pledge Agreement.

Section 1.03 No Liability. (a) Neither the directors nor officers of the Corporation nor any person executing Bonds, Ancillary Contracts, including this Pledge Agreement, Swap Contracts or other obligations of the Corporation shall be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance or execution and delivery thereof.

(b) **THIS AGREEMENT IS AN ANCILLARY FACILITY WITHIN THE MEANING OF THE ACT. THE ACT PROVIDES THAT THE ISSUANCE OF SECURITIES AND THE EXECUTION OF ANY ANCILLARY FACILITY UNDER THE PROVISIONS OF THE ACT SHALL NOT DIRECTLY, OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO PAY ANY AMOUNTS TO THE CORPORATION OR OWNER OF SECURITIES OR BENEFITTED PARTIES OR LEVY OR PLEDGE ANY FORM OF TAXATION WHATSOEVER THEREFOR. THE SECURITIES AND ANY ANCILLARY FACILITY SHALL NOT BE A DEBT OR LIABILITY OF THE STATE OR ANY AGENCY OR INSTRUMENTALITY THEREOF (OTHER THAN THE CORPORATION AS SET FORTH IN THE ACT), EITHER LEGAL, MORAL OR OTHERWISE, AND NOTHING CONTAINED IN THE ACT SHALL BE CONSTRUED TO AUTHORIZE THE CORPORATION TO INCUR ANY INDEBTEDNESS ON BEHALF OF OR IN ANY WAY TO OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF, AND THE SECURITIES AND ANY ANCILLARY FACILITY SHALL CONTAIN ON THE FACE THEREOF OR OTHER PROMINENT PLACE THEREON IN BOLD TYPEFACE A STATEMENT TO THE FOREGOING EFFECT. NO APPROPRIATION OF ANY MONEYS BY THE STATE TO THE CORPORATION IS AUTHORIZED IN THE ACT.**

ARTICLE II
PLEDGE OF SERIES 2007-1C Additional Pledged TSRS

Section 2.01 Pledge of Series 2007-1C Additional Pledged TSRs. (a) In order to further secure and provide a further source of payment for the Series 2007-1C Bonds in accordance with their terms and in accordance with the terms of this Pledge Agreement, the Corporation hereby pledges to the Trustee, and grants to the Trustee a first priority lien and security interest in, all of the Corporation's right, title, and interest, whether now owned or hereafter acquired, in, to, and under: (i) the Series 2007-1C Additional Pledged TSRs, (ii) the Series 2007-1C Additional Pledged TSRs Account, (iii) all money, instruments, investment property, and other property credited to or on deposit in the Series 2007-1C Additional Pledged TSRs Account, and all investment earnings thereon; (iv) all present and future claims, demands, causes and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments, payment intangibles and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing; and (v) all proceeds of the foregoing. The property described in the preceding sentence is referred to herein as the “Series 2007-1C Additional

Pledged Property." The Series 2007-1C Additional Pledged Property does not include any other Pledged TSRs or 2007 Unpledged TSRs, including, without limitation, 2007 Unpledged TSR's received prior to July 1, 2016, and including, without limitation, Series 2007-1B Additional Pledged TSRs, or rights in and to such other TSRs. The Corporation covenants and agrees that it will implement, protect, and defend the security interest and pledge made in this Section 2.01 by all appropriate action for the benefit of the Series 2007-1C Bondholders and any Beneficiary, the cost thereof to be an Operating Expense.

(b) The pledge of the Series 2007-1C Additional Pledged Property shall be valid and binding from the date of execution of this Pledge Agreement, and amounts so pledged and thereafter received shall immediately be subject to the lien of the pledge without any physical delivery thereof or further act, and the lien of such pledge shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Corporation, irrespective of whether such parties have notice thereof, and this Pledge Agreement need not be recorded or filed to perfect such pledge.

(c) The Series 2007-1C Additional Pledged Property is being pledged exclusively to the Series 2007-1C Bonds pursuant to the Act and pursuant to this Pledge Agreement, and the Series 2007-1C Additional Pledged Property is not Collateral within the meaning of the Indenture and is not subject to the lien of the Indenture.

Section 2.02 Payment of Series 2007-1C Bonds; Discharge of Pledge Agreement. Whenever all Series 2007-1C Bonds have been Fully Paid, then this Pledge Agreement and the lien, rights and security interests created by this Pledge Agreement shall terminate and become null and void, and the Corporation and the Trustee shall execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created hereunder. Any funds or other property held by the Trustee and not required for payment or redemption of the Series 2007-1C Bonds shall be distributed to the Corporation, as the registered owner of the Second Amended and Restated Residual Certificate, in accordance with the terms thereof and of the Amended and Restated Depository Trust Agreement.

ARTICLE III
ESTABLISHMENT OF SERIES 2007-1C ADDITIONAL PLEDGED TSRS ACCOUNT; OPTIONAL REDEMPTION OF SERIES 2007-1C BONDS AND APPLICATION OF SERIES 2007-1C ADDITIONAL PLEDGED TSRS; INVESTMENTS

Section 3.01 Establishment of Series 2007-1C Additional Pledged TSRs Account. (a) There is hereby created and established with the Trustee a special and irrevocable trust account designated the "Tobacco Settlement Financing Corporation Series 2007-1C Additional Pledged TSRs Account" (the "Series 2007-1C Additional Pledged TSRs Account") to be held in the custody of the Trustee, separate and apart from all other funds of the Corporation or the Trustee, including, without limitation, the funds and accounts created and held under the Indenture or under the Series 2007-1B Pledge Agreement, in accordance with the terms and provisions hereof. The Series 2007-1C Additional Pledged TSRs Account is to be held by the Trustee as a trust fund for, and is hereby irrevocably pledged to, the payment when due of the Accreted Value of the Series 2007-1C Bonds as provided in this Pledge Agreement. The Series 2007-1C Additional Pledged TSRs Account is not Collateral within the meaning of the Indenture and is not subject to the lien of the Indenture.

(b) Commencing July 1, 2016, the Trustee shall deposit all Series 2007-1C Additional Pledged TSRs received by it from the Depository Agent pursuant to the Amended and Restated Depository Trust Agreement into the Series 2007-1C Additional Pledged TSRs Account.

(c) On each Optional Redemption Date, the Trustee shall withdraw from the Series 2007-1C Additional Pledged TSRs Account and deposit with the Bond Trustee, for application in accordance with Section 5.04(f) of the Indenture, an amount equal to the amount necessary to pay the Accreted Value of the Applicable Series 2007-1C Bonds to be Redeemed on such Optional Redemption Date. In the event that the Trustee and the Bond Trustee shall not be one and the same Person, the Trustee shall make such withdrawal and payment to the Bond Trustee on the Business Day immediately preceding such Optional Redemption Date.

(d) When all of the Series 2007-1C Bonds have been Finally Paid, the balance on deposit in the Series 2007-1C Additional Pledged TSRs Account shall be paid to the Corporation, as the registered owner of the Second Amended and Restated Residual Certificate, in accordance with the terms thereof and of the Amended and Restated Depository Trust Agreement.

Section 3.02 Optional Redemption of Series 2007-1C Bonds. (a) The Corporation hereby exercises its election to call Series 2007-1C Bonds for optional redemption on each Optional Redemption Date in an aggregate Accreted Value equal to the aggregate Accreted Value of the Applicable Series 2007-1C Bonds to be Redeemed on such Optional Redemption Date.

(b) On May 1, 2017 and on each May 1 thereafter, or, if any such May 1 is not a Business Day, on the next preceding Business day, the Trustee shall, and is hereby authorized and directed to, provide the Bond Trustee, in the name of the Corporation, with a Supplemental Redemption Notice setting forth the aggregate Accreted Value of the Applicable Series 2007-1C Bonds to be Redeemed on such Optional Redemption Date.

Section 3.03 Investments. Pending its use under this Pledge Agreement, money in the Series 2007-1C Additional Pledged TSRs Account held by the Trustee may be invested by the Trustee in Eligible Investments maturing or redeemable at the option of the holder on or before each Optional Redemption Date and shall be so invested as directed in a Certificate of an Authorized Officer of the Corporation. In the absence of negligence or bad faith on its part, the Trustee shall not be liable for any losses on investments made at the direction of the Corporation.

3.04 Transaction Proceeds Account. There is hereby established with the Trustee a Transaction Proceeds Account to be held in the custody of the Trustee, separate and apart from all other funds of the Corporation or the Trustee, including, without limitation, the funds and accounts created and held under the Indenture, hereunder or under the Series 2007-1B Pledge Agreement, in accordance with the terms and provisions hereof. Simultaneously with execution and delivery hereof, the Corporation shall cause to be paid to the Trustee, for deposit to the Transaction Proceeds Account, the Series 2007-1C Bond Enhancement Premium. The amount in deposit in the Transaction Proceeds Account shall be disbursed, at the written direction of an Authorized Officer of the Corporation, to (1) make the payment to the State required pursuant to Section 2.01 of the Assignment Agreement, and (2) pay transaction costs relating to the execution and delivery of this Pledge Agreement. Pending such disbursements, the Trustee shall invest the amounts on deposit in the Transaction Proceeds Account in Eligible Investments as directed in writing by an Authorized Officer of the Corporation. For the avoidance of doubt, the Transaction Proceeds Account and amounts on deposit therein shall at all times be the sole property, and held for the sole benefit, of the Corporation and shall not be subject to the pledge and lien of this Pledge Agreement or of the Indenture.

ARTICLE IV
COVENANTS AND REPRESENTATIONS OF THE CORPORATION

Section 4.01 Contract; Obligations to Owners; Representations of the Corporation.

(a) In consideration of the payment of the Series 2007-1C Enhancement Premium by the Identified Series 2007-1C Bondholders, the provisions of this Pledge Agreement shall be a contract of the Corporation with all of the Series 2007-1C Bondholders. The pledge and grant of a security interest made in this Pledge Agreement and the covenants herein set forth to be performed by the Corporation shall be for the equal benefit, protection, and security of the Series 2007-1C Bonds, regardless of the time or times of their maturity, without preference, priority, or distinction of any thereof over any other.

(b) The Corporation covenants to pay when due all sums payable by it under this Pledge Agreement, but only from the Series 2007-1C Additional Pledged Property and subject to the limitations set forth in Section 1.03. The obligation of the Corporation to pay the amounts payable by the Corporation under this Pledge Agreement shall be absolute and unconditional, shall be binding and enforceable in all circumstances whatsoever, and shall not be subject to setoff, recoupment, or counterclaim. This Pledge Agreement constitutes an “ancillary facility” within the meaning of the Act and is entitled to the benefits of the Act.

(c) The Corporation represents that (i) it is duly authorized pursuant to law to execute, deliver, and perform the terms of this Pledge Agreement; (ii) all action on its part required for or relating to the execution and delivery of this Pledge Agreement has been duly taken; (iii) this Pledge Agreement, upon the execution and delivery hereof, shall be a valid and enforceable obligation of the Corporation in accordance with its terms; (iv) it has not heretofore conveyed, assigned, pledged, granted a security interest in, or otherwise disposed of the Series 2007-1C Additional Pledged Property; (v) the execution, delivery, and performance of this Pledge Agreement is not in contravention of law or any agreement, instrument, indenture, or other undertaking to which it is a party or by which it is bound and no other approval, consent, or notice from any governmental agency is required on the part of the Corporation in connection with the execution and delivery of this Pledge Agreement.

(d) This Pledge Agreement creates a valid pledge of the Series 2007-1C Additional Pledged Property in favor of the Trustee as additional security and as an additional source of payment for the Series 2007-1C Bonds, enforceable by the Trustee in accordance with the terms hereof.

Section 4.02 Covenants.

(a) *Protection of Series 2007-1C Additional Pledged Property*. The Corporation shall from time to time authorize, execute or authenticate, deliver and file all documents and instruments, and will take such other action, as is necessary or advisable to: (1) maintain or preserve the lien, pledge and security interest of this Pledge Agreement; (2) perfect or protect the validity of any grant made or to be made by this Pledge Agreement; (3) preserve and defend title to the Series 2007-1C Additional Pledged Property and the rights of the Trustee in the Series 2007-1C Additional Pledged Property against the claims of all Persons and parties, including the challenge by any party to the validity or enforceability of this Pledge Agreement or the Act or the performance by any party hereunder; (4) pay any and all taxes levied or assessed upon all or any part of the Series 2007-1C Additional Pledged Property, if any; or (5) carry out more effectively the purposes of this Pledge Agreement.

(b) *Limitation of Liens*. The Corporation shall not (1) permit the validity or effectiveness of this Pledge Agreement to be impaired, or permit the security interest created by this Pledge Agreement to be amended, hypothecated, subordinated, terminated, or discharged, or permit any Person to be released from any covenants or obligations with respect to the Series 2007-1C Bonds under this Pledge Agreement except as may be expressly permitted hereby, (2) permit any lien, charge, excise, claim, security interest, mortgage, or other encumbrance that ranks prior to or on a parity with the pledge and security interest granted hereby (other than the security interest created by this Pledge Agreement) to be created on or extend to or otherwise arise upon or burden the Series 2007-1C Additional Pledged Property or any part thereof or any interest therein or the proceeds thereof, or (3) permit the security interest created by this Pledge Agreement not to constitute a valid first priority security interest in the Series 2007-1C Additional Pledged Property.

(c) *Payments Restricted*. The Corporation shall not, directly or indirectly, make distributions from the Series 2007-1C Additional Pledged TSRs Account except in accordance with this Pledge Agreement.

ARTICLE V
THE TRUSTEE

Section 5.01 Duties and Obligations. The Trustee agrees to perform all the duties and obligations expressly imposed upon it by this Pledge Agreement, and, except for such duties and obligations, the Trustee shall not have any implied duties.

Section 5.02 Resignation, Removal and Replacement. (a) The Trustee may resign and be discharged of its duties and obligations created by this Pledge Agreement, and may be removed and discharged as Trustee under this Pledge Agreement, upon the same terms and conditions as set forth in Article VII of the Indenture, which terms and conditions are incorporated herein by reference. If the Trustee shall resign or be removed as Trustee under this Pledge Agreement as aforesaid, then, upon appointment of a successor Trustee for such purpose, in the same manner as provided in the Indenture for the appointment of a successor Bond Trustee, which provision in the Indenture is incorporated herein by reference, the said successor Trustee shall become the Trustee hereunder and all the title, rights, duties and obligations of the former Trustee under this Pledge Agreement and with respect to the moneys deposited or to be deposited under this Pledge Agreement shall become those of the successor Trustee, and upon acceptance by such successor Trustee of the trusts created hereunder, all further title, rights, duties and obligations of the former Trustee under this Pledge Agreement shall cease and be discharged, saving rights or liabilities theretofore accrued by the Authority or the former Trustee. No resignation or discharge of the Trustee shall take effect until a successor shall have been appointed and shall have accepted its appointment as Trustee hereunder, and until the Series 2007-1C Additional Pledged TSRs Account shall have been transferred to such successor.

(b) Any entity into which the Trustee may be merged or converted or with which it may be consolidated or any entity resulting from any merger, conversion or consolidation to which it shall be a party or any entity to which all or substantially all of the corporate trust business shall be sold or transferred (including its interest in this Pledge Agreement), shall be the successor to the Trustee without the execution or filing of any paper or the performance of any further act; provided, however, that such company shall be a bank or trust company organized under the laws of any state of the United States or a national banking association and shall be authorized by law to perform all the duties imposed upon it by this Pledge Agreement.

(c) The provisions of Article VII of the Indenture relating to the rights, duties and reimbursements of the Bond Trustee are hereby incorporated in this Pledge Agreement as if set forth in full herein and are hereby made applicable to the Trustee.

ARTICLE VI
MISCELLANEOUS

Section 6.01 Supplements and Amendments. This Pledge Agreement may not be supplemented or amended in any manner adverse to the interests of the Series 2007-1C Bondholders except in accordance with Section 10.01 of the Indenture. In all other respects, this Pledge Agreement may be supplemented or amended by agreement among the parties hereto.

Section 6.02 Notices. Unless otherwise expressly provided, all notices to the Corporation or the Trustee shall be in writing and shall be deemed sufficiently given if sent by registered or certified mail, postage prepaid and return receipt requested, recognized private overnight carrier, shipping charges prepaid and with acknowledgement of delivery, or hand delivered during business hours as follows:

To the Corporation:	Tobacco Settlement Financing Corporation c/o State of New Jersey, Office of Public Finance 50 West State Street, 5th Floor P.O. Box 005 Trenton, New Jersey 08625 Attention: Director, Office of Public Finance
To the Trustee and the Bond Trustee:	The Bank of New York Mellon Corporate Trust Administration 385 Rifle Camp Road, 3rd Floor Woodland Park, New Jersey 07424
To S&P:	Standard & Poor's Credit Market Services 55 Water Street, 38th Floor New York, New York 10041 Attn: Asset Backed Department

or, as to all of the foregoing, to such other address as the addressee shall have indicated by prior Written Notice to the one giving notice.

Any such communication also may be transmitted to the appropriate party by telephone and shall be deemed given or made at the time of such transmission if, and only if, such transmission of notice shall be confirmed by Written Notice as specified above.

Notice hereunder may be waived prospectively or retrospectively by the Person entitled to the notice, but no waiver shall affect any notice requirement as to other Persons.

Section 6.03 Third Party Beneficiaries. This Pledge Agreement is not intended for the benefit of and shall not be construed to create rights in parties other than the Corporation, the Trustee and the Series 2007-1C Bondholders. Except for the Series 2007-1C Bondholders, there are no third party beneficiaries to this Pledge Agreement.

Section 6.04 Successors and Assigns. All covenants and agreements in this Pledge Agreement by the Corporation shall bind its successors and assigns, whether so expressed or not. All agreements of the Trustee in this Pledge Agreement shall bind its successors.

Section 6.05 Governing Law. This Pledge Agreement shall be construed in accordance with and governed by the Constitution and the laws of the State.

Section 6.06 Limitation of Liability. No member, director, officer, or employee of the Corporation shall be individually or personally liable for the payments due under this Pledge Agreement, but nothing contained herein shall relieve any director, officer, or employee of the Corporation from the performance of any official duty provided by any applicable provisions of law or hereby.

Section 6.07 Signatures and Counterparts. This Pledge Agreement and each Supplemental Indenture may be executed and delivered in any number of counterparts, each of which shall be deemed to be an original, but such counterparts together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the Corporation and the Trustee have caused this Pledge Agreement to be executed their duly authorized offices as of the day and year first above written.

TOBACCO SETTLEMENT FINANCING CORPORATION

By______________________________________
Name: Andrew P. Sidamon-Eristoff
Title: President

THE BANK OF NEW YORK MELLON,
as Series 2007-1C Pledge Agreement Trustee

By: ________________________________
Name: David J. O'Brien
Title: Vice President

[SIGNATURE PAGE TO PLEDGE AGREEMENT]

EXHIBIT A
FORM OF OMNIBUS REDEMPTION NOTICE

March 7, 2014

The Bank of New York Mellon, as Trustee
385 Rifle Camp Road, 3rd Fl.
Woodland Park, NJ 07424

Re: Omnibus Notice of Optional Redemption
Tobacco Settlement Financing Corporation
Tobacco Settlement Asset-Backed Bonds, Series 2007-1C
Second Subordinate Capital Appreciation Bonds (Turbo Term Bonds)

Ladies and Gentlemen:

Reference is made to the Series 2007-1C Pledge Agreement, dated as of March 1, 2014 (the "Pledge Agreement"), between the Tobacco Settlement Financing Corporation (the "Corporation") and The Bank of New York Mellon, as Series 2007-1C Pledge Agreement Trustee (the "Pledge Agreement Trustee") relating to the above captioned bonds (the "Series 2007-1C Bonds"). Capitalize terms used but not defined in this notice shall have the meaning set forth in the Pledge Agreement or in the hereinafter defined Indenture.

The Series 2007-1C Bonds are issued pursuant to a Trust Indenture (the "Trust Indenture"), as supplemented by a Series 2007 Supplement (the "Series 2007 Supplement" and, together with the Trust Indenture, the "Indenture), both dated as of January 1, 2007, by and between the Corporation and The Bank of New York Mellon, as trustee (the "Bond Trustee"). The Series 2007-1C Bonds are subject to redemption at the option of the Corporation, in whole or in part, on any date on or after June 1, 2017, from any Maturity Date selected by the Corporation in its discretion and on such basis as the Bond Trustee shall deem fair and appropriate, including by lot, within a Maturity Date, in either case at a redemption price equal to 100% of the Accreted Value on the redemption date. Pursuant to Section 3.02 of the Pledge Agreement, the Corporation has exercised its option to call the Series 2007-1C Bonds for optional redemption on June 1, 2017 and on each June 1 thereafter until the Series 2007-1C Bonds have been Fully Paid (each such June 1, on "Optional Redemption Date") in an Aggregate Accreted Value (determined as of such Optional Redemption Date) equal to the maximum amount of Series 2007-1C Bonds that can be redeemed in Authorized Denominations from the balance on deposit in the Series 2007-1C Additional Pledged TSRs Account on the May 1 immediately preceding such Optional Redemption Date, or if such May 1 is not a Business Day, on the next preceding Business Day, or (b) all of the Series 2007-1C Bonds Outstanding as of such Optional Redemption Date (each such amount being referred to herein as the "Applicable Amount").

Pursuant to Section 5.04(f) of the Trust Indenture, the Bond Trustee shall be provided with 30 days prior notice of any optional redemption. Please accept this Omnibus Notice as the notice specified in said Section 5.04(f) and direction of the Corporation to call the Series 2007-1C Bonds for optional redemption in accordance with the provisions of the Indenture and as specified in the Pledge Agreement on each Optional Redemption Date in an amount equal to the Applicable Amount for such Optional Redemption Date. In the event that at any time the Pledge Agreement Trustee and the Bond Trustee shall not be one and the same Person, the

Corporation shall cause the Pledge Agreement Trustee to provide you with a Supplemental Notice of Optional Redemption in the form attached hereto as Exhibit A. The form of redemption notice to be given by the Bond Trustee to the holders of the Series 2007-1C Bonds to be redeemed is attached hereto as Exhibit B.

Very truly yours,

TOBACCO SETTLEMENT FINANCING CORPORATION

By: ______________________________
Andrew P. Sidamon-Eristoff
President

Receipt Acknowledged:

THE BANK OF NEW YORK MELLON

By:______________________________
Name: David J. O'Brien
Title Vice President

Dated: March 7, 2014

EXHIBIT B
FORM OF SUPPLEMENTAL REDEMPTION NOTICE

May 1, 20__

[Bond Trustee]
[Address]
[Address]

Re: Supplemental Notice of Optional Redemption
Tobacco Settlement Financing Corporation
Tobacco Settlement Asset-Backed Bonds, Series 2007-1C
Second Subordinate Capital Appreciation Bonds (Turbo Term Bonds)

Ladies and Gentlemen:

Notice is hereby given, on behalf of the Tobacco Settlement Financing Corporation (the "Corporation"), in accordance with Section 3.02 of the Pledge Agreement, dated as of March 1, 2014 (the "Series 2007-1C Pledge Agreement"), by and between the Corporation and The Bank of New York Mellon (the "Series 2007-1B Pledge Agreement Trustee"), to ______________________________, as Bond Trustee under the Trust Indenture, as supplemented by a Series 2007 Supplement, both dated as of January 1, 2007 (the "Indenture"), by and between the Corporation and the Bond Trustee, in connection with the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1C Second Subordinate Capital Appreciation Bonds (Turbo Term Bonds) maturing June 1, 2041 (the "Series 2007-1C Bonds"), that $______________ aggregate Accreted Value of Series 2007-1C Bonds shall be redeemed on June 1, 20__ (the "Redemption Date") in accordance with the terms of the Indenture.

TOBACCO SETTLEMENT FINANCING CORPORATION

By: The Bank of New York Mellon,
as Series 2007-1C Pledge Agreement Trustee

Receipt Acknowledged:

[Bond Trustee]

By:___________________________
Name:
Title

Dated:

APPENDIX D

FORM OF ASSIGNMENT AGREEMENT

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ASSIGNMENT AGREEMENT

between

THE STATE OF NEW JERSEY

and

TOBACCO SETTLEMENT FINANCING CORPORATION

Dated as of March 1, 2014

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Appendix A - Form of Second Amended and Restated Residual Certificate..A-1

THIS ASSIGNMENT AGREEMENT (the “Agreement”), dated as of March 1, 2014, between **THE STATE OF NEW JERSEY** (the “State”) and the **TOBACCO SETTLEMENT FINANCING CORPORATION** (the “Corporation”), a public body corporate and politic established in, but not of, the Department of the Treasury and an instrumentality of the State exercising public and essential governmental functions.

RECITALS:

WHEREAS, pursuant to the Act (as defined herein) and a Purchase and Sale Agreement (the “2002 Purchase Agreement”), dated as of August 1, 2002, between the Corporation and the State, the Corporation purchased from the State the entirety of the TSRs (as defined herein), and the State received in consideration therefor the proceeds from the sale of the Corporation’s Tobacco Settlement Asset Backed Bonds, Series 2002 (the “2002 Bonds”) and the Residual Certificate referred to in such 2002 Purchase Agreement (the “2002 Residual Certificate”), which evidenced, among other things, the beneficial ownership right of the State in, and the State’s right to receive, the portion of the TSRs that were not pledged to secure the 2002 Bonds; and

WHEREAS, pursuant to the Act and a Purchase and Sale Agreement, dated as of March 1, 2003, between the Corporation and the State, the Corporation thereafter purchased from the State the beneficial ownership right of the State in, and the State’s right to receive, the portion of the TSRs that were not pledged to secure the 2002 Bonds as evidenced by the Series 2002 Residual Certificate, and the State received in consideration therefor the proceeds from the sale of the Corporation’s Tobacco Settlement Asset Backed Bonds, Series 2003 (the “2003 Bonds”); and

WHEREAS, pursuant to the Act and a Trust Indenture, as supplemented by a Series 2007 Supplement, both dated as of January 1, 2007 (collectively, the “Indenture”), by and between the Corporation and the The Bank of New York Mellon, as trustee (the “Bond Trustee”), the Corporation issued its $3,622,208,081.50 Tobacco Settlement Asset-Backed Bonds, Series 2007-1 (the “Series 2007 Bonds”), consisting of (i) its $3,436,225,000.00 Series 2007-1A Senior Current Interest Serial Bonds and Series 2007-1A Senior Current Interest Turbo Term Bonds (collectively, the “Series 2007-1A Bonds”), (ii) its $126,198,000.00 Series 2007-1B First Subordinate Capital Appreciation Bonds (Turbo Term Bonds) (the “Series 2007-1B Bonds”), and (iii) its $59,785,081.50 Series 2007-1C Second Subordinate Capital Appreciation Bonds (Turbo Term Bonds) (the “Series 2007-1C Bonds” and together with the Series 2007-1B Bonds, the “Series 2007 Subordinate Bonds”); and

WHEREAS, the Series 2007 Bonds were issued in order to refund the Corporation’s then outstanding 2002 Bonds and 2003 Bonds; and

WHEREAS, the Series 2007 Bonds are secured by and payable from, among other things, all of the Corporation’s right, title and interest in the “Pledged TSRs”, consisting of 76.26% of the TSRs received by the State under the MSA; and

WHEREAS, the 23.74% of the TSRs owned by the Corporation that are not Pledged TSRs (the “2007 Unpledged TSRs”) are not pledged to the payment of the Series 2007 Bonds pursuant to the Indenture and are currently paid upon receipt from time to time to the State, as owner of the Amended and Restated Residual Certificate, dated January 29, 2007, issued by the Corporation in connection with the issuance of the Series 2007 Bonds (the “2007 Residual Certificate”); and

WHEREAS, simultaneously with the execution and delivery of this Agreement, and in consideration of the payment of the Series 2007-1B Bond Enhancement Premium (as hereinafter defined) by certain Series 2007-1B Bondholders (the "Identified Series 2007-1B Bondholders"), the Corporation is entering into a Pledge Agreement, dated as of March 1, 2014 (the "Series 2007-1B Pledge Agreement"), with The Bank of New York Mellon, as Series 2007-1B Pledge Agreement Trustee (in such capacity, the "Series 2007-1B Trustee") pursuant to which the Corporation is assigning a portion of the 2007 Unpledged TSRs, constituting 15.99% of the TSRs owned by the Corporation and received by the Depository Agent (as defined herein) on and after July 1, 2016 (the "Series 2007-1B Additional Pledged TSRs") to the payment of all of the Series 2007-1B Bonds, which Series 2007-1B Additional Pledged TSRs will be applied to the optional redemption of the Series 2007-1B Bonds in accordance with their terms, all subject to the terms and conditions set forth in the Series 2007-1B Pledge Agreement; and

WHEREAS, simultaneously with the execution and delivery of this Agreement, and in consideration of the payment of the Series 2007-1C Bond Enhancement Premium (as hereinafter defined) by certain Series 2007-1C Bondholders (the "Identified Series 2007-1C Bondholders"), the Corporation is entering into a Pledge Agreement, dated as of March 1, 2014 (the "Series 2007-1C Pledge Agreement" and, together with the Series 2007-1B Pledge Agreement, the "Pledge Agreements"), with The Bank of New York, as Series 2007-1C Pledge Agreement Trustee (in such capacity, the "Series 2007-1C Trustee" and together with the Series 2007-1B Trustee, collectively referred to as the "Pledge Agreement Trustees") pursuant to which the Corporation is assigning a portion of the 2007 Unpledged TSRs, constituting 7.75% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "Series 2007-1C Additional Pledged TSRs", and together with the Series 2007–1B Additional Pledged TSRs, the "Additional Pledged TSRs") to the payment of all of the Series 2007-1C Bonds, which Series 2007-1C Additional Pledged TSRs will be applied to the optional redemption of the Series 2007-1C Bonds in accordance with their terms, all subject to the terms and conditions set forth in the Series 2007-1C Pledge Agreement; and

WHEREAS, simultaneously with the execution and delivery of this Agreement, and in order to implement and facilitate the transactions contemplated by the Pledge Agreements, the State, the Corporation, the Pledge Agreement Trustees, the Bond Trustee and the Depository Agent are entering into an Amended and Restated Depository Agreement (the "Amended Depository Agreement") in order to amend and restate the 2007 Depository Agreement to provide for (i) the payment by the Depository Agent of the Series 2007-1B Additional Pledged TSRs to the Series 2007-1B Trustee in accordance with the Series 2007-1B Pledge Agreement, (ii) the payment of the payment by the Depository Agent of the Series 2007-1C Additional Pledged TSRs to the Series 2007-1C Trustee in accordance with the Series 2007-1C Pledge Agreement, and (iii) the payment of the remaining Unpledged TSRs to the State, as the registered owner of the Second Amended and Restated Residual Certificate (as hereinafter defined); and

WHEREAS, in order to facilitate the transactions contemplated to by the Pledge Agreements and the Amended Depository Agreement, and, in particular, to confirm the absolute right of the Corporation to pledge the Series 2007-1B Additional Pledged TSRs to the Series 2007-1B Bondholders and to pledge the Series 2007-1C Additonal Pledged TSRs to the Series 2007-1C Bondholders, the State is entering in tho this Assignment Agreement; and

WHEREAS, notwithstanding the execution and delivery of the Pledge Agreements, the Amended Depository Agreement and this Agreement, the State, as the holder of the Second Amended and Restated Residual Certificate (as hereinafter defined), shall retain for itself the continued right to receive (i) all 2007 Unpledged TSRs received by the Depository Agent prior to July 1, 2016, (ii) all Series 2007-1B Additional Pledged TSRs received by the Depository Agent after the Series 2007-1B Bonds have been Fully Paid (as hereinafter defined"), and (iii) all Series 2007-1C Additional Pledged TSRs received by the Depository Agent after the Series 2007-1C Bonds have been Fully Paid (collectively, the "Unpledged TSRs").

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, the parties hereto agree as follows:

ARTICLE I

DEFINITIONS

Section 1.01. Definitions. Capitalized terms used but not defined in the Agreement shall have the meanings given to such terms in the Indenture, the Pledge Agreements or the Amended Depository Agreement, as the case may be. In addition, for purposes of this Agreement, (a) terms defined in the recitals to this Agreement shall have the meanings set forth therein, and (b) the following terms shall have the meanings set forth below:

"Act" means the Tobacco Settlement Financing Corporation Act, now codified as Chapter 32 of the Pamphlet Laws of 2002 of The State of New Jersey.

"Assigned Additional Pledged TSRs" means, individually or collectively, the Assigned Series 2007-1B Additional Pledged TSRs and the Assigned Series 2007-1C Additional Pledged TSRs.

"Assigned Series 2007-1B Additional Pledged TSRs" means all of the State's beneficial ownership right, title and interest in and to, and the State's right, pursuant to the 2007 Residual Certificate, to receive, the Series 2007-1B Additional Pledged TSRs.

"Assigned Series 2007-1C TSRs" means all of the State's beneficial ownership right, title and interest in and to, and the State's right, pursuant to the 2007 Residual Certificate, to receive, the Series 2007-1C Additional Pledged TSRs.

"Consent Decree" means the Consent Decree and Final Judgment of the Superior Court, Chancery Division, Middlesex County in State v. R.J. Reynolds Tobacco Company, No. C-254-96.

"Depository Agent" means Bank of New York Mellon, acting as Depository Agent, under the Amended Depository Agreement.

"Fully Paid" shall have the meaning given to such term in Section 2.03(b) of the Indenture.

"Master Settlement Agreement" or "MSA" means the Master Settlement Agreement identified in the Consent Decree, including the related Escrow Agreement (as defined therein).

"Opinion of Counsel" means one or more written opinions of counsel who may be an employee of or counsel to the State, which counsel shall be acceptable to the respective Trustee.

"Outstanding" when used with respect to the Series 2007 Subordinate Bonds, shall exclude Series 2007 Subordinate Bonds that shall have been Fully Paid.

"Securities" means, in accordance with Section 4 of the Act, any securities, including without limitation any bonds, notes and other evidence of indebtedness, issued by the Corporation pursuant to Section 7 of the Act.

"Series 2007 Subordinate Bondholders" or "Holders" means the registered owners of Outstanding Series 2007 Subordinate Bonds.

"Series 2007 Subordinate Bond Enhancement Memorandum" means the Bond Enhancement Memorandum, dated March 6, 2014, delivered by the Corporation to the Series 2007 Subordinate Bondholders in connection with the enhancement of the Series 2007 Subordinate Bonds as set forth in the Pledge Agreements.

"Series 2007-1B Bond Enhancement Premium" means $46,506,899.25 to be paid by the Series 2007-1B Identified Bonholders in consideration of the execution and delivery of the Series 2007-1B Pledge Agreement, which Series 2007-1B Bond Enhancement Premium shall be remitted by the Corporation to the State as provided in Section 2.01(a).

"Series 2007-1C Bond Enhancement Premium" means $96,507,317.25 to be paid by the Series 2007-1C Identified Bonholders in consideration of the execution and delivery of the Series 2007-1C Pledge Agreement, which Series 2007-1C Bond Enhancement Premium shall be remitted by the Corporation to the State as provided in Section 2.01(b).

"State Lien" means a security interest, lien, charge, pledge, equity or encumbrance of any kind, attaching to the interests of the State in and to the Additional Pledged TSRs, whether or not as a result of any act or omission by the State.

"TSRs" means the Tobacco Settlement Revenues as defined in the Indenture.

"Second Amended and Restated Residual Certificate" means the Amended and Restated Residual Certificate, dated March 7, 2014, executed and delivered in connection with the execution and delivery of the Pledge Agreements, in the form attached hereto as Exhibit A, as may be amended from time to time.

Section 1.02. Other Definitional Provisions.

(a) The words "hereof," "herein," "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement; Article, Section, Schedule and Exhibit references contained in this Agreement are references to Articles, Sections, Schedules and Exhibits in or to this Agreement unless otherwise specified; and the term "including" shall mean "including without limitation."

(b) The definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms and to the masculine as well as to the feminine and neuter genders of such terms.

(c) Any agreement, instrument or statute defined or referred to herein or in any instrument or certificate delivered in connection herewith means such agreement, instrument or statute as from time to time amended, modified or supplemented and includes (in the case of agreements or instruments) references to all attachments thereto and instruments incorporated therein; references to a person are also to its permitted successors and assigns.

Section 1.03 No Liability. (a) Neither the directors, officers, employees or agents of the of the State or the Corporation shall be liable personally hereunder or be subject to any personal liability or accountability solely by reason of the issuance or execution and delivery hereof.

(b) **THE PLEDGE AGREEMENTS ARE ANCILLARY FACILITIES WITHIN THE MEANNG OF THE ACT. THE ACT PROVIDES THAT THE ISSUANCE OF SECURITIES AND THE EXECUTION OF ANY ANCILLARY FACILITY UNDER THE PROVISIONS OF THE ACT SHALL NOT DIRECTLY, OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO PAY ANY AMOUNTS TO THE CORPORATION OR OWNER OF SECURITIES OR BENEFITTED PARTIES OR LEVY OR PLEDGE ANY FORM OF TAXATION WHATSOEVER THEREFOR. THE SECURITIES AND ANY ANCILLARY FACILITY SHALL NOT BE A DEBT OR LIABILITY OF THE STATE OR ANY AGENCY OR INSTRUMENTALITY THEREOF (OTHER THAN THE CORPORATION AS SET FORTH IN THE ACT), EITHER LEGAL, MORAL OR OTHERWISE, AND NOTHING CONTAINED IN THE ACT SHALL BE CONSTRUED TO AUTHORIZE THE CORPORATION TO INCUR ANY INDEBTEDNESS ON BEHALF OF OR IN ANY WAY TO OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF, AND THE SECURITIES AND ANY ANCILLARY FACILITY SHALL CONTAIN ON THE FACE THEREOF OR OTHER PROMINENT PLACE THEREON IN BOLD TYPEFACE A STATEMENT TO THE FOREGOING EFFECT. NO APPROPRIATION OF ANY MONEYS BY THE STATE TO THE CORPORATION IS AUTHORIZED IN THE ACT.**

ARTICLE II

ASSIGNEMENT OF ADDITIONAL PLEDGED TSRs

Section 2.01. Assignment of Additional Pledged TSRs. (a) The State Representative, on behalf of the State, does hereby absolutely and presently grant, convey, transfer and assign to the Corporation, without recourse, the Assigned Series 2007-1B Additional Pledged TSRs until such time as the Series 2007-1B Bonds have been Fully Paid. As consideration for such assignment of the Assigned Series 2007-1B Additional Pledged TSRs by the State to the Corporation, the Corporation does hereby promise to pay, transfer, assign, set over and otherwise convey to the State, without recourse, (i) the net amount of the Series 2007-B Bond Enhancement Premium after payment of the transaction costs as set forth in Section 3.04 of the Series 2007-1B Pledge Agreement, and (ii) the Second Amended and Restated Residual Certificate as annexed hereto, as it relates to the Series 2007-1B Additional Pledged TSRs.

(b) The State Representative, on behalf of the State, does hereby absolutely and presently grant, convey, transfer and assign to the Corporation, without recourse, the Assigned Series 2007-1C Additional Pledged TSRs until such time as the Series 2007-1C Bonds have been Fully Paid. As consideration for such assignment of the Assigned Series 2007-1C Additional Pledged TSRs by the State to the Corporation, the Corporation does hereby promise to pay, transfer, assign, set over and otherwise convey to the State, without recourse, (i) the net amount of the Series 2007-C Bond Enhancement Premium after payment of the transaction costs as set forth in Section 3.04 of the Series 2007-1C Pledge Agreement, and (ii) the Second Amended and Restated Residual Certificate as annexed hereto, as it relates to the Series 2007-1C Additional Pledged TSRs.

(c) During the respective periods that (i) the Series 2007-1B Additional Pledged TSRs are payable to the Corporation and pledged under the Series 2007-1B Pledge Agreement, (ii) the Series 2007-1C Additional Pledged TSRs are payable to the Corporation and pledged under the Series 2007-1C Pledge Agreement, and (iii) the Pledged TSRs are payable to the Corporation and pledged under the Indenture, the right of the Corporation to receive the Pledged TSRs, the Series 2007-1B Additional Pledged TSRs, the Series 2007-1C Additional Pledged TSRs and the Unpledged TSRS shall be on a parity with one another, and no such right shall be inferior or superior to any other such right. None of the Corporation, the State, the Bond Trustee, the Series 2007-1B Trustee or the Series 2007-1C Trustee shall have the right to make a claim to make up all or any portion of an asserted deficiency in any of the Pledged TSRs, Series 2007-1B Additonal Pledged TSRs, Series 2007-1C Additional Pledged TSRs or Unpledged TSRSs from any other thereof.

(d) Notwithstanding the execution and delivery of the Pledge Agreements, the Amended Depository Agreement and this Agreement, the State, as the holder of the Second Amended and Restated Residual Certificate (as hereinafter defined), shall retain for itself the continued right to receive (i) all 2007 Unpledged TSRs received by the Depository Agent prior to July 1, 2016, (ii) all Series 2007-1B Additional Pledged TSRs received by the Depository Agent after the Series 2007-1B Bonds have been Fully Paid, and (iii) all Series 2007-1C Additional Pledged TSRs received by the Depository Agent after the Series 2007-1C Bonds have been Fully Paid (collectively, the "Unpledged TSRs").

ARTICLE III

THE STATE

Section 3.01. Representations of State. The State, as assignor, makes the following representations on which the Corporation may rely and is deemed to have relied in acquiring the Assigned Additional Pledged TSRs as set forth herein. The representations are made as of the date of this Agreement and shall survive the assignment of the Assigned Additional Pledged TSRs to the Corporation, and the pledge of the Additional Pledged TSRs by the Corporation pursuant to the Pledge Agreements.

(a) Power and Authority. The State is duly authorized pursuant to the Act to assign the Assigned Additional Pledged TSRs as set forth herein and has full power and authority to execute and deliver this Agreement and to carry out its terms.

(b) Binding Obligation. This Agreement has been duly authorized, executed and delivered by the State and, assuming the due authorization, execution and delivery of this

Agreement by the Corporation, constitutes a legal, valid and binding obligation of the State enforceable against the State in accordance with its terms.

(c) 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 by the State of the transactions contemplated by this Agreement, except for those which have been obtained and are in full force and effect.

(d) No Violation. The assignment by the State of the Assigned Additional Pledged TSRs and the fulfillment of the terms hereof do not, to the State's knowledge, in any material way conflict with, result in any material breach of any of the material terms and provisions of, or constitute (with or without notice or lapse of time) a material default under, any indenture, agreement or other instrument to which the State is a party or by which it shall be bound; nor violate any law or, to the State's knowledge, any order, rule or regulation applicable to the State of any court or of any federal or state regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the State or its property.

(e) No Proceedings. To the State's knowledge, except as may be disclosed in the Series 2007 Subordinate Bond Enhancement Memorandum, 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 the Act or this Agreement, (ii) seeking to prevent the assignment of the Assigned Additional Pledged TSRs or other transactions contemplated hereunder, or (iii) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of any of this Agreement, the Act, the MSA or the Consent Decree.

(f) Ownership of Assigned Additional Pledged TSRs. The State is the sole owner of the Assigned Additional Pledged TSRs to be assigned to the Corporation hereunder. On and after the date hereof, (i) the State shall have no right, title or interest in or to the Additional Pledged TSRs, and (ii) the Additional Pledged TSRs shall be property of the Corporation, and not of the State, and shall be owned, received, held and disbursed by the Corporation or respective Pledge Agreement Trustee and not by the State or the State Treasury.

(g) True Assignment; Absence of Liens on Additional Pledged TSRs. The State is assigning the Assigned Additional Pledged TSRs free and clear of any and all State Liens, pledges, charges, security interests or any other statutory impediments to transfer or conveyance of any nature encumbering the Additional Pledged TSRs. The assignment of the Assigned Additional Pledged TSRs is, and shall be treated as, a true and absolute assignment of the property from the State to the Corporation, and all of the right, title and interest in and to such property, so transferred and conveyed, and not as a pledge or any other security interest or lien for borrowing. As provided by the Act, the characterization by the State of such assignment as an absolute transfer or conveyance shall not be negated or adversely affected by (i) the fact that the beneficial interest in only a portion of the TSRs may be transferred to the Corporation or to the respective Trustee, (ii) the acquisition or retention by the State of a residual interest, (iii) the participation by any State official as a member or officer of the Corporation, (iv) the commingling of amounts arising with respect to the Additional Pledged TSRs with other amounts, (v) whether the State is responsible for collecting the Additional Pledged TSRs or otherwise enforcing the MSA or retains legal title to such portion of the Additional Pledged TSRs for the purposes of these collection activities, (vi) any characterization of the Corporation or its obligations for purposes of accounting, taxation or securities regulation, or (vii) any other factor whatsoever.

(h) Pledge Agreements. The State acknowledges that the Corporation will pledge the Additional Pledged TSR's as a further source of payment for the Series 2007 Subordinate Bonds pursuant to the Pledge Agreements and expressly consents to such pledges.

ARTICLE IV

COVENANT OF THE STATE

Section 4.01. Further Actions. Upon request of the Corporation or the respective Pledge Agreement 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 this Agreement.

ARTICLE V

REPRESENTATIONS AND COVENANTS OF THE CORPORATION

Section 5.01. Representations. The Corporation hereby represents and warrants to the State that (i) it is a public body corporate and politic and an instrumentality of the State created by the Act and established in, but not of, the Department of the Treasury, (ii) it is duly authorized pursuant to the Act to accept assignment of the Additional Pledged TSRs and has full power and authority to execute and deliver this Agreement, and (iii) this Agreement has been duly authorized, executed and delivered by the Corporation and, assuming due authorization, execution and delivery of this Agreement by the State, constitutes a legal, valid and binding obligation of the Corporation enforceable against the Corporation in accordance with its terms.

Section 5.02. Further Actions. Upon request of the State or the respective Trustee, the Corporation will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of this Agreement. The Corporation shall, as soon as practicable, pay to the State any amounts due to the State that are received by the Corporation in error.

Section 5.03. Residual. As part of the consideration for the sale to the Corporation by the State of the Additional Pledged TSRs, the Corporation agrees to issue the Second Amended and Restated Residual Certificate to the State in the form annexed hereto.

ARTICLE VI

MISCELLANEOUS

Section 6.01. Amendment. This Agreement may not be amended in any manner adverse to the interests of (a) the Owners of the Series 2007 Bonds and Beneficiaries except as permitted by Section 10.01 of the Indenture, (b) the Series 2007-1B Bondholders except as permitted by Section 6.01 of the Series 2007-1B Pledge Agreement, or (c) the Series 2007-1C Bondholders except as permitted by Section 6.01 of the Series 2007-1C Pledge Agreement. In all other respects, this Agreement may be amended by agreement among the parties hereto.

Section 6.02. Notices. All demands, notices and communications upon or to the State, the Corporation or the respective Trustee under this Agreement shall be in writing, personally delivered or mailed by certified mail, return receipt requested, and shall be deemed to have been duly given upon receipt at:

(a) in the case of the State:

State Treasurer, as State Representative
State House
125 West State Street
P.O. Box 002
Trenton, New Jersey 08625

(b) in the case of the Corporation:

Tobacco Settlement Financing Corporation,
c/o State of New Jersey, Office of Public Finance
50 West State Street
P.O. Box 005
Trenton, New Jersey 08625
Attention: Director, Office of Public Finance

(c) in the case of the Trustee:

Bank of New York Mellon
385 Rifle Camp Road
Woodland Park, New Jersey 07424
Attention: Corporate Trust Administration

As to each of the foregoing, at such other address as shall be designated by written notice to the Trustee and to the other parties.

Section 6.03. Limitations on Rights of Others. The provisions of this Agreement are solely for the benefit of the State, the Corporation, the Pledge Agreement Trustees, the owner of the Second Amended and Restated Residual Certificate, and the Series 2007 Subordinate Bondholders and benefitted parties, enforceable by the Bondholders and benefitted persons under the conditions contained in the Pledge Agreements, and nothing in this Agreement, whether express or implied, shall be construed to give to any other person any legal or equitable right, remedy or claim under or in respect of this Agreement or any covenants, conditions or provisions contained herein.

Section 6.04. Severability. Any provision of this Agreement that is prohibited or unenforceable shall be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof.

Section 6.05. Separate Counterparts. This Agreement may be executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

Section 6.06. Headings. The headings of the various Articles and Sections herein are for convenience of reference only and shall not define or limit any of the terms or provisions hereof.

Section 6.07. Governing Law. This Agreement shall 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 shall be determined in accordance with such laws.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their respective officers as of the day and year first above written.

TREASURER, STATE OF NEW JERSEY

By:__________________________________
Name: Andrew P. Sidamon-Eristoff

TOBACCO SETTLEMENT FINANCING CORPORATION

By:__________________________________
Name: Andrew P. Sidamon-Eristoff
Title: President

APPENDIX A

[insert Second Amended and Restated Residual Certificate]

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APPENDIX E

FORM OF AMENDED AND RESTATED DEPOSITORY TRUST AGREEMENT

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AMENDED AND RESTATED DEPOSITORY TRUST AGREEMENT

This Amended and Restated Depository Trust Agreement, dated as of March 1, 2014 (the "Amended Depository Agreement"), by and among The State of New Jersey (the "State"), the Tobacco Settlement Financing Corporation, a public body corporate and politic established in, but not of, the Department of the Treasury and an instrumentality of the State exercising public and essential governmental functions (the "Corporation"), The Bank of New York Mellon, a banking corporation organized and existing under the laws of the State of New York, as depository agent (in such capacity, the "Depository Agent"), as trustee under the hereinafter defined Indenture (in such capacity, the "Bond Trustee"), as trustee under the hereinafter defined Series 2007-1B Pledge Agreement (in such capacity, the "Series 2007-1B Trustee") and as trustee under the hereinafter defined Series 2007-1C Pledge Agreement (in such capacity, the "Series 2007-1C Trustee"). Capitalized terms used herein, to the extent not otherwise defined herein, shall have the meanings ascribed thereto in the Indenture, the hereinafter defined Series 2007-1B Pledge Agreement or the hereinafter defined Series 2007-1C Pledge Agreement.

WHEREAS, the State is a party to the Master Settlement Agreement (the "MSA") entered into by participating cigarette manufacturers, 46 states and six U.S. jurisdictions in November 1998 in the settlement of certain smoking-related litigation; and

WHEREAS, pursuant to a Trust Indenture, as supplemented by a Series 2007 Supplement, both dated as of January 1, 2007 (collectively, the " Indenture"), by and between the Corporation and the Bond Trustee, the Corporation issued its $3,622,208,081.50 Tobacco Settlement Asset-Backed Bonds, Series 2007-1 (the "Series 2007 Bonds"), consisting of (i) its $3,436,225,000.00 Series 2007-1A Senior Current Interest Serial Bonds and Series 2007-1A Senior Current Interest Turbo Term Bonds (collectively, the "Series 2007-1A Bonds"), (ii) its $126,198,000.00 Series 2007-1B First Subordinate Capital Appreciation Bonds (Turbo Term Bonds) (the "Series 2007-1B Bonds"), and (iii) its $59,785,081.50 Series 2007-1C Second Subordinate Capital Appreciation Bonds (Turbo Term Bonds) (the "Series 2007-1C Bonds"); and

WHEREAS, to secure the payment of the Series 2007 Bonds, the Corporation assigned and pledged to the Bond Trustee 76.26% of the TSRs (the "Pledged TSRs"), the remaining 23.74% (the "2007 Unpledged TSRs") being property of the registered owner of the Residual Certificate (the "2007 Residual Certificate"); and

WHEREAS, pursuant to the Act, the State is authorized and may arrange for the availability of the "residual interests" (as such term is defined in the Act) from the Corporation on such terms and conditions as the State Representative shall deem appropriate; and

WHEREAS, upon the execution and delivery of the Series 2007 Bonds, the 2007 Residual Certificate was executed by the Corporation and delivered to the State and registered in the name of the State on the books of the Corporation held by the Bond Trustee; and

WHEREAS, simultaneously with the execution and delivery of the Series 2007 Bonds, the State, the Bond Trustee, the Depository Agent and the Corporation entered into a Depository Trust Agreement, dated as of January 1, 2007 (the "2007 Depository Agreement") in order to create a depository trust account for the holding and administration of the TSRs and the transfer of the Pledged TSRs to the Bond Trustee as Depository Agent and the 2007 Unpledged TSRs to the State, all as provided therein; and

WHEREAS, simultaneously with the execution and delivery of this Amended Depository Agreement, and in consideration of the payment of a Series 2007-1B Enhancement Premium by the Identified Series 2007-1B Bondholders, the Corporation and the Series 2007-1B Trustee are entering into a Pledge Agreement, dated as of March 1, 2014 (the "Series 2007-1B Pledge Agreement"), pursuant to which the Corporation is assigning a portion of the 2007 Unpledged TSRs, constituting 15.99% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "Series 2007-1B Additional Pledged TSRs") to the payment of all of the Series 2007-1B Bonds, which Series 2007-1B Additional Pledged TSRs will be applied to the optional redemption of the Series 2007-1B Bonds in accordance with their terms, all subject to the terms and conditions set forth in the Series 2007-1B Pledge Agreement; and

WHEREAS, simultaneously with the execution and delivery of this Amended Depository Agreement, and in consideration of the payment of a Series 2007-1C Enhancement Premium by the Identified Series 2007-1C Bondholders, the Corporation and the Series 2007-1C Trustee are entering into a Pledge Agreement, dated as of March 1, 2014 (the "Series 2007-1C Pledge Agreement"; the Series 2007-1B Pledge Agreement and the Series 2007-1C Pledge Agreement are each referred to herein individually as a "Pledge Agreement" and collectively as the "Pledge Agreements"), pursuant to which the Corporation is assigning a portion of the 2007 Unpledged TSRs, constituting 7.75% of the TSRs owned by the Corporation and received by the Depository Agent on and after July 1, 2016 (the "Series 2007-1C Additional Pledged TSRs") to the payment of all of the Series 2007-1C Bonds, which Series 2007-1C Additional Pledged TSRs will be applied to the optional redemption of the Series 2007-1C Bonds in accordance with their terms, all subject to the terms and conditions set forth in Series 2007-1C Pledge Agreement; and

WHEREAS, the parties are entering into this Amended Depository Agreement in order to amend and restate the 2007 Depository Agreement to provide for (i) the payment by the Depository Agent of the Series 2007-1B Additional Pledged TSRs to the Series 2007-1B Trustee in accordance with the Series 2007-1B Pledge Agreement, and (ii) the payment by the Depository Agent of the Series 2007-1C Additional Pledged TSRs to the Series 2007-1C Trustee in accordance with the Series 2007-1C Pledge Agreement.

NOW THEREFORE, in consideration of the premises and other valuable consideration, the parties hereto agree as follows:

SECTION 1. <u>Application of Pledged TSRs, Series 2007-1B Additional Pledged TSRs, Series 2007-1C Additional Pledged TSRs and Unpledged TSRs</u>. As permitted by the Act, the State shall cause the MSA Escrow Agent (as defined in the MSA) to wire all TSRs directly to the Depository Agent, which shall deposit such TSRs to the credit of the "TSRs Depository Trust Account", which trust account is hereby created. Within one (1) Business Day, the Depository Agent shall apply the amounts on deposit in the TSRs Depository Trust Account as follows:

(a) The Depository Agent shall transfer that percentage of the amounts in the TSRs Depository Trust Account as shall constitute Pledged TSRs to the Bond Trustee for deposit in the Collection Account maintained under the Indenture. In all respects, the Depository Agent shall act as agent for the Bond Trustee and the owners of the Series 2007 Bonds with respect to the collection, custody and remittance of the Pledged TSRs, and the pledge of the Pledged TSRs under the Indenture shall not be impaired in any respect by the temporary holding thereof, for the account of the Bond Trustee, by the

Depository Agent in the TSRs Depository Trust Account and the temporary pledge thereof hereunder.

(b) Simultaneously with the transfer of Pledged TSRs to the Bond Trustee pursuant to paragraph (a) of this Section 1, the Depository Agent shall transfer that percentage of the amounts in the TSRs Depository Trust Account as shall constitute Series 2007-1B Additional Pledged TSRs to the Series 2007-1B Trustee for deposit in the Series 2007-1B Additional Pledged TSRs Account maintained under the Series 2007-1B Pledge Agreement. In all respects, the Depository Agent shall act as agent for the Series 2007-1B Trustee and the owners of the Series 2007-1B Bonds with respect to the collection, custody and remittance of the Series 2007-1B Additional Pledged TSRs, and the pledge of the Series 2007-1B Additional Pledged TSRs under the Series 2007-1B Pledge Agreement shall not be impaired in any respect by the temporary holding thereof, for the account of the Series 2007-1B Trustee, by the Depository Agent in the TSRs Depository Trust Account and the temporary pledge thereof hereunder.

(c) Simultaneously with the transfer of Pledged TSRs to the Bond Trustee pursuant to paragraph (a) of this Section 1, the Depository Agent shall transfer that percentage of the amounts in the TSRs Depository Trust Account as shall constitute Series 2007-1C Additional Pledged TSRs to the Series 2007-1C Trustee for deposit in the Series 2007-1C Additional Pledged TSRs Account maintained under the Series 2007-1C Pledge Agreement. In all respects, the Depository Agent shall act as agent for the Series 2007-1C Trustee and the owners of the Series 2007-1C Bonds with respect to the collection, custody and remittance of the Series 2007-1C Additional Pledged TSRs, and the pledge of the Series 2007-1C Additional Pledged TSRs under the Series 2007-1C Pledge Agreement shall not be impaired in any respect by the temporary holding thereof, for the account of the Series 2007-1C Trustee, by the Depository Agent in the TSRs Depository Trust Account and the temporary pledge thereof hereunder.

(d) Simultaneously with the transfer of Pledged TSRs to the Bond Trustee pursuant to paragraph (a) of this Section 1, the Depository Agent shall transfer to the registered owner of the Second Amended and Restated Residual Certificate, dated March 7, 2014 (the "Second Amended and Restated Residual Certificate") (i) all 2007 Unpledged TSRs received by the Depository Agent prior to July 1, 2016, (ii) all Series 2007-1B Additional Pledged TSRs received by the Depository Agent after the Series 2007-1B Bonds have been Fully Paid, and (iii) all Series 2007-1C Additional Pledged TSRs received by the Depository Agent after the Series 2007-1C Bonds have been Fully Paid (collectively, the "Unpledged TSRs"). In all respects, the Depository Agent shall act as agent for the owner of the Second Amended and Restated Residual Certificate with respect to the collection, custody and remittance of the Unpledged TSRs, and the Unpledged TSRs shall never be subject to the pledge or lien of the Indenture or either Pledge Agreement but shall at all times be the property of the registered owner of the Second Amended and Restated Residual Certificate.

(c) The percentage of the TSRs that constitute Pledged TSRs shall be determined as provided in the Indenture and may be increased (or decreased), as provided in the Indenture. As of the date of this Amended Depository Agreement, 76.26% of all TSRs shall constitute Pledged TSRs, 15.99% of all TSRs shall constitute Series 2007-1B Additional Pledged TSRs, and 7.75% of all TSRs shall constitute Series 2007-1C Additional Pledged TSRs.

SECTION 2. Pledge; Additional Trust Accounts. In accordance with Section 7(d) of the Act, the lien of the pledge effected by the Corporation hereunder shall be valid and binding at the time made hereunder as against all parties having claims of any kind in tort, contract or otherwise against the Corporation, irrespective of whether such parties have notice thereof. The Corporation and the State may cause additional depository trust accounts, or subaccounts within accounts to be created and maintained hereunder.

SECTION 3. Investment of Funds. Until transferred as provided herein, the Pledged TSRs, the Series 2007-1B Additional Pledged TSRs and the Series 2007-1C Additional Pledged TSRs shall be held uninvested. Unpledged TSRs may be invested in securities lawful for the investment of public funds at the written direction of the State Representative.

SECTION 4. Duties and Liabilities of the Depository Agent. The Depository Agent, being the same entity as the Bond Trustee, shall have all of the same rights and immunities set forth in Article VII of the Indenture and incorporated by reference in each Pledge Agreement as if fully set forth herein and made applicable to the duties set forth herein of the Depository Agent. Resignation or removal of the Depository Agent shall be under the same circumstances as set forth in Article VII of the Indenture for resignation or removal of the Bond Trustee. The Non-petition Covenant set forth in Section 7.07 of the Indenture shall be deemed to be set forth herein as the covenant of the Depository Agent.

SECTION 5. Amendment. This Amended Depository Agreement may not be amended in any manner adverse to the interests of (a) the Owners of the Series 2007 Bonds and Beneficiaries except as permitted by Section 10.01 of the Indenture, (b) the Series 2007-1B Bondholders except as permitted by Section 6.01 of the Series 2007-1B Pledge Agreement, or (c) the Series 2007-1C Bondholders except as permitted by Section 6.01 of the Series 2007-1C Pledge Agreement. In all other respects, this Agreement may be amended by agreement among the parties hereto.

SECTION 6. Notices. All demands, notices and communications upon or to the parties hereto shall be in writing, personally delivered or mailed by certified mail, return receipt requested, and shall be deemed to have been duly given upon receipt at:

(a) in the case of the State:

State Treasurer, as State Representative
State House
125 West State Street
P.O. Box 002
Trenton, New Jersey 08625

(b) in the case of the Corporation:

Tobacco Settlement Financing Corporation
c/o State of New Jersey, Office Of Public Finance
50 West State Street
P.O. Box 005
Trenton, New Jersey 08625
Attention: Director, Office of Public Finance

(c) in the case of the Depository Agent:

The Bank of New York Mellon
385 Rifle Camp Road
Woodland Park, NJ 07424
Attention: Corporate Trust Administration

(d) in the case of the Bond Trustee, the Series 2007-1B Trustee and the Series 2007-1C Trustee:

The Bank of New York Mellon
385 Rifle Camp Road
Woodland Park, NJ 07424
Attention: Corporate Trust Administration

SECTION 7. Severability. Any provision of this Amended Depository Agreement that is prohibited or unenforceable shall be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof.

SECTION 8. Separate Counterparts. This Amended Depository Agreement may be executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

SECTION 9. Governing Law. This Amended Depository Agreement shall 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 shall be determined in accordance with such laws.

IN WITNESS WHEREOF, the parties hereto have caused this Amended Depository Agreement to be duly executed by their respective officers as of the day and year first above written.

TREASURER, STATE OF NEW JERSEY

By: ________________________________

Name: Andrew P. Sidamon- Eristoff

TOBACCO SETTLEMENT FINANCING CORPORATION

By: ________________________________

Name: Andrew P. Sidamon-Eristoff
Title: President

THE BANK OF NEW YORK MELLON, as Depository Agent, Bond Trustee, Series 2007-1B Pledge Agreement Trustee and Series 2007-1C Pledge Agreement Trustee

By: ___________________________

Name: David J. O'Brien
Title: Vice President

APPENDIX F

FORM OF SECOND AMENDED AND RESTATED RESIDUAL CERTIFICATE

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TOBACCO SETTLEMENT FINANCING CORPORATION

SECOND AMENDED AND RESTATED RESIDUAL CERTIFICATE

REGISTERED OWNER: THE STATE OF NEW JERSEY

The TOBACCO SETTLEMENT FINANCING CORPORATION (the “Corporation”), a public body corporate and politic and an instrumentality of The State of New Jersey (the “State”), for value received, promises to pay to the registered owner of this Second Amended and Restated Residual Certificate (the “Second Amended and Restated Certificate”) (a) prior to July 1, 2016 and (b) from and after July 1, 2016, but only upon the payment in full of the Series 2007-1B First Subordinate Bonds and the Series 2007-1C Second Subordinate Bonds, all Unpledged TSRs and income of the Corporation that is not pledged to the payment of the Bonds or in excess of the Corporation’s requirement to pay its operating expenses, debt service, sinking fund requirements, reserve fund or escrow fund requirements, any other contractual obligations to the Bondholders or pursuant to any ancillary facility, including without limitation, the Pledge Agreements. Capitalized terms used but not defined in this Second Amended and Restated Certificate shall have the meaning given to the terms in either the Trust Indenture, as supplemented by a Series 2007-1 Supplement, both dated as of January 1, 2007, by and between the Corporation and The Bank of New York (now known as The Bank of New York Mellon), as Trustee, as the same may be amended and supplemented (the “Indenture”) or the Amended and Restated Depository Trust Agreement, dated as of March 1, 2014, by and among the State, the Corporation and the Trustee, acting as Trustee and Depository Agent (the “Depository Agreement”).

Payments under or in respect of this Second Amended and Restated Certificate shall be payable from (a) Unpledged TSRs from the sources provided therefor under the Depository Agreement, and (b) from the sources provided therefor under the Indenture. Notwithstanding anything to the contrary in this Second Amended and Restated Certificate, no amounts shall be due and payable from sources provided under the Indenture in respect of this Second Amended and Restated Certificate, and the registered owner of this Second Amended and Restated Certificate shall have no right to, or interest of any kind in, the payment of any such amount, unless and until the Trustee shall determine that funds are available therefor in accordance with Section 2.02 and Section 5.02(f) of the Indenture, and the Trustee shall in fact withdraw funds from the Series 2007-1 Accounts for such payment and transfer the same to the registered owner of this Second Amended and Restated Certificate. Notwithstanding anything to the contrary contained in the Indenture or this Second Amended and Restated Certificate, the Depository Agent shall pay the Unpledged TSRs to the owner of this Second Amended and Restated Certificate, upon receipt, from time to time, in accordance with the Depository Agreement and this Second Amended and Restated Certificate.

Reference is made to the Indenture and the Pledge Agreements for a description of the funds pledged and for the provisions with respect to the incurring of indebtedness and to the rights, limitations of rights, duties, obligations and immunities of the Corporation, the Trustee, the Bondholders and Beneficiaries.

This Second Amended and Restated Certificate is issuable only in fully registered form and may not be converted into bearer form. The Corporation and the Trustee may treat the registered owner hereof as the absolute owner of this Second Amended and Restated Certificate for all purposes, notwithstanding any notice to the contrary.

This Second Amended and Restated Certificate shall not be valid or become obligatory for any purpose until the certificate of authentication hereon shall have been dated and manually signed by the Trustee.

IN WITNESS WHEREOF, the TOBACCO SETTLEMENT FINANCING CORPORATION has caused this Second Amended and Restated Residual Certificate to be executed in its name by its President as of the 7th day of March, 2014.

TOBACCO SETTLEMENT
FINANCING CORPORATION

By:____________________________________
Name: Andrew P. Sidamon-Eristoff
Title: President

CERTIFICATE OF AUTHENTICATION

This Second Amended and Restated Residual Certificate is the Residual Certificate described in and issued in accordance with the within mentioned Indenture.

The Bank of New York Mellon, as Trustee

By: ______________________________
Authorized Officer

Date of Authentication: March 7, 2014

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APPENDIX G

FORM OF SUPPLEMENTAL CONTINUING DISCLOSURE UNDERTAKING

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SUPPLEMENTAL CONTINUING DISCLOSURE UNDERTAKING

This Supplemental Continuing Disclosure Undertaking ("Undertaking") is made as of March 1, 2014, by and between the Tobacco Settlement Financing Corporation, a public body corporate and politic established in, but not of, the Department of the Treasury and an instrumentality of the State of New Jersey (the "State") exercising public and essential governmental functions (the "Corporation"), and The Bank of New York Mellon, a banking corporation organized and existing under the laws of the State of New York, as trustee under the hereinafter defined Indenture and Continuing Disclosure Agreement (the "Bond Trustee"), and also as trustee under the Series 2007-1B Pledge Agreement (the "Series 2007-1B Pledge Agreement"), dated as of March 1, 2014, by and between the Corporation and the Bond Trustee, relating to the Corporation's Tobacco Settlement Asset-Backed Bonds, Series 2007-1B First Subordinate Capital Appreciation Bonds (the "Series 2007-1B Bonds"), and as trustee under the Series 2007-1C Pledge Agreement (the "Series 2007-1C Pledge Agreement" and, together with the Series 2007-1B Pledge Agreement, the "Pledge Agreements"), dated as of March 1, 2014, by and between the Corporation and the Bond Trustee, relating to the Corporation's Series 2007-1C Second Subordinate Capital Appreciation Bonds (the "Series 2007-1C Bonds" and together with the Series 2007-1B Bonds, the "Series B and C Bonds"). Capitalized terms used but not defined herein shall have the meanings given to them in the Pledge Agreements or in the Trust Indenture and the Series 2007-1 Supplement, both dated as of January 1, 2007 (collectively, the "Indenture"), by and between the Corporation and the Bond Trustee pursuant to which the Series B and C Bonds were issued.

SECTION 1. Purpose of the Undertaking.

In connection with the issuance of the Series 2007-1 Bonds, which included the issuance of the Series B and C Bonds, the Corporation and the Bond Trustee entered into that certain Continuing Disclosure Agreement, dated as of January 1, 2007 (the "Continuing Disclosure Agreement"), pursuant to which the Corporation is required to provide to the Bond Trustee, *inter alia*, its Annual Report (as defined in the Continuing Disclosure Agreement) in accordance with the terms thereof. The purpose of this Undertaking is to supplement the information to be contained in the Annual Report.

SECTION 2. Contents of Annual Report.

In addition to the information required to be included in the Annual Report in accordance with the terms of the Continuing Disclosure Agreement, the Annual Report to be delivered to the Bond Trustee shall contain or include by reference, the information set forth in the Bond Enhancement Memorandum, dated March 6, 2014, prepared in connection with the execution and delivery of the Pledge Agreements, solely under the following captions and each for the most recent fiscal year then ended: each and every one of the columns under "PROJECTED OPTIONAL REDEMPTION"- Projected Series 2007-1B Bonds Optional Redemption and Projected Series 2007-1C Bonds Optional Redemption", with the exception of "Additional Pledged TSRs Account Balance" which shall not be included.

SECTION 3. Termination of Obligation.

The obligations of the Corporation under this Undertaking shall terminate upon the defeasance, prior redemption or payment in full of all of the Series B and C Bonds.

SECTION 4. Beneficiaries.

This Undertaking shall inure solely to the benefit of the Bond Trustee, the State, the Corporation and the Owners of the Series B and C Bonds and each Owner of a Series B and C Bond is hereby declared to be a third party beneficiary of this Undertaking. Except as provided in the immediately preceding sentence, this Undertaking shall create no rights in any other person or entity.

SECTION 5. Default.

In the event of a failure of the Corporation to comply with any provisions of this Undertaking, the Bond Trustee, on behalf of the Owners of the Series B and C Bonds, may (and at the request of the Owners of at least twenty-five (25%) percent in aggregate principal amount of Outstanding Series B and C Bonds, after having provided to the Bond Trustee adequate security and indemnity, shall), take whatever action at law or in equity against the Corporation that is necessary or desirable to enforce the specific performance and observance of any obligation, agreement or covenant of the Corporation under this Undertaking and may compel the Corporation to perform and carry out its duties under this Undertaking; provided, that no person or entity shall be entitled to recover monetary damages hereunder under any circumstances.

SECTION 6. No Amendment to Continuing Disclosure Agreement.

This Undertaking shall not be deemed to constitute an amendment or modification of the Continuing Disclosure Agreement. The representations, covenants and warrants of the Corporation hereunder, including without limitation, to include the information in Section 2 hereof in its Annual Report to be delivered to the Bond Trustee pursuant the Continuing Disclosure Agreement, are distinct, separate and apart from and shall not be deemed to merge with, affect or impair the representations, covenants and warrants of the Corporation pursuant to the Continuing Disclosure Agreement.

SECTION 7. Indenture Provisions Relating to the Bond Trustee.

The provisions of Section 7.02 of the Indenture shall apply to the performance by the Bond Trustee of its obligations under this Undertaking.

SECTION 8. Notices.

All notices and other communications required or permitted under this Disclosure Agreement shall be in writing and shall be deemed to have been duly given, made and received only when delivered (personally, by recognized national or regional courier service, or by other messenger, for delivery to the intended addressee) or when deposited in the United States mail, registered or certified mail, postage prepaid, return receipt requested, addressed as set forth below:

(a) in the case of the State:

State Treasurer, as State Representative
State House
125 West State Street
P.O. Box 002
Trenton, New Jersey 08625

(b) in the case of the Corporation:

Tobacco Settlement Financing Corporation
c/o State of New Jersey, Office Of Public Finance
50 West State Street
P.O. Box 005
Trenton, New Jersey 08625
Attention: Director, Office of Public Finance

(c) in the case of the Bond Trustee:

The Bank of New York Mellon
385 Rifle Camp Road
Woodland Park, New Jersey 07424
Attention: Corporate Trust Administration

SECTION 9. Successors and Assigns.

All of the covenants, promises and agreements contained in this Undertaking by or on behalf of the Corporation or the Bond Trustee shall bind and inure to the benefit of their respective successors and assigns, whether so expressed or not.

SECTION 10. Headings for Convenience Only.

The descriptive headings in this Undertaking are inserted for convenience of reference only and shall not control or affect the meaning or construction of any of the provisions hereof.

SECTION 11. Counterparts.

This Undertaking may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

SECTION 12. Severability.

If any provision of this Undertaking, or the application of any such provision in any jurisdiction or to any person or circumstance, shall be held invalid or unenforceable, the remaining provisions of this Undertaking, or the application of such provision as is held invalid or unenforceable in jurisdictions or to persons or circumstances other than those in or as to which it is held invalid or unenforceable, shall not be affected thereby.

SECTION 13. Governing Law and Venue.

This Undertaking shall 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 shall be determined in accordance with such laws. The parties hereto agree that the Corporation or the State may be sued, pursuant to Section 5 hereof, only in a State court in the County of Mercer in the State.

SECTION 14. Compliance with L. 2005, c. 271. The Bond Trustee hereby acknowledges that it has been advised of its responsibility to file an annual disclosure statement on political contributions with the New Jersey Election Law Enforcement Commission ("ELEC") pursuant to N.J.S.A. 19:44A-20.13 (L. 2005, c. 271, section 3) if the Bond Trustee enters into agreements or contracts, such as this Undertaking, with a public entity, such as the Corporation, and receives compensation or fees in excess of $50,000 or more in the aggregate from public entities, such as the Corporation, in a calendar year. It is the Bond Trustee's responsibility to determine if filing is necessary. Failure to do so can result in the imposition of financial penalties by ELEC. Additional information about this requirement is available from ELEC at 888-313-3532 or at www.elec.state.nj.us.

SECTION 15. Compliance with L. 2005, c. 92. In accordance with L. 2005, c. 92, the Bond Trustee agrees that all services performed under this Undertaking or any subcontract awarded under this Undertaking shall be performed within the United States of America.

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IN WITNESS WHEREOF, the parties hereto have caused this Supplemental Continuing Disclosure Undertaking to be duly executed by their respective officers as of the day and year first above written.

TOBACCO SETTLEMENT FINANCING CORPORATION

By: ___________________________
Name: Andrew P. Sidamon-Eristoff
Title: President

THE BANK OF NEW YORK MELLON, as Bond Trustee

By: ___________________________
Name: David J. O'Brien
Title: Vice President

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APPENDIX H

NPM ADJUSTMENT STIPULATED PARTIAL SETTLEMENT AND AWARD AND SETTLEMENT TERM SHEET

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Hon. Fern M. Smith (Ret.)
JAMS
Two Embarcadero Center, Suite 1500
San Francisco, CA 94111
Telephone: (415) 982-5267
Fax: (415) 982-5287
ARBITRATOR

ARBITRATION

In the 2003 NPM Adjustment Proceedings

The signatory Participating Manufacturers ("PMs") and 19 of the States and Territories that are parties to this Arbitration have agreed to a Term Sheet to settle their dispute concerning the 2003 NPM Adjustment. The Term Sheet is attached as Exhibit A to this Stipulated Partial Settlement and Award, including an addendum reflecting the parallel provisions that the Term Sheet requires for Subsequent Participating Manufacturers ("SPMs").

The States and Territories that have signed the Term Sheet are Alabama, Arizona, Arkansas, California, Georgia, Kansas, Louisiana, Michigan, Nebraska, Nevada, New Hampshire, New Jersey, North Carolina, Tennessee, Virginia, West Virginia, Wyoming, the District of Columbia and Puerto Rico. This Stipulated Partial Settlement and Award refers to these States and Territories as "Signatory States" and to the PMs and the Signatory States collectively as the "Settling Parties."

32 of the States and Territories that are parties to this Arbitration have not signed the Term Sheet, and 27 of them have objected to the Term Sheet on a number of grounds. This

Stipulated Partial Settlement and Award refers to the Settling States that have not signed the Term Sheet as Non-Signatory States and to the 27 States that have objected as Objecting States.

The Panel heard initial presentations from the Settling Parties and the Objecting States regarding the Term Sheet and the objections at a two-day status conference on January 22-23, 2013. At that conference, the Panel made clear that it would neither "approve" the Term Sheet nor mediate a settlement, but that it would consider entering a stipulated partial award. The Settling Parties then jointly submitted a proposed stipulated partial award to whose entry they agreed. The Panel has reviewed that proposed award, has reviewed extensive briefs and supporting materials filed by the Settling Parties and the Objecting States, and has heard argument on the issues at a hearing on March 7-8, 2013. The Panel now awards as follows.

I. The Panel's Jurisdiction

1. The Panel has jurisdiction to enter this Stipulated Partial Settlement and Award and to rule on the objections as part of its jurisdiction over the 2003 NPM Adjustment dispute. As the Panel has previously explained, its jurisdiction under Section XI(c) of the MSA and the court orders compelling arbitration includes "all issues 'related to'" the 2003 NPM Adjustment dispute, including, but not limited to, whether or not the States diligently enforced their Qualifying Statutes for the year 2003. Order Re: Jurisdictional Objections, at 7, 13 (Lexis ID #34056745).

2. The MSA provides that this arbitration is "governed by the Federal Arbitration Act." MSA § XI(c). Once a dispute is committed to arbitration under the FAA, "the arbitrators normally have the authority to decide all matters necessary to dispose of the claim." *Ross Brothers Constr. Co. v. International Steel Servs.*, 283 F.3d 867, 875 (7th Cir. 2002); *see*

Ansari v. Qwest Commc'n Corp., 414 F.3d 1214, 1220-21 (10th Cir. 2005); *Shaw's Supermarkets, Inc. v. United Food & Commercial Workers,* 321 F.3d 251, 254 (1st Cir. 2003).

3. This includes authority to interpret and apply the parties' contract, to resolve any "issues relating to the substance of the dispute," and to decide "procedural questions ancillary to the substantive one." *United Paperworkers Int'l. Union v. Misco, Inc.*, 484 U.S. 29, 38 (1987); *Shaw's Supermarkets,* 321 F.3d at 254; *Nat'l Cas. Co. v. First State Ins. Grp.*, 430 F.3d 492, 499-500 (1st Cir. 2005). It also includes authority to determine the existence or effect of a settlement of the dispute. *United Steel Workers Int'l Union v. TriMas Corp.*, 531 F.3d 531, 539 (7th Cir. 2008).

4. The Panel has jurisdiction to rule on the issues raised concerning the MSA reallocation provisions and to determine how the 2003 NPM Adjustment will be allocated among the Non-Signatory States in light of the settlement. These are issues that are a central part of the 2003 NPM Adjustment dispute before the Panel and that involve interpretation of the MSA. The Panel has previously resolved issues concerning the reallocation provisions in the related context of "no contest" determinations, and no party disputed that the Panel had jurisdiction to do so. Order Re: PMs' Motion For Clarification on No-Contest Issue, at 18 (Lexis ID #38479237) ("No-Contest Order"). The Panel's jurisdiction to interpret and determine the operation of the reallocation provisions is no less where a State is no longer contested because of a settlement.

5. The Panel also has jurisdiction to incorporate and direct the Independent Auditor to implement those provisions of the settlement that govern the amount and mechanism of monetary payments as among the Settling Parties, specifically the amounts to be received by the PMs and the Disputed Payments Account ("DPA") funds to be released. These are integral provisions to the Settling Parties' settlement of the 2003 NPM Adjustment dispute in this

Arbitration. As these provisions would need to be applied and administered by the Independent Auditor, as the Objecting States object that the Independent Auditor may not implement them, and as the Panel has jurisdiction under Section XI(c) of the MSA to give direction to the Independent Auditor, it falls within the Panel's authority to rule on the objections and to provide appropriate direction to the Independent Auditor so that the Settling Parties will know whether their settlement will be given effect.

6. That the direction to the Independent Auditor includes implementation of the referenced settlement provisions as they pertain to years beyond 2003 does not necessarily take the Panel beyond its jurisdiction. Parties frequently enter into settlements that cover more than the claim they are litigating or arbitrating at the moment. Tribunals have jurisdiction to issue orders approving or giving effect to such broader settlements even where they would lack jurisdiction to adjudicate the additional claims being resolved. *Abramson v. Pennwood Inv. Corp.*, 392 F.2d 759, 762 (2d Cir. 1968); *F.M. v. Palm Beach County*, 912 F. Supp. 514, 515 (S.D. Fla. 1995), *aff'd*, 84 F.3d 438 (11th Cir. 1996) (summary order). Such jurisdiction exists even in the class-action context, where courts are asked not only to formally "approve" the settlement but also to render it binding on absent class members. *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 34 (1st Cir. 1991); *In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 221 Cir.

7. Here, moreover, the Panel is not "approving" the Term Sheet, much less rendering it binding on absent class members. It is just giving effect to the Settling Parties' agreed settlement payments as among themselves, by directing the Independent Auditor to implement the settlement provisions at issue. In doing so, the Panel is not assessing the merits of any NPM Adjustment dispute, including particularly questions of diligence or non-diligence for

any years other than 2003. Instead, the Objecting States' objections to these settlement provisions are based on legal arguments regarding MSA interpretive issues that are the same as to 2003 as to subsequent years.

8. Finally, even if there any were question about the Panel's jurisdiction to give that direction as to post-2003 years, the Settling Parties can agree to give the Panel jurisdiction to do so, as long as the Panel concludes (as it has) that the direction to the Independent Auditor does not adversely affect the legal rights of the Non-Signatory States. The Settling Parties have informed the Panel that they confer the Panel with the jurisdiction necessary to enter this Stipulated Partial Settlement and Award and agree to the Panel's exercising such jurisdiction.

II.

1. This Stipulated Partial Settlement and Award among the PMs and Signatory States resolves with finality the Settling Parties' dispute concerning the 2003 NPM Adjustment and certain subsequent years as to limited issues and provides direction to the Independent Auditor concerning releases from the DPA and amounts to be received by the PMs pursuant to the settlement.

2. This Stipulated Partial Settlement and Award is limited to: (a) incorporating the provisions of the Term Sheet that govern the amount and mechanism of monetary payments (amounts to be received by the PMs and the DPA funds to be released) as among the Settling Parties;[1] (b) directing the Independent Auditor to implement those provisions; (c) ruling how the 2003 NPM Adjustment will be allocated in light of the settlement among the Non-Signatory States that did not diligently enforce a Qualifying Statute during 2003; and (d) ruling on the objections raised by the Objecting States.

[1] These are Term Sheet §§ I, II, III.B.1, III.B.3-4, III.C.1, IV.A, IV.H, IV.I, IV.J.3, IV.K, Appendix A and the SPM addendum to the Term Sheet.

III. Directions To The Independent Auditor

1. The Independent Auditor is directed to implement the provisions of the Term Sheet incorporated in Section II above.

2. In implementing those provisions, the Independent Auditor will order the release of funds from the DPA as described in the Term Sheet and specified below, and allocate the released funds as described in the Term Sheet and specified below. In so doing, the Independent Auditor will ensure that the Non-Signatory Allocable Share of both the NPM Adjustment funds now in the DPA (principal and earnings) and the additional amounts to be paid into the DPA under the first sentence of Paragraph 5 of Appendix A to the Term Sheet remains in the DPA. The Independent Auditor will also apply the amounts to be received by the PMs as described in the Term Sheet and specified below. In so doing, the Independent Auditor will ensure that no part of those amounts are allocated to the Non-Signatory States.

3. The Independent Auditor will, in performing the duties under Paragraphs 1-2 above, (a) order the release of the funds in the DPA as provided by Paragraphs 5-7 of Appendix A to the Term Sheet, (b) allocate those released DPA funds solely among the Signatory States in the manner provided by Paragraph 6 of Appendix A to the Term Sheet and as they direct, (c) apply the amounts the PMs are to receive under § I of the Term Sheet and Paragraphs 1-3 and 7-8 of Appendix A to the Term Sheet and allocate those amounts among the PMs as they direct, (d) allocate those amounts solely among the Signatory States as they direct in the manner provided by § I.B of the Term Sheet and Paragraphs 4 and 6 of Appendix A to the Term Sheet, (e) apply the amounts the PMs are to receive under §§ II, III.B and III.C of the Term Sheet, allocate those amounts among the PMs as they direct, and allocate those amounts solely among the Signatory States in the manner provided by those provisions, and (f) make all calculations and

determinations required of it under the provisions of the Term Sheet incorporated in Section II of this Stipulated Partial Settlement and Award. These directions apply as to the parallel provisions for SPMs in the SPM addendum to the Term Sheet.

4. Based on the current Signatory States, the Independent Auditor's performance of the above requirements in connection with the April 2013 MSA payment will include:

(a) ordering that [$1,760,176,204.21] NPM Adjustment funds (plus the accumulated earnings thereon) be released from the DPA and that [$2,483,161,178.12] NPM Adjustment funds (plus the accumulated earnings thereon) remain in the DPA. These amounts are based upon payment into the DPA of the amounts required to be paid under the first sentence of Paragraph 5 of Appendix A to the Term Sheet and are subject to each Signatory State's right under Paragraph 5 of Appendix A to the Term Sheet to defer the release of its DPA funds;[2]

(b) allocating the amount released solely among the Signatory States as they except for $10 million that will be allocated to the Data Clearinghouse as provided by § of the Term Sheet;

(c) applying a credit of [$815,937,317.90] to the Original Participating Manufacturers' ("OPMs") MSA payment due on April 15, 2013[3] and allocating that credit among the OPMs as they direct; and

(d) allocating that credit solely among the Signatory States as they direct in the manner provided by Paragraph 4 of the Appendix A to the Term Sheet.

[2] [The numbers in this Paragraph 4 and Paragraph 6 below are subject to verification by the parties and Independent Auditor as being consistent with the provisions of Paragraphs 2-3, as the Independent Auditor has broader access to the relevant data, including the precise amount of NPM Adjustment funds in the DPA. The numbers are also subject to change if additional parties join the settlement.]

[3] Parallel credits for the SPMs are included in the SPM Appendix attached hereto. [Note: The amounts in Paragraph 4(c) and the SPM Appendix assume that the 2012 NPM Adjustment is identical to the 2011 NPM Adjustment and will need to be revised once the Independent Auditor calculates the actual 2012 NPM Adjustment in the upcoming weeks.]

(e) These instructions would be subject to change if additional States join the settlement. The Independent Auditor will act in accordance with Paragraphs 2-3 and the provisions of the Term Sheet referenced in Section II of this Stipulated Partial Settlement and Award in implementing the Stipulated Partial Settlement and Award as to MSA payments after April 2013 and as to the SPMs' MSA payments due on April 15, 2013.

5. There are NPM Adjustment amounts that are not yet in the DPA because the PMs' right to pay them into the DPA has not yet accrued: for example, the 2010-2012 NPM Adjustments for the OPMs, the 2012 NPM Adjustment for SPMs, and the NPM Adjustments for subsequent years for all PMs. The Term Sheet provides that the Signatory States' Allocable Shares of these amounts will not be held in the DPA, except as provided in § IV.A of the Term Sheet with respect to NPM Adjustments for 2015 and subsequent years. Unless the second exception in § IV.A of the Term Sheet applies, the Independent Auditor will instruct the PMs to deposit the Signatory States' Allocable Shares of these amounts into the DPA and will then promptly order the release of those Shares allocated as follows: (a) with respect to the 2010-14 NPM Adjustments, in the manner provided by Paragraph 6(ii) of Appendix A to the Term Sheet or as the Signatory States direct; and (b) with respect to the NPM Adjustments for 2015 and subsequent years, among the Signatory States and PMs in the manner provided by §§ IV.A and IV.J.3 of the Term Sheet, and (in the case of funds released to the Signatory States) as the Signatory States direct and (in the case of funds released to the PMs) as the PMs direct. If a PM also pays the Non-Signatory States' Allocable Shares of its portion of an NPM Adjustment covered by this Paragraph into the DPA, the Independent Auditor will ensure that only the Signatory States' aggregate Allocable Share of the amount deposited is released and that the Non-Signatory States' aggregate Allocable Share of the amount deposited remains in the DPA.

6. The Independent Auditor's performance of the requirements of Paragraph 5 in connection with the April 2013 MSA payment will include: (a) instructing the OPMs to deposit into the DPA the Signatory States' Allocable Shares of the 2010 NPM Adjustment for the OPMs, which based on the current Signatory States equals [$322,970,319.02]; (b) promptly ordering the release of that amount allocated among the Signatory States in the manner provided by Paragraph 6(ii) of Appendix A to the Term Sheet or as the Signatory States direct; and (c) if an OPM also pays the Non-Signatory States' Allocable Shares of its portion of the 2010 NPM Adjustment into the DPA, ensuring that only the Signatory States' aggregate Allocable Share of the amount deposited is released and that the Non-Signatory States' aggregate Allocable Share of the amount deposited remains in the DPA. These instructions would be subject to change if additional States join the settlement. The Independent Auditor will act in accordance with Paragraph 5 as to the SPMs in connection with the April 2013 MSA payment.

IV.

1. In light of the settlement, the 2003 NPM Adjustment will be allocated among the Non-Signatory States as follows. The dollar amount of the 2003 NPM Adjustment will be reduced by a percentage equal to the aggregate Allocable Shares of the Signatory States as of the date of the Panel's Final Award (as of the date of this Stipulated Partial Settlement and Award, that percentage is 41.9964405%). The Independent Auditor will treat the Signatory States as not subject to the 2003 NPM Adjustment for purposes of Section IX(d)(2)(B)-(C) of the MSA. The Signatory States' shares of the 2003 NPM Adjustment, as that Adjustment amount is reduced as provided above, will be governed by the reallocation provisions of Sections IX(d)(2) and IX(d)(4) of the MSA, and will thus be reallocated among all Non-Signatory States that did not diligently enforce a Qualifying Statute during 2003 as provided in those provisions. The

maximum portion of the 2003 NPM Adjustment that can be applied to a Non-Signatory State remains as provided by Section IX(d)(2)(D) of the MSA.

2. This judgment reduction is appropriate and adequate under the MSA and governing law. Where multiple parties have a potential shared contractual obligation and some of them settle and some do not, the non-settling parties cannot necessarily block the settlement, but may be entitled to a judgment reduction. The "three standard methods for reducing judgment against non-settling defendants after a partial settlement" are "*pro rata* (court divides the amount of the total judgment by the number of settling and non-settling defendants, regardless of each defendant's culpability), proportionate fault (after a partial settlement and trial of the nonsettling defendants, the jury determines the relative culpability of all the defendants and the non-settling defendant pays a commensurate percentage of the total judgment), and *pro tanto* (the court reduces the non-settling defendant's liability for the judgment against him by the amount previously paid by the settling defendants, without regard to proportionate fault)." *In re Enron Corp. Secs., Deriv. & ERISA Litig.*, 2008 U.S. Dist. Lexis 48516, at *20-21 (S.D. Tex. 2008); *see In re Masters Mates & Pilots Pens. Pl. Litig.*, 957 F.2d 1020, 1028 (2d Cir. 1992); *In re Jiffy Lube Secs. Litig.*, 927 F.2d 155, 160-61 & n.3 (4^{th} Cir. 1991).

3. Where non-settling defendants are given the protection of the applicable judgment-reduction method required under the contract and law, they are not prejudiced by the partial settlement. *See, e.g.*, *Enron*, 2008 U.S. Dist. Lexis 48516, at *60-61; *Eichenholtz v. Brennan*, 52 F.3d 478, 486-87 (3d Cir. 1996).

4. Under Paragraph 1, the Non-Signatory States receive the *pro rata* reduction, under which the dollar amount of the 2003 NPM Adjustment will be reduced by a percentage equal to the aggregate Allocable Shares of the Signatory Construing the parties' contract,

the Panel concludes that the MSA reallocation provisions indicate that the *pro rata* method is appropriate. These provisions use the specific term "pro rata," stating that the shares of diligent States are to be "reallocated among all other Settling States *pro rata* in proportion to their respective Allocable Shares." MSA § IX(d)(2)(C) (emphasis added); *see also* MSA § IX(d)(2)(D) ("pro rata in proportion to their respective Allocable Shares"). More fundamentally, the MSA also provides that the reallocation is not done on a relative fault basis. The amount of a diligent State's share that is reallocated is its *pro rata* share of the whole, not an amount derived from its particular fault level. Likewise, the amount of reallocated share that a non-diligent State receives is derived from its *pro rata* share of the liable not its fault level. If the reallocation of diligent States' shares is done on a *pro rata* basis in this way, the Panel reads the MSA as likewise meaning that a judgment reduction arising from some States' settlement of the diligent enforcement issue should be *pro rata* as well.

V. Objections of Objecting States

1. The Objecting States contend that the Term Sheet violates their rights under the MSA. While no party has claimed that the Term Sheet is not a good faith settlement, the Objecting States object to a number of its provisions, including the provisions for release of DPA funds and its lack of terms addressing how the reallocation provisions of the MSA (§§ IX(d)(2) and IX(d)(4)) would apply to the Signatory States' Allocable Shares of the NPM Adjustment. The Objecting States claim the Term Sheet's DPA provisions and its potential effect on the reallocation provisions adversely affect them. They also claim that these and other Term Sheet provisions constitute an amendment to the MSA that would require their consent under MSA § XVIII(j).

2. After reviewing the Objecting States' arguments and submissions, the Panel concludes that the objections are not grounds that bar entry of the Stipulated Partial Settlement and Award or that otherwise bar the Settling Parties from proceeding with the settlement pursuant to the Term Sheet.

3. The "general rule ... is that a non-settling party does not have standing to object to a settlement between other parties." *Jamie S. v. Milwaukee Pub. Schs.*, 668 F.3d 481, 501 (7th Cir. 2012). Non-settling parties have standing only if they allege the settlement creates "plain legal prejudice" to their rights. That standard is satisfied, for example, where the non-settling parties allege that the settlement strips them of a legal claim or cause of action. Importantly, however, that standard is not satisfied where the non-settling parties instead allege merely that the settlement denies them special benefits or imposes practical disadvantages on them. *See, e.g., id.*; *In re Integra Realty Resources, Inc.*, 262 F.3d 1089, 1102-03 (10th Cir. 2001); *In re Vitamins Antitrust Class Actions*, 215 F.3d 26, 28-31 (D.C. Cir. 2000); *Agretti v. ANR Freight Sys., Inc.*, 982 F.2d 242, 246-48

4. The Panel concludes that the Stipulated Partial Settlement and Award and the Term Sheet do not legally prejudice or adversely affect the Non-Signatory States. The Panel reasons as follows:

DPA. It is undisputed that, under the MSA, the PMs have the right of first recovery for NPM Adjustment funds in the DPA. *See* Order re: Transfers From DPA, at 2 (Lexis ID #37754064); *see also* MSA §§ XI(f)(2), XI(i)(1)(B). · the Term Sheet, the PMs have waived that right for the Signatory States, allowing the Signatory States to recover their Allocable Share of those DPA funds. *See* Term Sheet Appendix ¶¶ 5-6.

The PMs' limited DPA waiver for the Signatory States in no way prejudices the Non-Signatory States, legally or otherwise. The Non-Signatory States have no entitlement to the favorable treatment that the PMs have afforded the Signatory States as part of the consideration for settling their dispute. Nor will that favorable treatment harm the Non-Signatory States. They have failed to demonstrate any reasonable likelihood that they will recover less from the DPA than they would have recovered absent the settlement. Moreover, the PMs have expressly committed that, if any Non-Signatory State ever later demonstrates that it is at risk of recovering less from the DPA than it would have recovered from the DPA absent the settlement, the PMs will allow that State to recover the extra amount from the DPA and will themselves recover any resulting unpaid share of the NPM Adjustment through an appropriate credit against the next year's annual payment.

Reallocation. T[illegible] operation of the MSA reallocation provisions with respect to the 2003 NPM Adjustment will be as provided in Section IV. As described in Section IV, this provides the Non-Signatory States with appropriate and adequate protection under the MSA and the law from potential prejudice arising from the settlement's removal of the Signatory States from further contribution towards the 2003 NPM Adjustment.

The Panel does not agree with the Objecting States' contention that all Signatory States must be treated as non-diligent for purposes of the 2003 NPM Adjustment. There is no basis in the facts to assume that every Signatory State was non-diligent in 2003. Moreover, the Objecting States' position does not reflect any of the three standard methods of judgment reduction. Such an assumption would produce a considerably larger reduction in the Non-Signatory States' potential obligations than any of the standard methods. It is also contrary to the underlying principle of judgment reduction that, because a settlement is not tantamount to an admission of liability, settling defendants are not regarded as necessarily culpable or liable.

The Objecting States argue that the MSA reallocation provisions must be wholly inapplicable to a State's share unless there is an actual determination that the State was diligent. They claim that any approach by which any State's share is otherwise subject to reallocation is an "amendment" to the MSA requiring their consent. But the MSA does not directly speak as to the process to be used when some States settle diligent enforcement and some do not. It is thus within the Panel's jurisdiction to interpret the contract in light of governing law to determine what the appropriate process and judgment reduction is where there is a partial settlement of diligent enforcement involving fewer than all of the States. *United Paperworkers*, 484 U.S. at 38. There is thus no "amendment" to the MSA in the Panel doing so. Should any Objecting State, found by the Panel to be non-diligent, have a good faith belief that the *pro rata* deduction does not adequately compensate them for a Signatory State's removal from the re-allocation pool, their relief, if any, is by appeal to their individual MSA court. The cut-off date for inter-state suits set forth in the Panel's "no contest" order, is not applicable to such procedure.

Other objections. None of the Term Sheet's provisions imposes new legal obligations on the Non-Signatory States or deprives those States of existing legal rights. Thus, to the extent that the Objecting States object to the Term Sheet in other respects than those discussed above, the Panel hereby concludes that the Objecting States have not suffered "plain legal prejudice" from and are not adversely affected by the Term Sheet.

6. Neither this Stipulated Partial Settlement and Award nor the Term Sheet constitutes an amendment to the MSA that requires the consent of any Non-Signatory States under MSA § XVIII(j). As a threshold matter, the Term Sheet is not an "amendment" of the

MSA at all. Rather, it is a *settlement* of disputes that have arisen under the MSA as written, which does not address the procedures to be used should partial settlements take place. In any event, even if an amendment were involved, the MSA provides that it only must be signed by "all Participating Manufacturers affected by the amendment and by all Settling States affected by the amendment." MSA § XVIII(j). The Panel construes the term "affected by" to mean "materially prejudiced by." For the reasons discussed above, none of the Term Sheet's provisions "affect" the Non-Signatory States within the meaning of the contract. The only States bound by any terms in the Term Sheet are the Signatory States, i.e. the ones that have signed it, including, but not limited to, definitional changes regarding "Units Sold" or other terms in the MSA.

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VI. Conclusion

This Stipulated Partial Settlement and Award is entered on the Panel's understanding based on the representation of the Settling Parties that: (a) the second sentence of § IV.F of the Term Sheet regarding Panel oversight of the documentation process is not operative and (b) this Stipulated Partial Settlement and Award satisfies the condition in § IV.E.2 of the Term Sheet regarding a Panel order as to the Term Sheet, such ~~that the Term Sheet is now binding on all~~ signatories.[4]

SO ORDERED.

Dated: March 12, 2013

s/William G. Bassler
The Honorable William G. Bassler
Arbitrator

s/Abner J. Mikva
The Honorable Abner J. Mikva
Arbitrator

The Honorable Fern M. Smith
Chairperson

[4] As of this date, the Participating Manufacturers that are signatories to the Term Sheet are: Philip Morris USA Inc., R.J. Reynolds Tobacco Co., Lorillard Tobacco Co., Commonwealth Brands, Inc., Compania Industrial de Tabacos Monte Paz, S.A., Daughters & Ryan, Inc., Ets L Lacroix Fils S.A. (Belgium), Farmer's Tobacco Co. of Cynthiana, Inc., House of Prince A/S, 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), Japan Tobacco International U.S.A., Inc., King Maker Marketing, Inc., Kretek International, Liggett Group LLC, Lignum-2, Inc., OOO Tabaksfacrik Reemtsma Wolga (Russia), Peter Stokkebye Tobaksfabrik A/S, Premier Manufacturing, Inc., P.T. Djarum, Reemtsma Cigarettenfacbriken GmbH (Reemtsma), Santa Fe Natural Tobacco Company, Inc., Scandinavian Tobacco Group Lane Ltd (formerly Lane Limited), Sherman 1400 Broadway N.Y.C., Inc., Societe National d'Exploitation Industrielle des Tabacs et Allumettes (SEITA), Top Tobacco, L.P., Van Nelle Tabak Nederland B.V. (Netherlands), Vector Tobacco Inc., Von Eicken Group.

SPM APPENDIX

As directed by section III, paragraphs (2) and (3), of the Stipulated Partial Award, amounts to be credited to SPMs' April 15, 2013 payments are: [1]

Commonwealth Brands, Inc.	$	16,817,216
Compania Industrial de Tabacos Monte Paz, S.A.	$	156,667
Daughters & Ryan, Inc.	$	57,811
House of Prince A/S	$	979,764
Japan Tobacco International U.S.A., Inc.	$	1,632,410
King Maker Marketing, Inc.	$	1,723,694
Kretek International	$	255,848
Lane Limited	$	175,007
Lignum-2, Inc.	$	388,979
Peter Stokkebye Tobaksfabrik A/S	$	297,081
Premier Manufacturing, Inc.	$	1,332,213
P.T. Djarum	$	893,022
Reemtsma Cigarettenfabriken GmbH (Reemtsma)	$	60
Santa Fe Natural Tobacco Company, Inc.	$	2,405,747
Sherman 1400 Broadway N.Y.C., Inc.	$	250,061
Top Tobacco, L.P.	$	2,832,749
U.S. Flue-Cured Tobacco Growers, Inc.	$	676,935
Von Eicken Group	$	27,963

Some SPMs do not have an MSA payment due in 2013 sufficient to absorb the credit listed above. The Auditor shall permit any such SPM to carry forward its credit to April 15, 2013 payments for use in future years. Alternatively, if such SPM and any other PM jointly notify the Independent Auditor that the credit to be applied in 2013 has been transferred from the SPM to the other PM (the "transferee PM"), the Auditor shall credit the amount otherwise due the SPM with respect to its April 15, 2013 above to the transferee PM.

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1 Note: The amounts in this Appendix assume that the 2012 NPM Adjustment is identical to the 2011 NPM Adjustment and will need to be revised once the Independent Auditor calculates the actual 2012 NPM Adjustment. The numbers in this Appendix remain subject to verification. These numbers would be subject to change if the identity of the Signatory States changes.

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November 14, 2012

TERM SHEET

I. ACCRUED CLAIMS FOR 2003 TO 2011 AND 2012 NPM ADJUSTMENT

Accrued claims relating to the NPM Adjustment disputes for 2003 to 2011 and the 2012 NPM Adjustment would be handled as follows:

A. The basic methodology from the August 2010 MOU would be retained, with the following adjustments:

1. All amounts related to the 2010, 2011 and 2012 NPM Adjustments would be added to the terms of the settlement.

2. The settlement value would be increased from 29.5% to a percentage ranging from 37.5% to 46%. The applicable percentage within that range depends on the aggregate Allocable Share of the signatory Settling States as follows:

Aggregate Allocable Share	Settlement Value Percentage
80% or more	37.5%
75-79.9%	38.5%
70-74.9%	39.5%
65-69.9%	40.5%
60-64.9%	42.5%
55-59.9%	44.5%
50-54.9%	46%

Appendix A sets forth the reference date for determining the aggregate Allocable Share and the increased settlement value applicable to States that sign this Term Sheet after December 14, 2012 (or, in the case of States with December hearing dates, after the start of their hearing).

3. The amount contributed to fund the Data Clearinghouse would be reduced from $20,000,000 to $10,000,000.

B. The signatory Settling States would allocate the settlement amounts (either the application of the credits to the PMs or the receipt of amounts released from the DPA, or both) among themselves so as to fully compensate those signatory Settling States whose diligent enforcement for 2003 was uncontested for their share of the 2003 NPM Adjustment, plus interest.

C. These provisions would be implemented as provided in Appendix A.

II. TRANSITION

A. There will be a two-year transition period covering sales years 2013-2014 during which the revised NPM Adjustment will operate as follows.

B. The revised adjustment for non-SET-paid sales under Section III.C will not apply for those years. The revised adjustment for SET-paid sales under Section III.B will apply for those years, except for the final sentence of Section III.B.2.c and the tribal tax clause of footnote 1.

C. In addition, for each of those years, the signatory PMs will receive the amounts detailed in Section II.A.3 of the MOU, except that the percentage in (a) of that Section will be 25% and the Market Share Loss referred to in (a)-(d) of that Section will be the 2011 Market Share Loss.

III. NPM ADJUSTMENT FOR SUBSEQUENT YEARS

A. The terms of the MOU would be abandoned and replaced with the adjustments outlined herein.

B. SET-Paid NPM Sales[1]

1. *Adjustment.* Each year, an adjustment will be applied to a signatory Settling State's share of the OPMs' MSA Payment equal to the adjustment amount for each non-compliant NPM cigarette on which SET is paid in the state. The adjustment amount will be three times the per-cigarette escrow deposit rate in the Model Escrow Statute for the year of the sale, including the inflation adjustment in the statute. There will be a proportional adjustment for each signatory SPM in proportion to the size of its MSA payment for that year.

2. *Meaning of non-compliant NPM cigarettes.* Non-compliant NPM cigarettes are SET-paid NPM cigarettes as to which escrow was (i) not deposited at the Escrow Statute rate or (ii) released or refunded except as provided in the Escrow Statute as amended by Allocable Share Repeal. The term non-compliant NPM cigarettes does not include:

   a. cigarettes on which the escrow was deposited at the statutory rate by either: (i) the NPM or any other entity liable for such payments under the laws of the individual signatory Settling State, or (ii) a person or entity in the distribution chain on behalf of such NPM or other entity liable for such payments under such laws, so long as such state did not release or refund any part of the deposit, unless released pursuant to the terms of the Escrow Statute, as amended by Allocable Share Repeal;

   b. cigarettes on which a signatory Settling State recovered at the statutory rate on an escrow bond posted pursuant to the laws of that

[1] SET includes 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, for NPM cigarettes sold after 2014, an excise or other tax imposed by a state- or federally-recognized tribe on the distribution or sale of cigarettes. Except if otherwise indicated, references to "NPM sales," "NPM cigarettes" and "NPM volume" in this Term Sheet refer to NPM Cigarettes, with the term "Cigarette" having the meaning given in the MSA.

state, so long as such state did not release or refund any part of the deposit so recovered, unless released pursuant to the terms of the Escrow Statute, as amended by Allocable Share Repeal;

c. cigarettes as to which the state is barred from requiring escrow deposits from all entities liable for such payments under its individual state law, and from recovery on a remaining escrow bond, by an automatic stay or subsequent order in a federal bankruptcy proceeding or by order of a court of competent jurisdiction that requiring escrow deposits is barred by federal or state constitutional law (other than state constitutional provisions added or amended after the signature date of this document or state constitutional law as it may impact or be applied in relation to sovereign immunity or other Native American issues) or federal statutory or common law, so long as: (i) the state opposes and appeals the stay or order,[2] and (ii) the NPM and brand at issue were properly on the state's approved-for-sale directory, either in accordance with the terms of Complementary Legislation or pursuant to the order of a court of competent jurisdiction barring removal of the NPM or brand from that directory, within 30 days prior to the time of sale. This paragraph only applies to signatory Settling States that have requirements in effect that the NPM in question post a bond in at least the amount described in section 17(b) of the Appendix to the MOU and that importers are jointly and severally liable for escrow deposits due from an NPM with respect to NPM cigarettes that they import; or

d. SET-paid NPM cigarettes sold after 2014 in a signatory Settling State on which escrow was timely deposited in an amount equal to or greater than the Escrow Statute rate, but as to which the State releases a portion of such amount not to exceed 50% of the Escrow Statute rate pursuant to a tribal compact to a federally recognized tribe (or tribe that was recognized by that State as of January 1, 2012) with a reservation in that State where each of the following is true: (i) the release occurs no earlier than one year after the deposit is made, (ii) the cigarettes on which the escrow is released were sold in retail transactions to consumers on that tribe's reservation, (iii) the money released is provided to the tribe itself and used solely for public safety on such tribe's reservation and/or social services for tribal members (e.g., health care, education) and not for any function that could directly or indirectly promote or reduce the costs of cigarette production, marketing or sales, (iv) the money released is not used in any way for the benefit of an NPM or to facilitate NPM sales, (v) the compact makes the requirements of Section IV.L applicable to the tribe, and the tribe is in conformity with such

[2] Subject to any limitation arising from Rule 11 or similar state ethical rules.

requirements, and (vi) the State has amended its Escrow Statute to remove the NPM's right to reversion and interest as to (but only as to) the escrow to be released in conformity with the above requirements.[3] Provided, however, that (i) a signatory Settling State may not release more than $1 million in escrow as described in this paragraph in any year to all tribes collectively; and (ii) in the event a court strikes down a signatory Settling State's removal of the NPMs' right to reversion and interest described in (vi) above, such State may pay to tribes the amounts authorized under the remainder of this paragraph out of its general fund (subject to all other conditions and limits set forth above). A State that releases escrow as described in this paragraph has the responsibility of ensuring that (i)-(vi) and the terms of the preceding sentence are met.

3. *Safe Harbor*. No adjustments under this section will be applied to a signatory Settling State for any year in which the state demonstrated (a) that escrow was deposited on at least 96% of all NPM cigarettes sold in the state during that year on which SET was paid in the state, or (b) that the number of SET-paid NPM cigarettes sold in the state during that year on which escrow was not deposited did not exceed 2 million cigarettes.

4. *Timing*. The adjustment amount with respect to a signatory Settling State will be applied to that state's share of the signatory PMs' next annual MSA Payment. If a stay or order, as referenced *supra*, is reversed or otherwise becomes no longer operative and escrow is not then deposited on the cigarettes at issue, the adjustment on those cigarettes will be applied to that state's share of the signatory PMs' next annual MSA Payment unless a further stay or order is entered. Adjustment amounts applied to a state's share will be subject to appropriate repayments by the signatory PMs if escrow is deposited on the cigarettes at issue after application of the adjustment.

5. *Process*. The process will be as specified in Sections II.B.5 and IV.B of the MOU. The final settlement agreement will include provisions as to communication of information to the Data Clearinghouse.

C. Non-SET-Paid NPM Sales

1. Non-SET-Paid NPM Sales would be handled as to the signatory Settling States per the terms of the MSA, with the following adjustments:

[3] This paragraph applies only with respect to cigarettes of NPMs that existed in the U.S. market as of June 1, 2012 and does not apply with respect to cigarettes of NPMs that entered the U.S. market after that date. In addition, this paragraph does not apply where any NPM involved in the production, distribution or sale of the cigarettes at issue is one (or an affiliate or successor of one) affiliated with the tribe (or any members of the tribe) to which the escrow would be released. For purposes of this paragraph, a tribe with reservation land located in more than one State is considered to have a reservation in, and to be eligible for release of escrow from, only the State in which the largest portion of its reservation land is located.

a. The total NPM Adjustment liability (if any) of each signatory Settling State under the original formula for a year would be reduced by a percentage. The percentage would equal the sum of (i) the percentage represented by the fraction of the total SET-paid NPM volume in the MSA States divided by nationwide FET-paid NPM volume for that year;[4] plus (ii) in the case of a signatory Settling State that has, as of January 1 of the year at issue, executed documentation approving the PSS amendment, the percentage represented by the fraction of (x) the total equity-fee-paid NPM sales in those PSS that had in effect for the entire year at issue an NPM equity fee law that, by its terms, imposed a per-pack fee equal to or greater than 90% of the escrow rate for sales made that year under the Escrow Statute on all cigarette sales in such state that it has the authority under federal law to tax, divided by (y) nationwide FET-paid NPM volume.[5]

b. The liability reduction under paragraph (a) would be effectuated by each signatory Settling State that is found non-diligent and allocated a share of the NPM Adjustment amount receiving a reimbursement by the signatory PMs through the methodology detailed in Paragraph 3(a) of the Agreement Regarding Arbitration.

2. The Diligent Enforcement standard applies to all FET-paid NPM sales that the State reasonably could have known about and on which such State has the authority under federal law to tax or collect escrow, including (i) all

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[4] The total SET-paid NPM volume in the MSA States will be calculated as follows. SET-paid NPM volume in a signatory Settling State will be the number of SET-paid NPM sales in that State in that year as determined through the process described in Section III.B.5. SET-paid NPM volume in a non-signatory Settling State will be NPM sales in that State in that year on which the State's cigarette excise tax was paid (or on which another state tax on the distribution or sale of cigarettes or an excise or other tax imposed by a tribe was paid if that State in that year treated NPM sales on which such tax was paid as fully subject to the escrow requirement under that State's Escrow Statute). For a non-signatory Settling State, such volume will be as reported by that State under the Significant Factor procedures agreement (or other agreement among the parties as to the Significant Factor issue for that year), provided that any signatory PM or signatory Settling State may challenge that reported volume in the arbitration referenced in Sections III.C.4 and IV.J.1 as an inaccurate measure of the volume described in the preceding sentence. In the event of such a challenge, the arbitration panel's determination of the volume will be final and binding on all signatory PMs and signatory Settling States. References to "FET" include arbitrios de cigarillos in Puerto Rico.

[5] The final settlement agreement will include provisions addressing how the information for calculating the total equity-fee-paid NPM sales in each such PSS will be obtained. The current fee laws in MS and MN will be deemed to meet the requirements of clause (x) even though they otherwise would not so long as the per pack amount in effect under them remains at least as large as it is now. The signatory PMs further agree to the following: (i) the signatory OPMs agree to support the enactment in FL and TX of legislation meeting the requirements of clause (x) provided that such legislation is not in conjunction with any other legislative proposal and does not contain any provision that applies to the OPMs or their products or businesses; (ii) if the PSS amendment has become effective, the signatory SPMs agree not to oppose the enactment in FL and TX of legislation meeting the requirements of clause (x) provided that such legislation is not in conjunction with any other legislative proposal; and (iii) if a signatory PM supports the enactment in FL or TX of an equity fee law that does not meet the requirements of clause (x) and such law is enacted, the law will be deemed to meet the requirements of clause (x) as to that signatory PM (and, if enactment of the law was supported by signatory PMs with more than 60% Market Share, the law will be deemed to meet the requirements of clause (x) as to all signatory PMs).

such sales made via the Internet, (ii) all such tribal sales or sales on tribal lands, and (iii) all such sales that may otherwise constitute contraband.[6]

3. Factors relevant to the Diligent Enforcement determination include, but are not limited to: (i) whether the number of NPM sales in the State that were SET-paid and addressed under Section III.B was reduced by virtue of a policy or agreement not to require/collect SET or enforce an SET stamping requirement, or an indifference to SET collection or to enforcement of an SET stamping requirement; and/or (ii) whether the actual number of SET-paid NPM sales in the State during that year was significantly greater than the number of such sales addressed under Section III.B.[7]

4. The signatory Settling States agree that diligent enforcement will be determined as to them in a single arbitration each year. Future arbitrations under this Term Sheet would be governed by the arbitration terms outlined within the MOU, except to the extent necessary for a future merged arbitration to proceed as described in Section IV.J.1 below.

5. The signatory Settling States and the PMs will continue to discuss in good faith on an ongoing basis whether there are other actions that they can reasonably take to prevent non-SET-paid NPM sales.

IV. OTHER TERMS

A. *Withholding/Disputed Payment Accounts.* Except as provided in Section J below, the PMs will not withhold or pay into the DPA based on a dispute arising out of the revised NPM Adjustment, except if the dispute was noticed for arbitration by the PM over one year prior to the payment date and the arbitration has not begun despite good faith efforts by the PM.

B. *Most Favored Nations.* The MFN clause provided within the MOU would be retained.

C. *RYO.* Those terms relating to RYO in the MOU as to applying the SET-paid sales provision to RYO would be retained (i.e., it applies if tax other than SET is paid, and whether or not the state law requires that the containers be stamped). The signatory Settling States and the signatory PMs will continue to discuss in good faith on an ongoing basis the issues of pipe tobacco being sold for use as RYO and of cigarette rolling machines being located at retail establishments and clubs.

D. *Office.* Those terms of the MOU designating an office within each signatory Settling State as a point-of-contact on tobacco-related matters would be retained.

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[6] The following are exempt from the Diligent Enforcement standard: (i) NPM cigarette sales on a federal installation in a transaction that is exempt from state taxation under federal law, and (ii) NPM cigarette sales on a tribe's reservation by an entity owned and operated by that tribe or member of that tribe to a consumer who is an adult member of that tribe in a transaction that is exempt from state taxation under federal law.

[7] A finding referenced in (ii) will not increase the adjustment applicable to the State under Section III.B or the reduction under Section III.C.1(a)(i).

E. *Conditions of Settlement.* The terms of this Term Sheet are conditioned upon: (1) joinder by a critical mass of PMs and a critical mass of Settling States by December 14, 2012; and (2) approval of this Term Sheet's terms by the Arbitration Panel. On December 17, 2012, each party that has signed this Term Sheet will determine, in each party's sole discretion, whether a critical mass of PMs and Settling States have joined such that it will proceed with the settlement, provided that the signatory PMs agree that a critical mass of Settling States will have joined if the aggregate Allocable Share of the Settling States that sign this Term Sheet by December 14, 2012 and determine to proceed with the settlement on December 17, 2012 is 50% or more and such States include the States that participated directly in the drafting of this Term Sheet (AZ, AR, CA, MI, NE, NV, TN). If the settlement proceeds, additional Settling States and PMs may join the settlement following December 14, 2012 by signing this Term Sheet or the final settlement agreement up to the end date of the last individual State diligent enforcement hearing in the 2003 Arbitration, although they will have different payment obligations or payment rights as detailed in Appendix A. Settling States may join the settlement after the end date of the last individual State diligent enforcement hearing in the 2003 Arbitration if the signatory PMs, in their sole discretion, agree. PMs may join the settlement after the end date of the last individual State diligent enforcement hearing in the 2003 Arbitration if the signatory Settling States, in their sole discretion, agree.

F. *Settlement Agreement.* The parties will cooperate in the drafting and execution of a comprehensive final settlement agreement incorporating the terms of this Term Sheet, as well as all other customary terms and conditions acceptable to the parties. The documentation process will be subject to the oversight of the Arbitration Panel. Pending the execution of the final settlement agreement, this Term Sheet is binding on all signatories provided the conditions of Section IV.E are met.

G. *Necessary legislation.* All signatory Settling States must have the Escrow Statute, Complementary Legislation and Allocable Share Repeal in full force and effect. A signatory Settling State that does not currently have Allocable Share Repeal in full force and effect will have until the end of 2013 to put it into full force and effect. If it does not do so, starting with NPM cigarettes sold in 2014, NPM cigarettes on which that State releases escrow that would not be released under Allocable Share Repeal will be treated as non-compliant NPM cigarettes under Section II.B.

H. *Significant Factor.* The signatory Settling States agree that the significant factor condition to the NPM Adjustment is no longer operative as to them. Beginning for 2022, no NPM Adjustment will be applicable to the signatory Settling States for any year in which NPM Market Share is 3% or less.[8]

I. *Profit Adjustment.* The final settlement agreement will include appropriate provisions ensuring that the OPMs will not be subject to a profit adjustment under

[8] This Section does not affect the calculation of the amount of the NPM Adjustment under the MSA or this Term Sheet applicable to the signatory Settling States for any year in which NPM Market Share is greater than 3%.

Section B(ii) of Exhibit E arising from payments under Sections I-II being concentrated or recognized in less than 10 years.

J. *Relation with non-joining States.* If there are Settling States that are not signatory Settling States and the parties agree to proceed with the settlement:

1. The parties will cooperate in merging the arbitration under Section III.C.4 for a year with the diligent enforcement arbitration under Section XI(c) of the MSA as to non-joining States for that year.

2. The 2015 arbitration under Section III.C will not commence until the 2015 diligent enforcement arbitration begins as to non-joining States. The provisions of Section III.B will continue to apply on the schedule described in that Section.

3. In the interim, the signatory Settling States and the PMs will split the amounts at issue under III.C for 2015 and each subsequent year on a 50-50 basis, subject to repayment without interest by the PMs or credit without interest by the signatory Settling States after the arbitration for that year concludes. No more than 1 year would be subject to repayment or credit in any one year.

4. Notwithstanding the above, the PMs would have the right to commence the 2015 arbitration under Section III.C as to the signatory Settling States in advance of the above schedule if the volume of non-SET-paid NPM sales exceeds 9 billion cigarettes in each of any two years. After the first such year, the PMs and signatory Settling States would discuss measures that could be taken to avoid such sales. Notwithstanding the above, the signatory Settling States would have the right to commence the 2015 arbitration under Section III.C. as to the PMs in advance of the above schedule if the volume of non-SET-paid NPM sales is less than 2 billion cigarettes in each of any two years. Any early commencement under this paragraph requires the unanimous approval of the signatory members of the side seeking early commencement.

K. *Cap of MSA payment.* A signatory Settling State may not be subject to a total NPM Adjustment under this Term Sheet for a year in excess of its total MSA payment for that year.

L. *Taxes.* If a signatory Settling State has a law, regulation, systematic policy, compact or agreement with respect to taxes (applicability, amount, collection or refund) or stamping that is different for any NPM cigarettes than any PM cigarettes or a law, regulation, systematic policy, compact or agreement with respect to stamping that does not set forth specific requirements regarding when and what stamps are required, the law, regulation, systematic policy, compact or agreement will be relevant to the Diligent Enforcement determination.[9] In addition, if the difference between NPM and PM cigarettes with respect to taxes or stamping is material, the reduction in liability described in Section III.C.1(a)(i) will not be applied with respect to that State (if found non-exempt from the NPM Adjustment) for a year in which the difference is in effect.

M. *Additional Legislation.* If requested by a signatory Settling State, the PMs will support the enactment of legislation, provided that such legislation is not in conjunction with any other legislative proposal and contains no deviation of substance from the model language referred to below, which: (i) permits the release of taxpayer-confidential information to the Data Clearinghouse for the purpose of fulfilling its responsibilities under the settlement; (ii) imposes the bonding requirement described in Section III.B.2.c above, (iii) imposes the joint-and-several liability requirement described in Section III.B.2.c above, (iv) modifies the Escrow Statute in a manner consistent with Section III.C.2-3 above with respect to the subjects described in those Sections, and/or (v) permits a compact meeting the conditions described in Section III.B.2.d above and modifies the Escrow Statute in the manner described in Section III.B.2.d(vi) above. The final settlement agreement will include model language for the above modifications (including appropriate severability language) that signatory Settling States may choose, at their option, to use, and the PMs agree that the model language (or language containing no material deviation of substance from it) will not affect the status of a signatory Settling State's Escrow Statute as a Qualifying or Model Statute or any prior agreement to that effect. In addition, if requested by a signatory Settling State, the PMs will not oppose the Model Legislation set forth in Appendix A to the MOU. The signatory Settling States and the signatory PMs will continue to discuss in good faith on an ongoing basis support for other appropriate legislative enactments that would enhance enforcement of and/or improve compliance with the escrow requirement and for legislation prohibiting or limiting the sale of cigarettes to any consumer who is not in the physical presence of the seller at the time of sale.

N. *Potential New Participating Manufacturers.* Subject to the condition specified in the last sentence of this section, the PMs agree to waive rights under Section XVIII(b) of the MSA as to NPMs signing the MSA and becoming a Participating Manufacturer without making back-payments for sales in prior years that would otherwise be required under Section II(jj) of the MSA and/or without making full escrow deposits on such prior sales, provided that the following conditions are met: (i) the NPM signs the MSA within 120 days of the execution of the final settlement agreement; (ii) the NPM turns over the full amount on deposit in its existing escrow accounts to the Settling States; (iii) all other MSA terms are applicable to the NPM and the NPM waives any claim of immunity from enforcement of its MSA obligations; (iv) the NPM agrees to the other customary terms and conditions, apart from back-payments and escrow deposits, that the States have required for new

[9] This does not include (i) taxes or stamping requirements that differ for reservation sales and non-reservation sales provided that the taxes and stamping requirements applicable to reservation and non-reservation sales respectively are the same for both PM and NPM sales, or (ii) requirements that NPM cigarettes bear a stamp of a different color solely for purposes of identification.

Participating Manufacturers (including quarterly payments and de-listing); and (v) the NPM agrees that substantial non-compliance with its MSA obligations during the first five years after joining the MSA in the absence of a good-faith dispute would trigger the back-payment obligations that would otherwise have been required of it. The PMs do not waive rights under Section XVIII(b) of the MSA as to a new Participating Manufacturer's performance of its MSA obligations going forward. This section is conditioned upon the delivery to the PMs within 60 days of the execution of the final settlement agreement a binding agreement executed by all Settling States and the Foundation that NPMs that sign the MSA pursuant to this provision without making full back-payments will not be considered Participating Manufacturers for purposes of Section IX(e) of the MSA.[10]

O. *Release of Escrow.* Except pursuant to the unanimous consent of the signatory PMs, signatory Settling States will not release or refund escrow deposited for the resolved years 1999-2012 or transition years 2013-2014 except to a State or as provided in the Escrow Statute as amended by Allocable Share Repeal. Any release or refund of escrow deposited for subsequent years will be addressed as provided in Section III.B for SET-paid NPM sales and as provided in Section III.C and the Diligent Enforcement standard for non-SET-paid NPM sales.

[10] This provision does not apply to any entity that had previously agreed to sign the MSA and to make any back-payments. The PMs retain their rights under Section XVIII(b) of the MSA as to any such entity.

APPENDIX A:

1. The OPMs receive a total amount equal to (a) the aggregate Allocated Settlement Percentage of the signatory Settling States multiplied by \$6.52 billion; and (b) the aggregate Allocated Settlement Percentage of the signatory Settling States multiplied by the OPMs' full 2010-12 NPM Adjustments. Each signatory Settling State's Allocated Settlement Percentage equals the product of its Allocable Share percentage and the applicable settlement value percentage under Paragraph 2.[11]

2. (A) For Settling States that sign this Term Sheet by 6:00 P.M. PST on the initial sign-on date and determine to proceed with the settlement on December 17, 2012, the applicable settlement value percentage is that reflected in the grid below, with the aggregate Allocable Share being the aggregate Allocable Share of the Settling States that sign this Term Sheet by the Reference Date and proceed with the settlement:

Aggregate Allocable Share	Settlement Value Percentage
80% or more	37.5%
75-79.9%	38.5%
70-74.9%	39.5%
65-69.9%	40.5%
60-64.9%	42.5%
55-59.9%	44.5%
50-54.9%	46%

Except as provided below, the initial sign-on date is December 14, 2012. For Settling States whose individual State diligent enforcement hearing in the 2003 Arbitration is scheduled to begin in December 2012 (WA, AZ and CO), the initial sign-on date is the day preceding the beginning of its hearing unless the beginning of its hearing is deferred until after December 14, 2012. At the present time, WA and AZ have agreed to such deferral, and their initial sign-on date will be December 14, 2012 so long as the Panel approves the deferral.

(B) For Settling States that sign this Term Sheet (or, in the case of Settling States that do not sign this Term Sheet, the final settlement agreement) after the initial sign-on date, the applicable settlement value percentage is 59%. The signatory PMs, in their sole discretion, may waive all or part of the increase above the applicable settlement value percentage under subparagraph (A) as to such a State without triggering the MFN clause in this Term Sheet and without any obligation to provide a similar waiver to any other State.[12]

(C) The Reference Date is December 21, 2012. A Settling State that signs this

[11] References to a State's "Allocable Share" percentage in this Term Sheet are to the percentage set forth for that State as listed in Exhibit A of the MSA.

[12] Approval by signatory PMs representing at least 85% Market Share in 2011 will be sufficient for this waiver and will bind the remaining signatory PMs.

Term Sheet after the initial sign-on date but by the Reference Date will be counted as part of the aggregate Allocable Share under subparagraph (A) whether or not the signatory PMs waived the increased percentage applicable to such State under subparagraph (B).

3. (A) The amount under Paragraph 1 will be provided by the OPMs receiving credits reflecting the total amount specified in Paragraph 1 (the "Total OPM Amount"). Subject to Section IV.I, the credits will be applied as follows: (i) 50% of the Total OPM Amount as a credit against the OPMs' MSA annual payment due in April 2013; and (ii) a [__]% reduction in the OPMs' MSA annual payment under Section IX(c)(1) of the MSA due in each of April 2014-2017, plus interest on the amount of each reduction (except as provided in the accompanying footnote) at the Prime Rate calculated from April 15, 2013.[13]

(B) The amount of the percentage in subparagraph (A)(ii) will be the percentage that, when applied to the OPMs' estimated MSA annual payments due in April 2014-2017 (the estimate being after the Inflation Adjustment, Volume Adjustment and Previously Settled States Reduction, but before the remaining adjustments, reductions and offsets under the MSA), yields a total reduction equal to 50% of the Total OPM Amount. (For example, if 50% of the Total OPM Amount were $1 billion and the OPMs' estimated MSA annual payments for 2014-2017 (as adjusted as specified above) were $5 billion per year, the percentage in subparagraph (A)(ii) would be 5%.) The percentage will be filled in with respect to the MSA annual payment due in April 2014 pursuant to these specifications as of the Reference Date (once the Total OPM Amount is known), subject to change in the event additional Settling States sign this Term Sheet or the final settlement agreement after the Reference Date. With respect to each of the reductions to the MSA annual payments due in April 2015-2017, the percentage will be recalculated annually on October 15 of the year prior to the year the payment is due (for example, on October 15, 2014 for the MSA annual payment due in April 2015) to reflect the percentage that, when applied to an estimate of the OPMs' next annual payment based upon inflation and volume in the first 9 months of the year prior to the year the payment is due, yields a reduction equal to 12.5% of the Total OPM Amount.[14]

(C) The final settlement agreement will include provisions that will apply in the event the Total OPM Amount increases after the Auditor's Final Calculation of the MSA annual payment due on April 15, 2013 as a result of increased State

[13] Interest will only be paid on the portion of each reduction that exceeds 20% of the signatory Settling States' aggregate Allocable Share of amounts previously withheld by an OPM and paid into the DPA pursuant to Paragraph 5.

[14] The reductions to be applied in 2014-2017 do not count in calculating the NPM Adjustment or toward the cap in Section IV.K (the final settlement agreement will include provisions addressing how the OPMs will receive the funds at issue if such a State does not have a sufficient MSA payment remaining in any such year to apply the reductions due that year). In addition, the final settlement agreement will include provisions regarding the accrual of the reductions.

participation after that date and that specify how the increased part of that Amount will be provided to the OPMs. Unless the parties agree otherwise, those provisions will be consistent with the principles of this Appendix, including providing for payment of 50% of the increased part of that Amount by first-available credit and of the remaining 50% by reduction.

(D) Each credit and reduction will be allocated among the OPMs as directed by the OPMs.

4. The credit and reductions under Paragraph 3 will be allocated solely among the signatory Settling States and will not be allocated to the Allocated Payment of any non-signatory Settling State. Except as provided in Section I.B or as may be agreed upon by the parties in the final settlement agreement, the credit and each of the reductions will be allocated among the signatory Settling States in proportion to their respective Shares. A signatory Settling State's "Share" means the percentage yielded by dividing its Allocated Settlement Percentage by the aggregate Allocated Settlement Percentages of all signatory Settling States.[15]

5. Any OPM that withheld amounts with respect to an NPM Adjustment will pay that amount into the DPA by seven days after approval of this Term Sheet's terms by the Arbitration Panel. Each OPM that paid amounts attributed to the 2003, 2004, 2006, 2007, 2008 or 2009 NPM Adjustments into the DPA (including previously withheld amounts paid into the DPA pursuant to the preceding sentence) will, as of the date it receives confirmation from the Independent Auditor that it will apply all of the credits and reductions described in Paragraphs 1-3 and allocate them as described in Paragraphs 4 and 6, instruct the Escrow Agent and the Independent Auditor to release to the signatory Settling States from the DPA an amount equal to the total amounts attributed to such NPM Adjustments (plus the accumulated earnings thereon) multiplied by the aggregate Allocable Share percentage of the signatory Settling States, less amounts allocated to the Data Clearinghouse per Section I.A.3 above. Individual signatory Settling States may choose to have their DPA releases spread over 2013-2017. This would not affect any credits, adjustments or other calculations.

6. The signatory Settling States and OPMs will jointly instruct the Escrow Agent and Independent Auditor: (i) to apply all of the credits and reductions described in Paragraphs 1-3, and to allocate them among the OPMs as described in Paragraph 3

[15] Subject to the limits specified below, a signatory Settling State that signs this Term Sheet by the Reference Date may elect, by notice to the parties no later than the Reference Date, for its Share of the Total OPM Amount to be applied entirely as a credit against the OPMs' MSA annual payment due in April 2013. In that event, the overall amounts of the respective credit and reductions under Paragraph 3 will not change, but the credit and reductions will be allocated among the signatory Settling States differently so that (i) each electing State is allocated a portion of the April 2013 credit equal to its Share of the Total OPM Amount and is allocated none of the 2014-2017 reductions, and (ii) each other signatory Settling State is allocated a lower portion of the April 2013 credit and a corresponding higher portion of each of the 2014-2017 reductions as necessary to fulfill the provisions of Paragraph 4. Unless the OPMs agree otherwise, the election right will not be available if it would result in a profit adjustment under Section B(ii) of Exhibit E of the MSA or if it is not possible to apply the preceding sentence because too many signatory Settling States have already sought to make that election.

and solely among the signatory Settling States as described in Paragraph 4; and (ii) to allocate the amount released from the DPA under Paragraph 5 solely among the signatory Settling States in proportion to their respective Allocable Shares, except for those amounts allocated to the Data Clearinghouse.

7. There will be parallel provisions for SPMs so that each signatory SPM receives the same (*i.e.*, no greater) relative payment amounts on the same general timetable and makes the same relative releases (including amounts paid into the DPA attributed to the 2010-11 NPM Adjustments) through an equivalent process.

8. The remaining methodology in the August 2010 MOU would be retained, including as to SPMs that withheld funds (including in excess of their total payment amounts under this Term Sheet), SPMs that are not current on their undisputed or adjudicated MSA payment amounts or that expressly waived or assigned Adjustment claims, and late-joining Settling States or PMs. Late-joining Settling States would be eligible to join subject to the provisions of Section IV.E, but their payment amount would be as provided in Paragraph 2. Any late-joining OPM will be treated in the same manner as a late-joining SPM was to have been treated under the August 2010 MOU. A PM or Settling State that signs this Term Sheet after the initial sign-on date (for PMs, 6:00 P.M. PST on December 14, 2012; for States, as provided in Paragraph 2) will be considered late-joining, provided that, in the case of a late-joining Settling State, the signatory PMs may waive all or part of the increased payment from that State as provided in Paragraph 2.

SPM ADDENDUM

The following reflects the parties' agreement as to the parallel provisions under Paragraph 7 of Appendix A with respect to the individual SPMs listed in Exhibit A hereto. [1]

1. Each listed SPM will receive a total amount equal to (a) the aggregate Allocated Settlement Percentage of the signatory Settling States multiplied by the amount listed for that SPM in the attached Exhibit A; and (b) the aggregate Allocated Settlement Percentage of the signatory Settling States multiplied by that SPM's full 2010-12 NPM Adjustments.

2. Each listed SPM that paid amounts attributed to any of the 2003, 2004 or 2006-2011 NPM Adjustments into the DPA, will, as of the date it receives confirmation from the Independent Auditor that it will apply all of the credits, payments, and reductions described in Paragraph 4 below (or in the case of Liggett and Vector, Paragraph 5 below) and allocate them consistent with Paragraphs 4 and 6 of Appendix A and Paragraph 3 below, instruct the Escrow Agent and the Independent Auditor to release to the signatory Settling States from the DPA an amount equal to the total amounts attributed to such NPM Adjustments (plus the accumulated earnings thereon) multiplied by the aggregate Allocable Share percentage of the signatory Settling States.

3. The parallel provisions to Paragraphs 4 and 6 of Appendix A will include provisions for instructions to the Escrow Agent and Independent Auditor (i) to apply all of the credits, payments, and reductions described in Paragraphs 4 and 5 below and to allocate them solely among the signatory Settling States; (ii) to allocate amounts paid or released by each SPM solely among the signatory Settling States; and (iii) to recognize and apply the provisions regarding carryforward and transfer of credits described in footnote 2 below.

4. The amount under Paragraph 1 will be provided by each listed SPM (except for Liggett and Vector) receiving credits reflecting the total amount specified for that SPM in Paragraph 1 in one of the following three ways:

(i) the SPM receiving its full amount under Paragraph 1 as a credit against its MSA annual payment under Section IX(c)(1) of the MSA due in April 2013;

(ii) the SPM receiving (a) 50% of its amount under Paragraph 1 as a credit against its MSA annual payment under Section IX(c)(1) of the MSA due in April 2013; and (b) a [__]% reduction in its MSA annual payment under Section IX(c)(1) of the MSA due in each of April 2014-2017, plus interest on the amount of each reduction at the Prime Rate calculated from April 15, 2013; or

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[1] The definitions in the Term Sheet and Appendix A apply to this Addendum. References to Appendix A are to Appendix A to the Term Sheet.

(iii) the SPM receiving (a) 30% of its amount under Paragraph 1 as a credit against its MSA annual payment under Section IX(c)(1) of the MSA due in April 2013, and (b) a [__]% reduction in the SPM's MSA annual payment under Section IX(c)(1) of the MSA due in each of April 2014-2016, plus interest on the amount of each reduction for the years 2014, 2015, and 2016 at the Prime Rate calculated from April 15, 2013.

(iv) The option in subparagraph (iii) is available only if enough listed SPMs have selected options (i) or (ii) above such that, in combination with the amounts that would be credited in 2013 under subparagraph (iii)(a), at least 50% of the aggregate amounts due to all listed SPMs under Paragraph 1 are credited in 2013. For purposes of this calculation, the amounts for Liggett and Vector under Paragraph 1 will be deemed credited in 2013, although those amounts will be conferred as provided in Paragraph 5 below.

(v) The percentages in subparagraphs (ii) and (iii) will be the percentage that, when applied to the listed SPM's estimated MSA annual payments due in April 2014-2017 (in the case of subparagraph (ii)) or April 2014-2016 (in the case of subparagraph (iii)), in each case with the estimate being after the Inflation Adjustment and Volume Adjustment but before the remaining adjustments, reductions and offsets under the MSA, yields a total reduction equal to 50% of the amount due the listed SPM under Paragraph 1 (in the case of subparagraph (ii)) or 70% of the amount due the listed SPM under Paragraph 1 (in the case of subparagraph (iii)). The percentages will be filled in with respect to the MSA annual payment due in April 2014 pursuant to these specifications as of the Reference Date (once the amount due the listed SPM under Paragraph 1 is known), subject to change in the event additional Settling States sign this Term Sheet or the final settlement agreement after the Reference Date. With respect to each of the reductions to the MSA annual payments due after April 2014, the percentage will be recalculated annually on October 15 of the year prior to the year the payment is due (for example, on October 15, 2014 for the MSA annual payment due in April 2015) to reflect the percentage that, when applied to an estimate of the listed SPM's next annual payment based upon inflation and volume in the first 9 months of the year prior to the year the payment is due, yields a reduction equal to 12.5% of the amount due the listed SPM under Paragraph 1 (in the case of subparagraph (ii)) or 23.3333333% of the amount due the listed SPM under Paragraph 1 (in the case of subparagraph (iii)). [2]

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[2] The reductions to be applied in 2014-2017 do not count in calculating the NPM Adjustment or toward the cap in Section IV.K (the final settlement agreement will include provisions addressing how the SPMs will receive the funds at issue if such a State does not have a sufficient MSA payment remaining in any such year to apply the reductions due that year). In addition, the final settlement agreement will include provisions regarding the accrual of the reductions. A listed SPM that has no MSA payment obligation in 2013 against which the credit under Paragraph 4 due in 2013 may be applied, or whose MSA payment obligation for 2013 is less than the amount of the credit to which it is entitled that year under Paragraph 4 may, if it chooses, carry the unused portion of the credit forward and apply it in future years or may transfer the unused portion of the credit to another PM that may apply such credit against its own payment. An

5. With respect to Liggett and Vector, which withheld certain funds, the amount under Paragraph 1 will be handled pursuant to this Paragraph. Liggett and Vector will receive no credit against their MSA payments and instead will receive the benefit of the settlement and address previously withheld amounts for the 2004-2010 adjustments as follows. No later than April 15, 2013, each of those companies will pay to the signatory Settling States the excess of (a) $44,098,572 (for Liggett) or $2,624,625 (for Vector) multiplied by the aggregate Allocable Share percentage of the signatory Settling States; over (b) the amount to which that company is entitled under Paragraph 1; plus (c) 12.8090288% of $27,185,288 (for Liggett) or $1,834,639 (for Vector) multiplied by the aggregate Allocable Share percentage of the signatory Settling States. Following these payments, the amount Liggett and Vector have withheld with respect to NPM Adjustments shall be reduced by $44,098,572 (for Liggett) and $2,624,625 (for Vector) multiplied by the aggregate Allocable Share percentage of the signatory Settling States, plus the amount of all accrued interest on those amounts, reflecting the settlement between Liggett and Vector and the Signatory States with respect to those States' Allocable Share of the NPM Adjustment claims. With respect to the 2003, 2007 (for Vector), 2011, and 2012 NPM Adjustments, Liggett and Vector will be governed by Paragraph 2.

6. With respect to Farmers Tobacco Company of Cynthiana, Inc., which withheld certain funds, the amount under Paragraph 1 will be handled pursuant to this Paragraph. Farmers Tobacco will receive no credit against its MSA payments and instead will receive the benefit of the settlement and address previously withheld amounts for the 2003-2009 adjustments as follows. No later than April 15, 2013, Farmers Tobacco will pay to the signatory Settling States the excess of (a) $20,028,552 multiplied by the aggregate Allocable Share percentage of the signatory Settling States; over (b) the amount to which Farmers Tobacco is entitled under Paragraph 1. Following these payments, the amount Farmers Tobacco has withheld with respect to NPM Adjustments shall be reduced by $20,028,552 multiplied by the aggregate Allocable Share percentage of the signatory Settling States, plus the amount of all accrued interest on those amounts, reflecting the settlement between Farmers Tobacco and the Signatory States with respect to those States' Allocable Share of the NPM Adjustment claims. (The amount for Farmers Tobacco in Exhibit A referenced in Paragraph 1(a) is not multiplied by 112.8090288%.) [1]

SPM that is not current on its undisputed or adjudicated payment obligations under the MSA or any amendment to the MSA, or that has been delisted by any State as of August 31, 2012 for failure to generally perform its MSA financial obligations when due, shall (in addition to treatment specified under the term sheet and Appendix A) not be entitled to carry the unused portion of the credit forward or transfer it to another PM, and any amounts to be received by such an SPM under the Term Sheet, and any amounts transferred to it under this footnote, will be applied to its unpaid obligations and will not otherwise be credited to that SPM except to the extent such amounts exceed the signatory Settling States' aggregate Allocable Share of such unpaid obligations.

[1] The numbers in Exhibit A and Paragraphs 5 and 6 remain subject to verification.

7. The final settlement agreement will include provisions that will apply in the event the amounts due the SPMs under Paragraph 1 increase after the Auditor's Final Calculation of the MSA annual payment due on April 15, 2013 as a result of increased State participation after that date and that specify how the increased part of that Amount will be provided to each SPM. Unless the parties agree otherwise, those provisions will be consistent with the principles of this Addendum. Also, this Addendum may be supplemented to address additional SPMs joining the Term Sheet.

EXHIBIT A

Formula derivation:				
OPM NPM Adjustments 2003-2009	$	5,779,679,225		
OPM Amount Specified in App. A, ¶ 1	$	6,520,000,000		
Percent by which OPM Amount Specified in App. A, ¶ 1 exceeds 2003-2009 Adjustments		12.8090288%		

SPM (to be verified)		**NPM Adj. 2003-2009**		**112.8090288% of NPM Adj 2003-09 (¶ 1 amount)**
Commonwealth Brands, Inc.	$	201,218,098	$	226,992,182
Compania Industrial de Tabacos Monte Paz, S.A.	$	468,522	$	528,536
Daughters & Ryan, Inc.	$	269,022	$	303,481
Farmers Tobacco of Cynthiana	$	20,028,552	$	20,028,552
House of Prince A/S	$	4,495,813	$	5,071,683
Japan Tobacco International U.S.A., Inc.	$	3,888,474	$	4,386,550
King Maker Marketing, Inc.	$	7,257,720	$	8,187,364
Kretek International	$	1,158,476	$	1,306,866
Lane Limited	$	803,048	$	905,911
Liggett Group LLC	$	37,006,861	$	41,747,081
Lignum-2, Inc.	$	1,138,201	$	1,283,994
Peter Stokkebye Tobaksfabrik A/S	$	1,229,041	$	1,386,469
Premier Manufacturing, Inc.	$	4,945,073	$	5,578,489
P.T. Djarum	$	4,143,605	$	4,674,360
Reemtsma Cigarettenfabriken GmbH (Reemtsma)	$	275	$	311
Santa Fe Natural Tobacco Company, Inc.	$	19,446,985	$	21,937,955
Sherman 1400 Broadway N.Y.C., Inc.	$	885,232	$	998,621
Top Tobacco, L.P.	$	12,941,925	$	14,599,660
Vector Tobacco Inc.	$	2,141,354	$	2,415,641
Von Eicken Group	$	118,127	$	133,257
U.S. Flue Cured Tobacco Growers, Inc.	$	1,751,910	$	1,976,312
Total	$	325,336,312	$	364,443,024

MEMORANDUM OF UNDERSTANDING

The following pages consist of selected information from the August 2010 Memorandum of Understanding referenced in the NPM Adjustment Settlement Term Sheet.

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MEMORANDUM OF UNDERSTANDING

The following is a Memorandum of Understanding ("MOU") containing the principal terms of a comprehensive settlement of the NPM Adjustment dispute, including resolution of the 2003-2009 NPM Adjustments (the "Accrued Claims") and revision of the NPM Adjustment for subsequent years. The MOU is binding on all signatories, provided that both the MOU and the settlement are conditioned on joinder by a critical mass of PMs, and by a critical mass of Settling States as provided in Section IV.C.4 below.[1] The parties contemplate the prompt drafting and execution of a comprehensive final settlement agreement that will incorporate the terms of this MOU, as well as other customary terms and conditions acceptable to the parties.

I. ACCRUED CLAIMS AND 2010 NPM ADJUSTMENT

The 2003-2010 NPM Adjustments will be resolved with respect to all Settling States that join the Settlement ("Joining States") as provided in Section IV.C.4 on the following basis:

A. Refunds and Reductions

The PMs that join the settlement ("PMs") shall receive reductions of MSA payments as follows:

1. The OPMs shall receive a total amount, in the form of reductions and retained withheld payments as specified below, equal to (a) the aggregate Allocated Settlement Percentage of all Joining States multiplied by $6.422 billion; and (b) the aggregate Allocated Settlement Percentage of all Joining States multiplied by the OPMs' full 2010 NPM Adjustment under the original formula. Each Joining State's Allocated Settlement Percentage shall equal the product of its Allocable Share percentage and (x) 29.5% in the case of Joining States that sign this MOU by October 1, 2010, or (y) 59% in the case of Joining States that sign this MOU after October 1, 2010, but before execution of the final settlement agreement.

2. The amount under Paragraph 1 will be provided to the OPMs by their receiving a credit against their MSA annual payment due in April 2011 in the total amount specified in Paragraph 1 less the Joining States' aggregate Allocable Share percentage of the $419.8 million withheld by R.J. Reynolds Tobacco Company with respect to the 2006 NPM Adjustment. The Joining States waive and release any claim or right to their aggregate Allocable Share percentage of the $419.8 million withheld by R.J. Reynolds Tobacco Company with respect to the 2006 NPM Adjustment.

3. Each OPM that paid amounts attributed to the 2003, 2004, 2006 or 2007 NPM Adjustments into the Disputed Payments Account will, as of the date that the credit under Paragraph 2 is actually received, instruct the Escrow Agent and the Independent Auditor to release to the Joining States from that Account an amount equal to the total amounts attributed to such NPM Adjustments (plus the accumulated earnings thereon) multiplied by the aggregate

[1] This draft term sheet is being prepared by the PMs' and the States' respective negotiating teams for presentation to their respective clients. It has not been approved by any PM or any State.

Allocable Share percentage of all Joining States, less amounts allocated pursuant to Paragraph 4(c). The parties will cooperate in taking available steps to allow the credit and release to occur as soon as possible following execution of the final settlement agreement, including in advance of April 15, 2011.

4. The Joining States and OPMs will jointly instruct the Escrow Agent and Independent Auditor:

(a) To recognize and apply the credits described in Paragraphs 1-2 and to allocate the credits solely among the Joining States pro rata, in proportion to their respective Allocated Settlement Percentages.

(b) To allocate the amount released from the Disputed Payments Account under Paragraph 3 solely among the Joining States pro rata, in proportion to their respective Allocable Shares.

(c) To allocate up to $20 million of the accumulated earnings in the Disputed Payments Account on funds to be released from that Account pursuant to Paragraph 3 to a tax-exempt account to be identified by the Joining States to fund the Data Clearinghouse as provided in Section IV.A.

5. The OPMs and Joining States will jointly seek a ruling from the Panel that the Escrow Agent and Independent Auditor are to act in accordance with the instructions described in Paragraph 4. Obtaining such a ruling is a condition to the settlement.

6. There will be parallel provisions for SPMs that provide for each SPM that signs this MOU by October 1, 2010 to receive the same (*i.e.*, no greater) relative payment amounts, and for each SPM that signs this MOU after October 1, 2010 to receive 50% of the same (*i.e.*, no greater) relative payment amounts, in each case subject to the same conditions.[2] There will also be parallel provisions for SPMs to Paragraphs 4 and 5.

B. Release or Reduction in the Case of Certain SPMs

Notwithstanding the foregoing, any SPM that has expressly waived or assigned to the Settling States any claim to an NPM Adjustment for any year shall not be entitled to any release or reduction related to that year pursuant to Section A.

[2] These conditions include release of funds and earnings in the Disputed Payments Account corresponding to Paragraph 3 and re-payment of withheld amounts on the 2003-2009 NPM Adjustments to the extent greater than the payment amount the SPM is to receive under this MOU, in each case as of the later of the date the payment amount corresponding to Paragraph 2 is actually received by the SPM or the date of the final settlement agreement. Where a PM is not current on its undisputed or adjudicated payment obligations under the MSA or any amendment to the MSA, any amounts to be received by it under this MOU will be applied to such unpaid obligations and will not otherwise be credited to that PM except to the extent such amounts exceed the Joining States' aggregate Allocable Share of such unpaid obligations.

II. NPM ADJUSTMENT FOR SUBSEQUENT YEARS

The following revised NPM Adjustment will apply to the Joining States in lieu of the original NPM Adjustment.

A. Transition

1. There will be a two-year transition period covering sales years 2011-2012 during which the revised NPM Adjustment will operate as follows.

2. The revised adjustment for stamped NPM sales described in Section B will apply.

3. The revised adjustment for unstamped NPM sales described in Section C will not apply until sales year 2013. Instead, the OPMs would receive for each of 2011 and 2012:

(a) 15% of the NPM Adjustment under the original formula up to the amount of the 2009 Market Share Loss multiplied by the aggregate Allocable Share percentage of all Joining States;

(b) 30% of any part of the NPM Adjustment under the original formula arising from NPM sales of 1 to 100 million cigarettes above the 2009 Market Share Loss, multiplied by the aggregate Allocable Share pereentage of all Joining States;

(c) 40% of any part of the NPM Adjustment under the original formula arising from NPM sales of 100 million to 200 million cigarettes above the 2009 Market Share Loss, multiplied by the aggregate Allocable Share percentage of all Joining States; and

(d) 50 % of any part of the NPM Adjustment under the original formula arising from NPM sales of more than 200 million cigarettes above the 2009 Market Share Loss, multiplied by the aggregate Allocable Share percentage of all Joining States.

Each SPM that joins the settlement would receive proportional adjustments in proportion to the size of its MSA payment for that year.

funding for the Data Clearinghouse shall be paid from the earnings or principal of the amount allocated under Section I.A.4(c), and the reasonable costs will thereafter be paid 50% by the PMs and 50% by the Joining States.

B. Arbitration

1. Disputes specified in Sections II.C.3(c), II.C.(4)(b), II.C.4(c) and III.D will be submitted to arbitration as described in those Sections. In addition, disputes arising from calculations or determinations of the Data Clearinghouse that involve over $10 million or 10% of the affected States' Allocated Payments for that year, whichever is less, and disputes regarding whether a representation described in this MOU was inaccurate will be submitted to binding arbitration. The parties will cooperate in the prompt commencement and conduct of the arbitrations, as set forth in Paragraph 3, and may agree to pursue mediation in lieu of arbitration. The foregoing is not intended to alter or amend Section XI(c) of the MSA.

2. Any Joining State and any PM that is affected by the dispute may participate in the arbitration concerning that dispute and in the selection of the panel as provided in Paragraph 3. The arbitration will be before a single panel to address both common and state-specific issues. If a State has issues specific to that state, it may submit those to the panel for determination. The panel shall decide all issues necessary to resolve the dispute and shall not lack jurisdiction or the duty to do so because of the failure of a Joining State or PM to participate. Unless specified otherwise by the arbitration panel, the rulings of the panel in binding arbitrations will be binding on all parties to the settlement, whether or not they participated in the arbitration or in the selection of the panel. Unless specified otherwise by the arbitration panel, any additional measures or reporting recommended by the panel in non-binding arbitrations under Section II.C.3(c) will be treated as having been recommended to all Joining States (in the case of additional measures) and PMs (in the case of reporting), whether or not they participated in the arbitration or in the selection of the panel.

3. The arbitration panel will be selected as follows. The participating PMs (collectively) and the participating Joining States (collectively) will each select one neutral arbitrator chosen from JAMS (unless the parties agree to a substitute) within 90 days of the sending of the initial arbitration notice by a party under this Section. If the 90-day period expires without a side having selected its arbitrator, JAMS (unless the parties agree to a substitute) will choose the arbitrator for that side. Within 60 days of the selection of the two arbitrators, those two arbitrators will choose the third neutral arbitrator, who shall be a retired Article III federal judge. Once selected, the panel will establish a scheduling order either as agreed to by the parties or if not agreed, as determined by the panel. That panel shall hear all disputes to be submitted to arbitration under Paragraph 1 for the year in question.

3. *RYO.* The settlement agreement will contain the provisions necessary to implement the terms and intent of this MOU fully as to RYO. These provisions will include: (a) provisions that make the provisions of Section II.B applicable to SET (or equivalent tax) paid RYO in the case of Joining States that do not require that RYO containers be stamped; (b) that, for any Joining State that does not require that RYO containers be stamped, the mandatory provisions of the model legislation include provisions sufficient to require NPMs to make escrow deposits at the Escrow Statute rate on RYO sales in the State; and (c) provisions for non-binding arbitration as described in Section IV.B in the event that non-SET (or equivalent tax) paid NPM RYO sales exceed 4 million pounds in a year; in such an arbitration, the arbitrators would identify any further measures that are not available under the model legislation that a Joining State could reasonably take to prevent non-SET (or equivalent tax) paid NPM RYO sales in that State and recommend their adoption, and any such recommended measures would be treated as recommended measures under Section II.C.3(c) and Section II.C.4(b).

5. *Office*. Each Joining State shall identify or establish an office, department or other point of contact to which information regarding potential violations of the provisions of the model legislation (or its functional equivalent), the Model Escrow Statute, Complementary Legislation and Allocable Share Repeal, as enacted in each such Joining State, can be reported by consumers, retailers, wholesalers, jobbers, manufacturers or others involved with the manufacture, distribution or sale of cigarettes. Each Joining State shall report publicly, to the extent permissible under any applicable confidentiality restrictions, the reports made and the actions, if any, taken to address each such report.

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Appendix A -- Model Legislation

MANDATORY

Sec. [1]. Restrictions on Transactions in Unstamped Cigarettes.

(a) Cigarettes may be sold in, into or from the State only in packages.

(b) Except as provided in this Section, all packages of cigarettes sold in or into the State shall bear a stamp permitted under Section [4] and no person may sell, transport or cause to be transported unstamped cigarettes in, into or from, or possess unstamped cigarettes in, the State.

(c) No person other than a stamping agent may affix a stamp listed in Section [4] to any package. A stamping agent must affix the appropriate stamp under Section [4] to the package containing any unstamped cigarettes it acquires prior to selling those cigarettes in or into the State. Stamping agents may sell cigarettes in or into the State, may purchase cigarettes for re-sale in or into the State, and may affix a stamp listed in Section [4] to a package only if (i) the manufacturer and brand family of the cigarettes are listed on the state directory at the time of stamping and (ii) the stamping agent is the manufacturer or importer of the cigarettes or purchased the cigarettes directly from the manufacturer or importer of the cigarettes.

(d) A manufacturer or importer may possess, transport or cause to be transported unstamped cigarettes that it manufactures or imports. A manufacturer or importer may sell its unstamped cigarettes in or into the State to a stamping agent under the following circumstances: (i) the manufacturer and brand family of the cigarettes are at the time of sale listed on the state directory; or (ii) if the manufacturer and brand family of the cigarettes are not at the time of sale listed on the state directory, only if (A) the stamping agent is authorized to affix the stamp of or, where permitted under subsection (e) pay the taxes imposed by, another State on whose directory the manufacturer and brand family of the cigarettes are listed at the time of sale, (B) the stamping agent would be permitted to re-sell the cigarettes from this State into that other State under subsection (e) and (C) the stamping agent receiving the cigarettes holds a directory license from [name of State agency] pursuant to Section [2(c)] and has given at least 5 days notice to [name of State agency] before the cigarettes are transferred.

(e) A manufacturer or importer may sell its cigarettes from this State into another State only if the sale is to a person authorized by the law of the other State to affix the stamp required by the other State prior to re-sale or the manufacturer or importer first affixes the stamp required by the other State to the package containing the cigarettes. Any other stamping agent may sell cigarettes from this State into another State only if it first affixes the stamp required by the other State to the package containing the cigarettes. If the law of the other State permits the sale of the cigarettes to consumers in a package not bearing a stamp, a manufacturer, importer or stamping agent may sell cigarettes into the other State without a stamp only if (i) it first pays any excise, use or similar tax imposed on the cigarettes by the other State or (ii) in the case of sale by a manufacturer or importer, the sale is to a person authorized by the law of the other State to pay such tax and the manufacturer or importer reports the name and address of the recipient and the quantity and brand of the cigarettes to the taxing authority of the other State by 15 days following the end of the month in which the sale was made. Notwithstanding the above, a person may not sell cigarettes from this State into another State if the sale would violate the law of the other State, or affix the stamp required by the other State or pay the excise, use or similar tax imposed by the other State if doing so would violate the law of the other State.

(f) A manufacturer or importer may sell unstamped cigarettes as permitted under subsection (d) or (e) through its sales entity affiliate. If the manufacturer or importer does so: (i) it may sell or otherwise transfer the unstamped cigarettes to its sales entity affiliate in connection with the sale; (ii) the sales entity affiliate may sell, possess, transport or cause to be transported the unstamped cigarettes in connection with the sale to the same extent as the manufacturer or importer could under this Section if it were making the sale directly; (iii) in the case of sales permitted under subsection (d), the stamping agent will be deemed to have purchased the cigarettes directly from the manufacturer or importer; and (iv) in the case of sales permitted under subsection (e), the sales entity affiliate may act for the manufacturer or importer in affixing the stamp required by the other State or paying the taxes imposed by the other State prior to the sale, in lieu of the manufacturer or importer doing so itself, to the same extent as the manufacturer or importer could do so. A manufacturer or importer shall notify [name of State agency] prior to beginning selling cigarettes through its sales entity affiliate under this subsection. Such notification shall identify the sales entity affiliate, certify the facts that the manufacturer or importer believes qualify it as a sales entity affiliate as defined in this Act, and be updated promptly in the event of any changes.

(g) A stamping agent may possess unstamped cigarettes for sale in or into the State provided that (i) it is permitted to purchase, sell and affix a stamp to the package containing such cigarettes under subsection (b) and (ii) it affixes the appropriate stamp under Section [4] to the package containing such cigarettes within 15 days of receipt of the cigarettes and prior to selling the cigarettes in or into the State. This requirement shall not apply to a manufacturer, importer or sales entity affiliate that is a stamping agent to the extent it is selling, transferring, transporting, causing to be transported or possessing unstamped cigarettes as permitted under this Section.

(h) Except as provided below, a stamping agent may possess unstamped cigarettes for sale from this State into another State provided that (i) it affixes the stamp required by the other State to the package containing the cigarettes, or if permitted under subsection (e), pays any excise or similar tax imposed on the cigarettes by the other State, within 15 days of receipt of the cigarettes and prior to selling the cigarettes in or into the other State; and (ii) neither the sale nor the affixing of the stamp or payment of taxes would violate the law of the other State. A stamping agent may not purchase or possess unstamped cigarettes in this State for sale into another State where the manufacturer and brand family of the cigarettes are not at the time of sale listed on this State's directory unless it holds a directory license pursuant to Section 2(c). The requirements of this subsection shall not apply to a manufacturer, importer or sales entity affiliate that is a stamping agent to the extent it is selling, transferring, transporting, causing to be transported or possessing unstamped cigarettes as permitted under this Section.

(i) A stamping agent may transfer, transport or cause to be transported unstamped cigarettes that it owns and is permitted to possess under subsections (g) or (h) from one of its facilities in this State to another of its facilities. If the facility to which the cigarettes are transferred is located in this State or the cigarettes are to be re-sold in this State, the applicable time period for affixing a stamp or payment of tax under those subsections shall remain in effect and shall continue to run from the date of the stamping agent's original receipt of the cigarettes. If the facility to which the cigarettes are transferred is located outside of this State, the stamping agent shall report the quantity and brand of the cigarettes to the [name of State agency] and the taxing authority of the other State by 15 days following the end of the month in which the transfer was made. Notwithstanding the above, a stamping agent may not transfer cigarettes from this State into another State if the transfer would violate the law of the other State.

(j) A common carrier or contract carrier may possess and transport unstamped cigarettes in connection with a sale or other transfer permitted under subsections (d)-(f) or (i), if the common carrier or contract carrier has in its possession documents establishing that title to the unstamped cigarettes remains with the manufacturer, importer or stamping agent or bills of lading or other shipping documents establishing that it is delivering the cigarettes on behalf of a person authorized to sell or transfer the unstamped cigarettes under subsections (d)-(f) or (i) and, in each case, such documents list the name and address of the person to whom the cigarettes are being delivered. A public warehouse may possess unstamped cigarettes on behalf of a manufacturer, importer or stamping agent if the public warehouse maintains records to show receipt from a person authorized to sell or transfer the unstamped cigarettes under subsections (d)-(f), provided that in the case of a stamping agent this shall not extend the 15-day period for affixing of stamps or payment of taxes under subsections (g) or (h).

(k) Manufacturers and importers and their contractors, agents, common carriers or contract carriers may possess, transport or cause to be transported unstamped cigarettes in, into or from this State for use in connection with consumer testing permitted under the law of the State in which the testing is to be done, provided that (i) such cigarettes are not currently commercially marketed in the United States, (ii) the manufacturer pays applicable State excise taxes on such cigarettes by return, (iii) in the case of a non-participating manufacturer, the non-participating manufacturer makes escrow payments on such cigarettes under [cross-reference State's escrow statute] and Section [5], or, in the case of a participating manufacturer, such cigarettes are included in its volume for purposes of the Master Settlement Agreement (as defined in [cross-reference to complementary law]); (iv) the cigarettes are provided at no cost to the consumer testing participants; and (v) and the quantity of cigarettes so used by a manufacturer or importer for consumer testing shall not exceed a reasonable quantity.

(l) A person shall not be subject to penalty under this Act for possession of up to 600 cigarettes bearing the stamp of another State for consumption by that person or that person's family if the cigarettes are physically brought into the State by such person or a member of that person's family. *[Note: States may reduce the number below 600.]*

(m) No person may sell cigarettes or cigarette inputs to, or purchase cigarettes from, any person in another State if the sale or purchase would violate the law of the other State.

Sec. [2]. Stamping Agent Licenses

(a) Any manufacturer, importer, sales entity affiliate, wholesaler or retailer that engages in the business of selling cigarettes may apply to be licensed as a stamping agent, in accordance with this Section [2]. A license shall be issued by [name of State agency] to an applicant upon the applicant's (i) meeting all requirements in [cross-reference existing requirements for its particular license]; (ii) certifying on a form prescribed by [name of State agency] that it will comply with the requirements in Section [3]; (iii) consenting to the jurisdiction of the State to enforce the requirements of this Act, and waiving any claim of sovereign immunity to the contrary; (iv) waiving any confidentiality laws as necessary to permit the [name of State agency] to create and make available the list described in subsection (b) and to share information reported under this Act and [cross-reference other State reporting requirements] with the taxing or law enforcement authorities of other States or with [insert reference to Data Clearinghouse]; and (v) in the case of an applicant located outside of the State, designating an agent in the State for service of process in connection with enforcement of this Act.

(b) The [name of State agency] shall list on its website the names of all persons licensed as stamping agents under this Section [2]. Manufacturers, importers and sales entity affiliates shall be entitled to rely upon the list in selling cigarettes as provided in Section [1].

(c) A manufacturer, importer, sales entity affiliate, wholesaler or retailer that engages in the business of selling cigarettes that holds a valid stamping agent license under subsection (a) may apply for a directory license allowing it to purchase or possess in the State cigarettes of a manufacturer or brand family not at the time of purchase listed on the state directory for sale into another State where permitted under Section 1. A directory license shall be issued by [name of State agency] to an applicant upon the applicant's (i) demonstrating that it holds a valid license under subsection (a), (ii) providing a certification by an officer thereof on a form prescribed by [name of State agency] that any cigarettes of a manufacturer or brand family not listed on the state directory will be purchased or possessed solely for sale or transfer into another State as permitted by Section 1; and (iii) waiving any confidentiality laws as necessary to permit the [name of State agency] to create and make available the list described in subsection (e). The directory license shall remain in effect for a period of one year.

(d) No directory license may be issued to a person that acted inconsistently with a certification it previously made under subsection (c).

(e) The [name of State agency] shall list on its website the names of all persons holding a directory license. Manufacturers, importers, sales entity affiliates and stamping agents shall be entitled to rely upon the list in selling cigarettes as provided in Section [1].

Sec. [3]. Licensed stamping agents; requirements.

Each stamping agent shall:

(a) Comply with Section [1] with regard to affixing stamps;

(b) Comply with Section [4] and [cross-reference applicable tax law provisions] with regard to which stamp to affix;

(c) Pay to the State all taxes applicable under [cross-reference applicable tax law provisions] to cigarettes it sells or present documentation demonstrating that such taxes were paid prior to the sale;

(d) Provide complete and accurate reports as required under Sections [6], [6A] and [8]; and

(e) Certify quarterly that it has complied with all requirements of this Act.

Sec. [4]. Required stamps.

[This section will need to be customized for each State depending upon its tax policy. States will be permitted to include (i) a regular excise tax stamp, (ii) a tax-exempt stamp, (iii) a tribal tax stamp or (iv) another type of stamp representing a specified level of tax different from the regular excise tax; provided that, in the case of stamps within (ii), (iii) or (iv), the State sets forth specific requirements regarding the circumstances when the stamps are permitted and those requirements are the same as to all manufacturers' cigarettes.]

Sec. [5]. Relationship with escrow and complementary laws.

(a) The definition of "units sold" under Section [_] of [cross-reference State's escrow statute] shall include all non-participating manufacturer cigarettes that are required to be sold in a package bearing a stamp permitted under Section [4] or are described in Section [1(k)].

(b) All escrow deposits under [cross-reference State's escrow statute] shall be made on a quarterly basis, no later than 30 days after the end of each calendar quarter in which the sales are made. Each failure to make a full quarterly installment deposit shall constitute a separate violation of [cross-reference State's escrow statute].

(c) The [name of State agency] shall promptly review the amount deposited by each non-participating manufacturer for each calendar quarter against the reports received under Sections [6-8] and other information, and shall invoice each non-participating manufacturer for which it concludes that an additional deposit was owed.

(d) The [name of State agency] shall promptly remove from the state directory any non-participating manufacturer and its brand families where that non-participating manufacturer fails to make or have made on its behalf deposits equal to the full amount owed for a quarter as of the date due under subsection (b). [Cross-reference existing state complementary legislation regarding process protections.]

(e) An importer shall be jointly and severally liable for escrow deposits due from a non-participating manufacturer with respect to non-participating manufacturer cigarettes that it imports.

(f) As a condition to being listed and having its brand families listed on the state directory, a manufacturer must certify annually that it holds a valid permit under 26 U.S.C. § 5713 and provide a copy of such permit to [name of State agency];

(g) The [name of State agency] shall promulgate rules and regulations necessary to implement subsections (a)-(f).

Sec. [6]. Stamping Agent Reports.

Each stamping agent shall, within 15 days following the end of each month, file a report on a form to be prescribed by the [name of State agency] and certify to the State that the report is complete and accurate. The report shall contain, in addition to any further information that the [name of State agency] may reasonably require to assist it in enforcing this Act and [cross-reference State's escrow statute, contraband law and tax law], the following information:

(a) the total number of cigarettes acquired by the stamping agent during that month for sale in or into the State or for sale from this State into another State, sold in or into the State by the stamping agent during that month, and held in inventory in the State or for sale into the State by the stamping agent as of [the last Friday of that month/the end of the month], in each case identifying by name and number of cigarettes (i) the manufacturers of those cigarettes and (ii) the brand families of those cigarettes; and *[Note: State may choose the inventory date.]*

(b) the total number of stamps under Section [4] it affixed during that month, and identifying (i) how many of each type of stamp it affixed by number and total dollar amount of tax paid, (ii) the total number of cigarettes contained in the packages to which it affixed each respective type of tax stamp and (iii) by name and number of cigarettes, the manufacturers and brand families of the packages to which it affixed each respective type of tax stamp.

(c) In the case of a stamping agent that is a manufacturer or importer, reports under subsection (a) shall not include cigarettes it sold to a stamping agent as permitted under Section [1(d)(i)] and that it separately reports pursuant to Section [7]. In the case of a stamping agent that is a retailer, reports under subsection (a) do not have to include cigarettes contained in packages that bore a stamp permitted under Section [4] at the time the stamping agent received them and that the stamping agent then sold at retail.

(d) The [name of State agency] may share the information reported under this section with the taxing or law enforcement authorities of this State or other States or with [insert reference to Data Clearinghouse] as provided in [insert reference to settlement agreement and related documents regarding Data Clearinghouse].

Sec. [6A]. Reports of Cigarettes not on State Directory.

Any person that during a month acquired, purchased, sold, possessed, transferred, transported or caused to be transported in or into this State cigarettes of a manufacturer or brand family that were not on the State directory at the time shall, within 15 days following the end of that month, file a report on a form to be prescribed by the [name of State agency] and certify to the State that the report is complete and accurate. The report shall contain, in addition to any further information that the [name of State agency] may reasonably require to assist it in enforcing this Act and [cross-reference State's escrow statute, contraband law and tax law], the following information:

(a) the total number of those cigarettes, in each case identifying by name and number of cigarettes (i) the manufacturers of those cigarettes, (ii) the brand families of those cigarettes, (iii) in the case of a sale or transfer, the name and address of the recipient of those cigarettes, (iv) in the case of an acquisition or purchase, the name and address of the seller or sender of those cigarettes, and (v) the other State(s) on whose directory the manufacturer and brand family of those cigarettes were listed at the time and whose stamps the person is authorized to affix, or where permitted under Section [1(e)] whose taxes the person is authorized to pay; and

(b) in the case of acquisition, purchase or possession, the details of the person's subsequent sale or transfer of those cigarettes, identifying by name and number of cigarettes (i) the brand families of those cigarettes, (ii) the date of the sale or transfer, (iii) the name and address of the recipient, (iii) the number of stamps of each other State that the person affixed to the packages containing those cigarettes during that month, (iv) the total number of cigarettes contained in the packages to which it affixed each respective other State's stamp, (v) by name and number of cigarettes, the manufacturers and brand families of the packages to which it affixed each respective other State's stamp and (vi) a certification that it reported each sale or transfer to the taxing authority of the other State by 15 days following the end of the month in which the sale or transfer was made and attaching a copy of all such reports. If the subsequent sale or transfer were from this State into another State in packages not bearing a stamp of the other State, the report shall also contain the information described in Section [8(b)(iii).]

(c) Reports under this Section shall be in addition to reports under Sections 6, 7 or 8.

(d) The [name of State agency] may share the information reported under this section with the taxing or law enforcement authorities of this State or other States or with [insert reference to Data Clearinghouse] as provided in [insert reference to settlement agreement and related documents regarding Data Clearinghouse].

Sec. [7]. Manufacturer and Importer Reports.

(a) Each manufacturer and importer that sells cigarettes in or into the State shall, within 15 days following the end of each month, file a report on a form to be prescribed by the [name of State agency] and certify to the State that the report is complete and accurate.

(b) The report shall contain the following information: the total number of cigarettes sold by that manufacturer or importer in or into the State during that month, and identifying by name and number of cigarettes (i) the manufacturers of those cigarettes, (ii) the brand families of those cigarettes and (iii) the purchasers of those cigarettes. A manufacturer's or importer's report shall include cigarettes sold in or into the State through its sales entity affiliate.

(c) The requirements of subsection (a) shall be satisfied and no further report shall be required under this Section with respect to cigarettes if the manufacturer or importer timely submits to [name of State agcncy already receiving reports under 15 U.S.C. § 376] the report or reports required to be submitted by it with respect to those cigarettes under 15 U.S.C. § 376 to [State agency] and certifies to the State that the reports are complete and accurate.

(d) Upon request by [name of State agency] a manufacturer or importer will subject to this Section will provide copies of similar reports that it filed in other States.

(e) Each manufacturer and importer that sells cigarettes in or into the State shall either: (i) submit its federal returns, as dcfined below, to [name of State agency] by 60 days after the close of the quarter in which the returns were filed or (ii) submit to the United States Treasury a request or consent under Internal Revenue Code Section 6103(c) authorizing the Alcohol and Tobacco Tax and Trade Bureau and, in the case of a foreign manufacturer or importer, the U.S. Customs Service to disclose the manufacturer's or importer's federal returns, as defined below, to [name of State agency] as of 60 days after the close of the quarter in which the returns were filed.

(f) The [name of State agency] may share the information reported under this section with the taxing or law enforcement authorities of this State or other States or with [insert reference to Data Clearinghouse] as provided in [insert reference to settlement agreement and related documents regarding Data Clearinghouse].

Sec. [8]. Out of State Sales Reports.

(a) Any person that sells cigarettes from this State into another State shall, within 15 days following the end of each month, file a report on a form to be prescribed by the [name of State agency] and certify to the State that the report is complete and accurate.

(b) The report shall contain the following information:

(i) the total number of cigarettes sold from this State into another State by the person during that month, identifying by name and number of cigarettes (A) the manufacturers of those cigarettes, (B) the brand families of those cigarettes and (C) the name and address of the each recipient of those cigarettes;

(ii) the number of stamps of each other State the person affixed to the packages containing those cigarettes during that month, the total number of cigarettes contained in the packages to which it affixed each respective other State's stamp and by name and number of cigarettes, the manufacturers and brand families of the packages to which it affixed each respective other State's stamp; and

(iii) if the person sold cigarettes during that month from this State into another State in packages not bearing a stamp of the other State, (A) the total number of cigarettes contained in such packages, identifying by name and number of cigarettes, the manufacturers of those cigarettes, the brand families of those cigarettes and the name and address of each recipient of those cigarettes; and (B) the person's basis for belief that such State permits the sale of the cigarettes to consumers in a package not bearing a stamp, and the amount of excise, use or similar tax imposed on the cigarettes by paid by the person to such State on the cigarettes, provided that manufacturers and importers need include the information described in this clause (B) only as to cigarettes not sold to a person authorized by the law of the other State to affix the stamp required by the other State or, where permitted under Section [1(e)], to a person authorized by the law of the other State to pay the excise, use or similar tax imposed on the cigarettes by the other State.

(c) In the case of a manufacturer or importer, the report shall include cigarettes sold from this State into another State through its sales entity affiliate. A sales entity affiliate shall file a separate report under this Section only to the extent that it sold cigarettes from this State into another State not separately reported under this Section by its affiliated manufacturer or importer.

(d) The report shall also attach reports filed under Sections 1(e) and 1(i) with [name of State agency] or the taxing authority of another State.

(e) The [name of State agency] may share the information reported under this section with the taxing or law enforcement authorities of this State or other States or with [insert reference to Data Clearinghouse] as provided in [insert reference to settlement agreement and related documents regarding Data Clearinghouse].

Sec. [9]. Revocation of License and Removal from State Directory; penalties.

[Note: the penalties for violation of an Optional or Tribal provision are to be included only where the State has enacted the corresponding Optional or Tribal provision.]

(a) The license of a stamping agent shall be subject to termination if it

(i) fails to provide a report required under Section [6], [6A] or [8] or a certification as provided in Section 3(e);

(ii) files an incomplete or inaccurate report or files an inaccurate certification;

(iii) fails to pay taxes as provided in Section 3(c) or deposit escrow as provided in Section 16;

(iv) sells cigarettes in or into the State in a package that bears a stamp permitted under Section [4] that is not the correct stamp under [cross-reference applicable tax law provisions] and provides for a lower level of tax than the correct stamp;

(v) sells unstamped cigarettes in, into or from the State or possesses unstamped cigarettes in the State except as provided in Section [1];

(vi) purchases, sells in or into the State, or affixes a tax stamp to a package containing, cigarettes of a manufacturer or brand family that is not at the time listed on the State directory, or possesses such cigarettes more than [10-20] days after receiving notice that the manufacturer or brand family is not on the State directory, except as expressly permitted under this Act; or

(vii) purchases or sells cigarettes in violation of Sections [1, 9(d) or 20].

(b) In the case of a failure under subsection (a)(i)-(iv) that was not knowing or intentional, the stamping agent shall be entitled to cure the failure during the period set forth in Section [10(a)]. The license of a stamping agent that fully cures the failure during that period shall not be terminated on account of that failure. *[Note: A State may use a different cure period or mechanism if not more favorable to the stamping agent.]*

(c) In the case of a knowing or intentional failure under subsection (a)(i)-(iv), or of any violation described in subsection (a)(v)-(vi), the stamping agent shall for a first violation be subject to a civil penalty of up to $1,000 and be guilty of a [Class IV] misdemeanor and for a second or subsequent violation be subject to a civil penalty of up to $5,000 per violation and be guilty of a [Class II] misdemeanor. In the case of violations described in subsection (a)(iv)-(vi), each sale constitutes a separate offense. *[Note: criminal penalties are optional.]*

(d) The [name of State agency] shall promptly remove any stamping agent whose license is terminated from the list required by Section [4(b)] and shall publish a notice of the termination on [State agency's] website and send notice of the termination to all stamping agents and to all persons listed on the state directory. Beginning 10 days following the publication and sending of such notice, no person may sell cigarettes to, or purchase cigarettes from, the stamping agent whose license has been terminated.

(e) If a stamping agent whose license has been terminated is a manufacturer of cigarettes, it and its brand families shall be removed from the State directory.

(f) A stamping agent whose license is terminated shall eligible for reinstatement:

(i) 90 days following the termination, in the case of a first failure under subsection (a)(i)-(iv) that was not knowing or intentional;

(ii) 180 days following the termination, in the case of a second failure under subsection (a)(i)-(iv) that was not knowing or intentional;

(iii) one year following the termination, in the case of a third or subsequent failure under subsection (a)(i)-(iv) that was not knowing or intentional;

(iv) one year following the termination, in the case of a first knowing or intentional failure under subsection (a)(i)-(iv) or violation described in subsection (a)(v)-(vii); and

(v) three years following the termination, in the case of a second of subsequent knowing or intentional failure under subsection (a)(i)-(iv) or violation described in subsection (a)(v)-(vii).

[Note: A State may use different reinstatement periods if not more favorable to the stamping agent.]

(g) A manufacturer that fails to file a complete and accurate report required under Section 7 or 8 shall be entitled to cure the failure during the period set forth in Section [10(g)]. If the manufacturer fails to fully cure the failure during that period, it and its brand families shall be removed from the State directory.

(h) A manufacturer that knowingly or intentionally sells cigarettes in violation of Section [1, 9(d) or 20] and its brand families shall be removed from the State directory.

(i) A non-participating manufacturer whose total nationwide reported sales on which federal excise tax [or, in the case of sales in Puerto Rico, arbitrios de cigarillos] is paid exceed the sum of its nationwide reports under [cross-reference PACT Act] and any intrastate sales reports by more than 5 percent of its total sales or [1] million cigarettes, whichever is less, shall be subject to removal from the State directory unless it cures or satisfactorily explains the discrepancy within the time period set forth in Section [10(g)].

(j) Any person that is not a stamping agent or manufacturer that fails to file a complete and accurate report required under Section 7 or 8 shall be entitled to cure the failure during the period set forth in Section [10(j)]. If the person fails to fully cure the failure during that period, it shall be subject to a civil penalty of up to $1,000 per violation and shall be ineligible to hold any license of the State regarding cigarette sales until the date specified by subsection (f) for violations of subsection (a)(i).

(k) A directory license shall be subject to termination if the licensee acts inconsistently with its certification under Section [2(c)] or violates any provision of this Act

(l) Any person that knowingly or intentionally sells cigarettes in violation of Section [1, 9(d) or 20], or that knowingly or intentionally sells cigarettes in or into the State in a package that bears a stamp permitted under Section [4] that is not the correct stamp under [cross-reference applicable tax law provisions] and provides for a lower level of tax than the correct stamp, shall for a first violation be subject to a civil penalty of up to $1,000 and be guilty of a [Class IV] misdemeanor and for a second or subsequent violation be subject to a civil penalty of up to $5,000 per violation and be guilty of a [Class II] misdemeanor. Each sale constitutes a separate violation. *[Note: criminal penalties are optional.]*

Sec. [10]. Procedure.

[Note: States may use provisions of their existing administrative procedure act or similar process laws or regulations so long as they are comparable to, and not substantially more favorable to the stamping agent, manufacturer or other person than, the corresponding provision below. States may use provisions of their Complementary Legislation instead of subsections (f)-(i) if those provisions are fully applicable to the grounds for removal in this model legislation. The procedures for violations of, or termination or removal under, Optional or Tribal provision are to be included only where the State has enacted the corresponding Optional or Tribal provision.]

(a) The [name of State agency] shall provide a notice of termination to any stamping agent whose license it determines is subject to termination under Sections [9] or [18]. The notice shall state the grounds for the termination and inform the stamping agent that, except as provided in subsection (b), its license will be terminated 30 days following the date of the notice.

(b) During the [30] days following the date of the notice, the stamping agent may (i) in the case of a failure under Section [9(a)(i)-(iv)] that was not knowing or intentional, fully cure the failure or (ii) submit documentation to the [name of State agency] demonstrating that its determination described in the notice was incorrect. Unless the [name of State agency] determines that the stamping agent has satisfied either (i) or (ii), the license of such stamping agent shall be terminated 30 days following the date of the notice.

(c) A stamping agent whose license is terminated shall have an opportunity for a hearing before [name of State agency] within 30 days following the license termination. The [name of State agency] shall reverse the termination if it determines that the stamping agent has demonstrated that its license was not subject to termination.

(d) A stamping agent that unsuccessfully challenges a license termination either in a hearing under subsection (c) or in court shall pay the State's reasonable costs and attorney's fees incurred in contesting the challenge. *[Note: This provision is optional.]*

(e) If for any reason during the period from 30 days after the date of the notice until a final judgment, the termination is stayed or suspended, then the [name of State agency] shall promptly reinstate that stamping agent to the list required by Section [2(b)] during the time of the stay or suspension, but shall note the fact of the stay on that list and shall send notice of the stay to all persons described in Section [9(d)]. Any person that sells cigarettes to, or purchases cigarettes from, that stamping agent after the earlier of receiving notice of the stay of termination or 10 days after the fact of the stay was noted on the list under Section [2(b)], shall be jointly and severally liable for any taxes applicable to such cigarettes under [cross-reference applicable tax law provisions] and for any escrow due on such cigarettes under [cross-reference State's escrow statute] during the period of the stay if the stay is subsequently lifted and the termination reinstated. The periods of time for reinstatement under Section [9(f)] shall be tolled during the period in which a stay of termination is in effect.

(f) The [name of State agency] shall provide a notice of removal to any manufacturer that it determines should be removed or have any of its brand families removed from the State directory under Sections [9] or [18]. The notice shall state the grounds for the removal and inform the manufacturer that, except as provided in subsection (g), it or its brand families will be removed from the State directory 30 days following the date of the notice.

(g) During the 30 days following the date of the notice, the manufacturer may (i) fully cure the failure or violation or (ii) submit documentation to the [name of State agency] demonstrating that its determination described in the notice was incorrect. Unless the [name of State agency] determines that the manufacturer has satisfied either (i) or (ii), it or its brand families will be removed from the State directory 30 days following the date of the notice.

(h) A manufacturer that is removed or has any of its brand families removed the State directory shall have an opportunity for a hearing before [name of State agency] within 30 days following the removal. The [name of State agency] shall reinstate the manufacturer and its brand families to the State directory if it determines that the manufacturer has demonstrated that it and its brand families were not subject to removal from the State directory.

(i) A manufacturer that unsuccessfully challenges a removal either in a hearing under subsection (h) or in court shall pay the State's reasonable costs and attorney's fees incurred in contesting the challenge. *[Note: This provision is optional.]*

(j) [Parallel provisions to (a)-(d) for importers or other persons subject to penalty under Section 9(j).]

(k) [Parallel provisions to (a)-(d) for directory licensees.]

(l) Each person may provide a name and address to which notices under this Section and Sections [9], [18] and [20(j)] are to be sent. Notice periods under this Section run from the date of notice sent to such name and address or, in the case of a person that does not provide a name and address, the last known company address.

Sec. [11]. Contraband Product.

Any cigarettes or cigarette inputs sold, possessed, transported, caused to be transported or purchased in violation of this Act shall be deemed to be contraband and shall be subject to seizure and forfeiture to the State. Any cigarettes or cigarette inputs forfeited to the State under this Section shall be destroyed or used for law enforcement purposes and then destroyed. *[Note: If the state has a general statutory provision on contraband cigarettes, include the following: "Any cigarettes that are contraband under this Section shall also be contraband within the meaning of [cross-reference general state cigarette contraband statute]."]*

Sec. [12]. Roll Your Own Tobacco.

[This will need to be customized for each State depending on how it taxes RYO. The provisions will need to be sufficient to provide for the application and transposition of all provisions of this Act other than the stamping requirement to RYO, including the requirement that NPMs make escrow payments on all RYO sales in the State, and, in the case of States that tax RYO but do not require stamping of RYO containers, provisions that transpose the provisions of this Act to RYO on which tax is due.]

Sec. [13]. Regulations.

The [name of State agency] may promulgate rules and regulations necessary and proper to effect the purposes of or enforce this Act.

Sec. [14]. Severability.

The provisions of this Act shall be severable.

Sec. [15]. Definitions.

[Note: Definitions used only in Optional or Tribal provisions are mandatory only where the State has enacted the corresponding Optional or Tribal provision.]

(_) "Brand family" has the meaning set forth in [cross-reference State complementary legislation definition].

(_) "Cigarette" means a cigarette within the meaning set forth in [cross-reference State escrow statute definition] that is subject to federal excise tax.[1] The term "cigarette" as used in this Act and [cross-reference State escrow statute definition] shall follow the interpretation of the term "cigarette" and "roll your own" used by the Alcohol and Tobacco Tax and Trade Bureau.

(_) "Cigarette inputs" means any machinery or other component parts typically used in the manufacture of cigarettes, including, without limitation, tobacco whether processed or unprocessed, cigarette papers and tubes, cigarette filters or any component parts intended for use in the making of cigarette filters, and any machinery typically used in the making of cigarettes.

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[1] Note: this definition would need to be revised in Puerto Rico and the territories as FET is not due on sales in those jurisdictions.

(_) References to "days" refer to calendar days unless specified otherwise.

(_) "Federal returns" mean all federal excise tax returns and all monthly operational reports on Alcohol and Tobacco Tax and Trade Bureau Form 5210.5, and all adjustments, changes and amendments to the foregoing.

(_) "Importer" means any person in the United States to whom non-tax-paid cigarettes manufactured in a foreign country are shipped or consigned; any person who removes cigarettes for sale or consumption in the United States from a customs bonded manufacturing warehouse; and any person who smuggles or otherwise unlawfully brings cigarettes into the United States.

(_) "Indian tribe" means any Indian tribe, band, nation, Alaska Native village or other organized group or community that is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians under the laws of the United States.

(_) A "knowing or intentional" violation or failure is one where the person knowingly or intentionally engaged in conduct without a good faith belief that the conduct was consistent with the provision of this Act at issue. *[Note: State may use an existing definition of these terms if the definition is similar.]*

(_) "Manufacturer" means a person that manufactures, fabricates, or assembles cigarettes.

(_) "Non-participating manufacturer" means a manufacturer that is not a participating manufacturer.

(_) "Non-participating manufacturer cigarettes" means cigarettes (i) of a brand family that is not included in the certification of a participating manufacturer under [cross-reference State complementary legislation] or (ii) that are subject to the escrow requirement under [cross-reference State escrow statute] because the participating manufacturer in whose certification the brand family is included is not generally performing its financial obligations under the Master Settlement Agreement.

(_) "Package" means any pack or other container on which a stamp could be applied consistent with and as required by this Act that contains one or more individual cigarettes for sale. Nothing in this Act shall alter any other applicable requirement with respect to the minimum number of cigarettes that may be contained in a pack or other container of cigarettes. References to "package" do not include a container of multiple packages.

(_) "Participating manufacturer" has the meaning set forth in [cross-reference State complementary legislation].

(_) "Person" means any natural person, trustee, company, partnership, corporation or other legal entity, including any Indian tribe or instrumentality thereof or any member of an Indian tribe.

(_) "Purchase" means any acquisition in any manner or by means for any consideration. The term includes transporting or receiving product in connection with a purchase.

(_) "Qualified Tribal Lands" means any lands both (i) title to which is either in trust by the United States for the benefit of any Indian tribe or individual or held by any Indian tribe or individual subject to restriction by the United States against alienation and (ii) over which an Indian tribe exercises governmental power.

(_) "Retailer" means a person that sells cigarettes for consumption or use by the purchaser.

(_) "Sale" or "sell" means any transfer, exchange or barter in any manner or by any means for any consideration. The term includes distributing or shipping product in connection with a sale.

(_) References to a sale "in" or "into" a State refer to the State of the destination point of the product in the sale, without regard to where title was transferred. References to a sale "from" a State refer to the sale of cigarettes that are located in that State to the destination in question, without regard to where title was transferred.

(_) "Sales Entity Affiliate" means an entity that (1) sells cigarettes that it acquires directly from a manufacturer or importer and (2) is affiliated with that manufacturer or importer. Entities are affiliated with each other if one directly, or indirectly through one or more intermediaries, controls or is controlled by or is under common control with the other. Unless provided otherwise, references to "manufacturer" or "importer" include any sales entity affiliate of that manufacturer or importer.

(_) "Shortfall Amount" means the difference between (1) the full amount of the deposit required to be made by a non-participating manufacturer for a calendar quarter under Section [5(b)] and (2) the sum of (i) any amounts pre-collected by a stamping agent and deposited into escrow for that calendar quarter on behalf of the non-participating manufacturer under Section [16(c)], (ii) the amount deposited into escrow by the non-participating manufacturer for that calendar quarter under Section [5(b)], (iii) any amounts deposited into escrow for that calendar quarter under Section [5(e)] by an importer on such non-participating manufacturer's cigarettes, and (iv) any amounts collected by the State for that calendar quarter under the bond posted by the non-participating manufacturer under Section [17]. The Shortfall Amount, if any, for a non-participating manufacturer for a calendar quarter shall be calculated by [State agency] within 15 days following the date on which the State determines the amount it will collect on the bond posted by the non-participating manufacturer as provided in Section [17]. *[Note: This definition concerns two optional provisions. If a State enacts one of these provisions, but not the other, the definition will need to be modified.]*

(_) "Stamping agent" means a manufacturer, importer or wholesaler that holds a valid license under Section [2] of this Act.

(_) References to a "State" or this "State" includes all land that is within the borders of the State, including all Qualified Tribal Lands and any other lands held by or on behalf of an Indian tribe within that State's borders. References to sales in, into or from a State include any sales in, into or from Qualified Tribal Lands or any other lands held by or on behalf of an Indian tribe within that State's borders. References to possession in a State include possession on Qualified Tribal Lands or any other lands held by or on behalf of an Indian tribe within that State's borders. Reference to another "State" or other "States" include the District of Columbia, Puerto Rico and the territories of the United States.

(_) "State directory" or "directory" means the directory compiled by the [name of State agency] under [cross-reference State complementary legislation] or, in the case of references to another State's directory, the directory compiled under the similar law in that other State.

(_) "Unstamped cigarettes" means any cigarettes that are not contained in a package bearing a stamp permitted under Section [4].

(_) "Wholesaler" means a person that purchases cigarettes for sale or resale but does not include any person when and to the extent such person is acting as a manufacturer, importer, or retailer.

OPTIONAL

Sec. [16]. Additional responsibility for escrow deposits.

(a) A stamping agent shall be responsible for escrow deposits required under [cross-reference State's escrow statute] and Section [5] in the event it receives notice from [State agency] that there is a Shortfall Amount with respect to non-participating manufacturer cigarettes stamped by it.

(b) The liability of a stamping agent for escrow deposits shall be calculated as follows: If there is a Shortfall Amount for a non-participating manufacturer for a calendar quarter, each stamping agent that sold cigarettes of that non-participating manufacturer during the calendar quarter shall deposit into such escrow account as shall be designated by the State an amount equal to the applicable Shortfall Amount multiplied by a fraction, the numerator of which is the number of cigarettes of that non-participating manufacturer sold in or into the State by the stamping agent during that calendar quarter and the denominator of which is the total number of cigarettes of that non-participating manufacturer sold by all stamping agents in or into the State during that calendar quarter. Provided, that any non-participating manufacturer cigarettes sold in or into the State by a stamping agent during the calendar quarter on which the stamping agent collected and deposited the required escrow deposit amount on or before the due date for deposits for that quarter under Section [5(b)] shall be excluded from both the numerator and the denominator of the fraction in the immediately preceding sentence. To the extent a stamping agent makes payments with respect to a Shortfall Amount under this subsection, such stamping agent shall have a claim against the non-participating manufacturer for such amount.

(c) A stamping agent is authorized to require a non-participating manufacturer to pre-pay the escrow deposit amount to the stamping agent, for deposit by the stamping agent on behalf of the non-participating manufacturer into an escrow account designated by the State, as a condition of the stamping agent's agreement to purchase cigarettes of that non-participating manufacturer.

Sec. [17]. Bond.

[Note: A State may also enact a bond requirement that is broader than the following if it wants broader application of Section II.B.2(y) of the MOU.]

(a) A non-participating manufacturer shall post a bond for the benefit of the State if (i) its cigarettes were not sold in the State during any one of the four preceding calendar quarters, (ii) it or any person affiliated with it failed to make a full and timely escrow deposit due under [cross-reference State's escrow statute] or Section [5] during any of the five preceding calendar years, unless the failure was not knowing or reckless and was promptly cured upon notice, or (iii) it or any person affiliated with it, or any of its brands or brands of a person affiliated with it, were removed from the state directory of any State during any of the five preceding calendar years, unless the removal were determined to have been erroneous or illegal. Entities are affiliated with each other if one directly, or indirectly through one or more intermediaries, controls or is controlled by or is under common control with the other.

(b) The bond shall be posted at least 10 days in advance of each calendar quarter as a condition to the non-participating manufacturer and its brand families being included in the state directory for that quarter. The amount of the bond shall be the greater of (i) the greatest required escrow amount due from the non-participating manufacturer or its predecessor for any of the 12 preceding calendar quarters or (ii) $25,000.

(c) If a non-participating manufacturer that posted a bond has failed to make or have made on its behalf deposits equal to the full amount owed for a quarter within 15 days following the due date for the quarter under Section [5(b)], the State may execute upon the bond in the amount equal to any remaining amount of the escrow due. Amounts the State collects on a bond shall be deposited into the State treasury and shall reduce the amount of escrow due from that non-participating manufacturer in the dollar amount collected. Escrow obligations above the amount collected on the bond remain due from that non-participating manufacturer and, as provided in Sections [5(e)] and [16], from the importers and stamping agents that sold its cigarettes during that calendar quarter.

(d) The [name of State agency] shall promulgate rules and regulations necessary to implement subsections (a)-(c).

Sec. [18]. Reciprocity.

(a) The license of a stamping agent may be subject to termination if its similar license is terminated in any other state based on acts or omissions that would, if done in this State, be grounds for license termination under this Section, unless the stamping agent demonstrates that its termination in the other State was effected without due process. A stamping agent whose license is terminated under this subsection shall be eligible for reinstatement upon the earlier of the date specified by Section 9(f) for the act or omission in question or reinstatement of its license by the other State.

(b) A manufacturer and its brand families may be removed from the State directory if it is removed from the directory of another State based on acts or omissions that would, if done in this State, be grounds for removal from the State directory under this Section or [cross-reference State complementary legislation], unless the manufacturer demonstrates that its removal from the other State's directory was effected without due process. A manufacturer that is removed from the State directory under this subsection shall be eligible for reinstatement upon the earlier of the date on which it cures the violation or is reinstated to the directory in the other State.

(c) The applicable procedures under Section 10 shall apply to terminations and removals under this Section.

TRIBAL

Sec. [19]. Refunds of State Excise Taxes and Escrow Deposits.

(a) A person that paid taxes applicable under [cross-reference applicable tax law provisions] on cigarettes sold in an exempt transaction shall be eligible for a refund of the taxes paid on those cigarettes. A person that deposited escrow due under [cross-reference State's escrow statute] on cigarettes sold in an exempt transaction shall be eligible for a release of the escrow deposited on those cigarettes.

(b) Only the following cigarette sales are exempt transactions:

(i) Cigarette sales on a federal installation in a transaction that is exempt from state taxation under federal law.

(ii) Cigarette sales on an Indian tribe's Qualified Tribal Lands by a retail outlet or other entity owned and operated by that tribe or a tribal member for official tribal use or to a consumer who is an adult enrolled member of that tribe domiciled on that tribe's Qualified Tribal Lands.

(c) Except as provided in subsection (f), the person seeking a refund of taxes or release of escrow must submit an application to [name of State agency] providing documentation sufficient to demonstrate (i) that the cigarettes were sold in a package bearing the correct stamp permitted under Section [4] and, as to refund of taxes, that the stamp was one that required payment of tax, (ii) that the person paid the applicable taxes or deposited the escrow in question, (iii) that the cigarettes were sold in an exempt transaction, (iv) as to release of escrow, that the cigarettes were non-participating manufacturer cigarettes, and (v) that the person has not obtained the refund or release on the cigarettes previously. The documentation shall include, in addition to information necessary to meet the requirements listed above and any other information that the [name of State agency] may reasonably require, documents showing the identity of the seller and purchaser and the places of shipment and delivery of the cigarettes. The [name of State agency] shall verify the accuracy and completeness of the required documentation and information before granting the requested refund.

(d) If a meritorious refund claim under subsection (c) is not paid within 60 days of submission of the required documentation, the refund shall include interest at the prime rate from the date of submission of the required documentation.

(e) The total number of cigarettes found to be sold in exempt transactions under subsection (b)(ii) in any year on an Indian tribe's Qualified Tribal Lands shall not exceed 14,600 cigarettes times the number of enrolled adult members of that tribe domiciled on its Qualified Tribal Lands during the preceding calendar year. The [name of State agency] shall not permit (i) refunds of taxes paid on cigarettes claimed to be sold in exempt transactions under subsection (b)(ii) on that tribe's Qualified Tribal Lands in excess of that total number; or (ii) release of escrow deposited on a non-participating manufacturer's cigarettes claimed to be sold in exempt transactions under subsection (b)(ii) on that tribe's Qualified Tribal Lands in excess of that total number times the market share percentage of that non-participating manufacturer on that tribe's Qualified Tribal Lands during that year.

(f) As to refunds of taxes, the [name of State agency] and an Indian tribe may agree upon a refund formula to operate in lieu of application for refunds under subsection (c). The aggregate refund provided to an Indian tribe under a formula for a year shall not exceed the lesser of (i) the aggregate tax paid by entities owned and operated by that tribe or member of that tribe on cigarettes sold in exempt transactions under subsection (b)(ii) on that tribe's Qualified Tribal Lands during that year or (ii) the aggregate tax due under [cross-reference tax law provision applicable to tribal sales on Qualified Tribal Lands] on the number of cigarettes that would be used during that year by enrolled adult members of that tribe domiciled on that tribe's Qualified Tribal Lands during the preceding calendar year based on the national average smoking incidence for all adults and the national average annual cigarettes used by an adult smoker, in each case as published most recently by the Centers for Disease Control. Refunds of taxes under subsection (c) shall not be available for cigarettes sold in exempt transactions on the Qualified Tribal Lands of an Indian tribe that agrees upon a refund formula under this subsection.

(g) As to release of escrow, the [name of State agency] and an Indian tribe may agree upon a refund formula to operate in lieu of application for releases under subsection (c) if the formula meets the requirements of this subsection. The formula shall assign to the tribe credits for release of escrow that the tribe may allocate among non-participating manufacturers that sold cigarettes on that tribe's Qualified Tribal Lands during that year. The aggregate credits provided to an Indian tribe under a formula for a year shall not exceed the aggregate escrow deposit due under [cross-reference State's escrow statute] on the number of non-participating manufacturer cigarettes represented by the product of (i) the number of cigarettes that would be used during that year by enrolled adult members of that tribe domiciled on that tribe's Qualified Tribal Lands during the prior calendar year based on the national average smoking incidence for all adults and the national average annual cigarettes used by an adult smoker, in each case as published most recently by the Centers for Disease Control, times (ii) the aggregate national market share percentage of non-participating manufacturers for the preceding calendar year, as determined by the [independent auditor under the master settlement agreement/Data Clearinghouse]. A non-participating manufacturer allocated a credit by an Indian tribe under a formula shall be entitled to a release of escrow deposited by it or on its behalf for cigarette sales in or into the State during that year in the amount of the credit, provided that no non-participating manufacturer shall be entitled to a release in excess of the total escrow deposited by it or on its behalf for cigarette sales in or into the State during that year. Releases of escrow under subsection (c) shall not be available for cigarettes sold in exempt transactions on the Qualified Tribal Lands of an Indian tribe that agrees upon a refund formula under this subsection.

(h) In order for an Indian tribe, entities owned and operated by that tribe or a member of that tribe, or persons doing business with that tribe or such entities to be entitled to a refund of taxes or release of escrow under this Section for cigarettes sold on that tribe's Qualified Tribal Lands during a year, the tribe shall provide documentation to the [name of State agency] by April 15 of that year sufficient to demonstrate the number of enrolled adult members of that tribe domiciled on its Qualified Tribal Lands during the preceding calendar year. The [name of State agency] shall verify the accuracy and completeness of the required documentation and information before granting the refunds or releases. For purposes of this subsection and subsections (e)-(g), a tribal member domiciled on Qualified Tribal Lands for part of a year counts as a fraction reflecting the portion of the year domiciled on those Lands. A formula under subsection (f) or (g) shall incorporate and be subject to the provisions of this subsection.

(i) Amounts the State collects on a bond under [cross-reference bond section] shall not be subject to release under this Section. References in this section to escrow deposited by a non-participating manufacturer or other person shall not include amounts collected by the State on a bond.

(j) The [name of State agency] shall promulgate rules and regulations necessary to implement this Section.

Sec. [20]. Effect of certain violations.

(a) The [name of State agency] shall list on its website any person that both (i) claims not to be subject, or holds itself out as not subject, to enforcement of any provision of this Act by reason of lack of jurisdiction of the State or sovereign immunity and (ii) the [name of State agency] has a reasonable basis to believe has not fully complied with any provision of this Act. The [name of State agency] shall promptly publish and regularly update the list of such persons on its website.

(b) The [name of State agency] shall not include on the list any person described in subsection (a) that submits an enforceable certification in accordance with rules or regulations to be promulgated by [name of State agency] that such person will not assert that it is not subject to enforcement of any provision of this Act based on an asserted lack of State jurisdiction or claim of sovereign immunity.

(c) Except as provided in subsection (d), it shall be unlawful for any person to sell cigarettes or cigarette inputs to, or purchase cigarettes from, any person that is on the list described in subsection (a). A supplier of cigarette inputs may obtain advance approval from [name of State agency] to sell inputs to a person on the list if the supplier demonstrates that the input will not be used for the manufacturing of cigarettes.

(d) Notwithstanding subsection (c), a person may sell cigarettes to, or purchase cigarettes from, persons on the list if the manufacturer and brand of such cigarettes is on the State directory and, prior to the sale or purchase, a stamping agent that is not on the list affixed a tax stamp permitted under Section [4] to the package containing such cigarettes.

(e) It shall be unlawful for any person that is on the list described in subsection (a) to sell, transport or cause to be transported cigarettes in or into this State unless (i) the manufacturer and brand of such cigarettes is on the State directory and (ii) prior to the sale or transport, a stamping agent that is not on the list affixed a tax stamp permitted under Section [4] to the package containing such cigarettes.

(f) The [name of State agency] shall provide a notice to any person that it determines should be placed on the list described in subsection (a). The notice shall state the grounds for the listing and inform the person that, except as provided in subsection (g), it will be placed on the list 30 days following the date of the notice.

[Note: As to subsections (f)-(h), States may use provisions of their existing administrative procedure act or similar process laws or regulations so long as they are comparable to, and not substantially more favorable to the listed person than, the corresponding provision in subsections (f)-(h).]

(g) During the 30 days following the date of the notice, the person may (i) submit the certification described in subsection (b) or (ii) submit documentation to the [name of State agency] demonstrating that its determination described in the notice was incorrect. Unless the [name of State agency] determines that the person has satisfied either (i) or (ii), it shall be placed on the list 30 days following the date of the notice.

(h) A person that is placed on the list shall have an opportunity for a hearing before [name of State agency] within 30 days. The [name of State agency] shall remove the person from the list if it determines that the person has demonstrated that its inclusion on the list was not proper under this Section.

(i) A person that unsuccessfully challenges being placed on the list either in a hearing under subsection (h) or in court shall pay the State's reasonable costs and attorney's fees incurred in contesting the challenge. *[Note: This provision is optional.]*

(j) If for any reason during the period from 30 days after the date of the notice until a final judgment, a person's placement on the list described in subsection (a) is stayed or suspended, then the [name of State agency] shall promptly remove that person from the list during the time of the stay or suspension, but shall note the fact of the stay on that list and shall send notice of the stay to all persons described in Section [9(d)]. Any person that sells cigarettes or cigarette inputs to, or purchases cigarettes from, that person after the earlier of receiving notice of the stay of listing or 10 days after the fact of the stay was noted on the list, shall be jointly and severally liable for any taxes applicable to such cigarettes under [cross-reference applicable tax law provisions] and for any escrow due on such cigarettes under [cross-reference State's escrow statute] during the period of the stay if the stay is subsequently lifted and the placement on the list reinstated.

Sec. [21]. Compacts.

Neither the State nor any agency or department thereof shall enter into any future agreement, compact or treaty with any Indian tribe that is inconsistent with the provisions of this Act.

APPENDIX I

TABLE OF ACCRETED VALUES

Table of Accreted Values for the Series 2007-1B Bonds (Accreted Values Shown Per $5,000 Maturity Amount)

Date	Accreted Value	Date	Accreted Value
January 29, 2007	$738.00	June 1, 2024	$1,939.16
June 1, 2007	752.07	December 1, 2024	1,993.94
December 1, 2007	773.31	June 1, 2025	2,050.27
June 1, 2008	795.16	December 1, 2025	2,108.19
December 1, 2008	817.62	June 1, 2026	2,167.75
June 1, 2009	840.72	December 1, 2026	2,228.98
December 1, 2009	864.47	June 1, 2027	2,291.95
June 1, 2010	888.89	December 1, 2027	2,356.70
December 1, 2010	914.00	June 1, 2028	2,423.28
June 1, 2011	939.82	December 1, 2028	2,491.73
December 1, 2011	966.37	June 1, 2029	2,562.13
June 1, 2012	993.67	December 1, 2029	2,634.51
December 1, 2012	1,021.75	June 1, 2030	2,708.93
June 1, 2013	1,050.61	December 1, 2030	2,785.46
December 1, 2013	1,080.29	June 1, 2031	2,864.15
June 1, 2014	1,110.81	December 1, 2031	2,945.06
December 1, 2014	1,142.19	June 1, 2032	3,028.26
June 1, 2015	1,174.45	December 1, 2032	3,113.81
December 1, 2015	1,207.63	June 1, 2033	3,201.77
June 1, 2016	1,241.75	December 1, 2033	3,292.22
December 1, 2016	1,276.83	June 1, 2034	3,385.23
June 1, 2017	1,312.90	December 1, 2034	3,480.86
December 1, 2017	1,349.99	June 1, 2035	3,579.19
June 1, 2018	1,388.13	December 1, 2035	3,680.31
December 1, 2018	1,427.34	June 1, 2036	3,784.28
June 1, 2019	1,467.66	December 1, 2036	3,891.18
December 1, 2019	1,509.12	June 1, 2037	4,001.11
June 1, 2020	1,551.76	December 1, 2037	4,114.14
December 1, 2020	1,595.59	June 1, 2038	4,230.36
June 1, 2021	1,640.67	December 1, 2038	4,349.87
December 1, 2021	1,687.02	June 1, 2039	4,472.75
June 1, 2022	1,734.68	December 1, 2039	4,599.11
December 1, 2022	1,783.68	June 1, 2040	4,729.04
June 1, 2023	1,834.07	December 1, 2040	4,862.63
December 1, 2023	1,885.88	June 1, 2041	5,000.00

Table of Accreted Values for the
Series 2007-1C Bonds
(Accreted Values Shown Per $5,000 Maturity Amount)

Date	Accreted Value	Date	Accreted Value
January 29, 2007	$701.95	June 1, 2024	$1,891.67
June 1, 2007	715.68	December 1, 2024	1,946.53
December 1, 2007	736.44	June 1, 2025	2,002.98
June 1, 2008	757.80	December 1, 2025	2,061.07
December 1, 2008	779.77	June 1, 2026	2,120.84
June 1, 2009	802.38	December 1, 2026	2,182.34
December 1, 2009	825.65	June 1, 2027	2,245.63
June 1, 2010	849.60	December 1, 2027	2,310.75
December 1, 2010	874.24	June 1, 2028	2,377.77
June 1, 2011	899.59	December 1, 2028	2,446.72
December 1, 2011	925.68	June 1, 2029	2,517.68
June 1, 2012	952.52	December 1, 2029	2,590.69
December 1, 2012	980.15	June 1, 2030	2,665.82
June 1, 2013	1,008.57	December 1, 2030	2,743.13
December 1, 2013	1,037.82	June 1, 2031	2,822.68
June 1, 2014	1,067.92	December 1, 2031	2,904.54
December 1, 2014	1,098.89	June 1, 2032	2,988.77
June 1, 2015	1,130.75	December 1, 2032	3,075.44
December 1, 2015	1,163.55	June 1, 2033	3,164.63
June 1, 2016	1,197.29	December 1, 2033	3,256.41
December 1, 2016	1,232.01	June 1, 2034	3,350.84
June 1, 2017	1,267.74	December 1, 2034	3,448.02
December 1, 2017	1,304.50	June 1, 2035	3,548.01
June 1, 2018	1,342.33	December 1, 2035	3,650.90
December 1, 2018	1,381.26	June 1, 2036	3,756.78
June 1, 2019	1,421.32	December 1, 2036	3,865.73
December 1, 2019	1,462.54	June 1, 2037	3,977.83
June 1, 2020	1,504.95	December 1, 2037	4,093.19
December 1, 2020	1,548.59	June 1, 2038	4,211.89
June 1, 2021	1,593.50	December 1, 2038	4,334.04
December 1, 2021	1,639.72	June 1, 2039	4,459.73
June 1, 2022	1,687.27	December 1, 2039	4,589.06
December 1, 2022	1,736.20	June 1, 2040	4,722.14
June 1, 2023	1,786.55	December 1, 2040	4,859.09
December 1, 2023	1,838.36	June 1, 2041	5,000.00

APPENDIX J

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