NEW ISSUE **BOOK-ENTRY ONLY**

In the opinion of the Attorney General of the State of Michigan and in the opinion of Co-Bond Counsel, subject to compliance with certain covenants, under existing law, the interest on the Series 2008A Bonds and the Series 2008C Bonds (1) is excluded from gross income for federal income tax purposes, (2) is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations but is included in the adjusted current earnings of certain corporations for purposes of computing the federal alternative minimum tax imposed on such corporations, and (3) is excluded from taxable income for purposes of the State of Michigan personal income tax. See "TAX MATTERS — The Series 2008A Bonds and the Series 2008C Bonds" herein. The interest on the Series 2008B Bonds is included in gross income for federal income tax purposes and the Series 2008B Bonds and the interest thereon are not exempt from taxation by the State of Michigan or any political subdivision thereof. See "TAX MATTERS — The 2008B Bonds" herein.

$202,408,464.40
MICHIGAN TOBACCO SETTLEMENT FINANCE AUTHORITY
Tobacco Settlement Asset-Backed Bonds, Series 2008

$114,860,000 Series 2008A
Current Interest Turbo Term Bonds

$29,874,650.00 Series 2008B
Taxable Capital Appreciation Turbo Term Bonds

$57,673,814.40 Series 2008C
Capital Appreciation Turbo Term Bonds

The Michigan Tobacco Settlement Finance Authority (the "**Authority**") is a public body corporate and politic of the State of Michigan (the "**State**"), separate and distinct from the State, exercising public and essential governmental functions and created by the Michigan Tobacco Settlement Finance Authority Act, 2005 PA 226, MCL 129.261 et seq., as may be amended from time to time (the "**Act**").

The Tobacco Settlement Asset-Backed Bonds, Series 2008 are comprised of three series of turbo term bonds – the Tobacco Settlement Asset-Backed Bonds, Series 2008A, which are fixed rate current interest term bonds (the "**Series 2008A Bonds**"), the Tobacco Settlement Asset-Backed Bonds, Series 2008B, which are taxable capital appreciation bonds (the "**Series 2008B Bonds**") and the Tobacco Settlement Asset-Backed Bonds, Series 2008C, which are capital appreciation bonds (the "**Series 2008C Bonds**" and, together with the Series 2008A Bonds and the Series 2008B Bonds, the "**Series 2008 Bonds**"). The Series 2008 Bonds are to be issued as Senior Bonds, Additional Bonds and Refunding Bonds (each as defined herein) pursuant to a Trust Indenture, dated as of May 1, 2006 (the "**Trust Indenture**") between the Authority and The Bank of New York Trust Company, N.A., as successor in interest to J.P. Morgan Trust Company, National Association, as trustee (the "**Indenture Trustee**"), and a Series 2008 Supplement thereto (the "**Series 2008 Supplement**" and the Trust Indenture as so supplemented, the "**Indenture**"). The Series 2008 Bonds are being issued in order to, among other things, make a payment in the amount of $60,000,000 to the State for deposit in the State's General Fund, to refund the Authority's outstanding Indexed Floating Rate Turbo Term Bonds, Series 2006B (the "**Series 2006B Bonds**"), and to refund through purchase in the open market and retirement of the Authority's outstanding Capital Appreciation Turbo Term Bonds, Series 2006C (the "**Series 2006C Bonds**", which, together with the Authority's Fixed Rate Turbo Term Bonds, Series 2006A (the "**Series 2006A Bonds**") and the Series 2006B Bonds, are collectively referred to herein as the "**Series 2006 Bonds**"). The Indenture permits the issuance of Refunding Bonds and Additional Bonds (as such terms are defined herein) subject to the satisfaction of certain conditions described herein. The Series 2008 Bonds, together with the Series 2006 Bonds and any other Refunding Bonds and Additional Bonds to be issued under the Indenture, are referred to herein as the "**Bonds**."

Pursuant to the Purchase and Sale Agreement by and between the State and the Authority, dated as of May 1, 2006, which is being amended and restated in connection with the issuance of the Series 2008 Bonds (the "**2006 Purchase Agreement**"), the Authority purchased the right, title and interest in and to 13.34% of (i) all tobacco settlement revenue that is received by the State that is required to be made under the terms of the Master Settlement Agreement entered into by participating tobacco product manufacturers, 46 states and six other U.S. jurisdictions in November 1998 in settlement of certain smoking-related litigation (the "**MSA**"), by tobacco manufacturers to the State, and that is payable to the State on or after April 1, 2008, (ii) all lump sum or partial lump sum payments of tobacco settlement revenue, whenever received, that are allocable to a payment that is payable on or after April 1, 2008 under the terms of the MSA by tobacco manufacturers to the State, and (iii) the State's rights to receive the tobacco settlement revenue referred to in (i) and (ii) under the MSA (such percentage of such payments and rights, as more fully described herein, the "**2006 Sold Tobacco Receipts**"). The 2006 Sold Tobacco Receipts include 13.34% of any amounts due to the State and withheld or deposited in the Disputed Payments Account (as defined herein) on or after April 1, 2008, by the tobacco manufacturers as a result of a dispute as to the amount of a payment required to be made by them under the MSA, and that are subsequently paid by the tobacco manufacturers or released from the Disputed Payments Account, but specifically exclude any right to or interest in amounts withheld or deposited in the Disputed Payments Account before April 1, 2008.

The Bonds are special revenue obligations of the Authority and are payable solely from the 2006 Pledged TSRs (as hereinafter defined) and the other collateral pledged under the Indenture. The "**2006 Pledged TSRs**" are the right, title and interest of the Authority in and to, initially, 100% of the 2006 Sold Tobacco Receipts. The Authority has no assets available for the payment of the Bonds other than the 2006 Pledged TSRs and the other Collateral (defined herein). Pursuant to the Indenture, in connection with the issuance of Additional Bonds or Refunding Bonds, from time to time the Authority may reduce the percentage of 2006 Sold Tobacco Receipts pledged under the Indenture as 2006 Pledged TSRs upon the satisfaction of certain conditions as more fully set forth under "SECURITY FOR THE BONDS" herein. The pledge will not be reduced in connection with the issuance of the Series 2008 Bonds, and the Authority has covenanted in the Indenture that so long as any Series 2008 Bonds are Outstanding under the Indenture, the Authority will not reduce the percentage of 2006 Sold Tobacco Receipts constituting 2006 Pledged TSRs.

The State has also previously sold to the Authority the right, title and interest in and to the "**2007 Sold Tobacco Receipts**" (as more fully described herein). The 2007 Sold Tobacco Receipts do not secure the Series 2008 Bonds and are not available to the Series 2008 Bondholders. On August 20, 2007 the Authority issued its $522,991,697.00 initial principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2007 (the "**Series 2007 Bonds**"), which are secured by the 2007 Sold Tobacco Receipts. The 2006 Sold Tobacco Receipts will not secure the Series 2007 Bonds and are not available to the Series 2007 Bondholders. The right of the Indenture Trustee to receive the 2006 Sold Tobacco Receipts is equal to and on a parity with and is not inferior or superior to the right of the 2007 Indenture Trustee (as defined herein) to receive the 2007 Sold Tobacco Receipts and the right of the State to receive the portion of the State's tobacco receipts not sold to the Authority by the State (the "**Unsold Tobacco Receipts**"). Neither the Authority nor the Indenture Trustee shall have any right to make a claim to make up all or any portion of a deficiency in the 2006 Pledged TSRs from the Unencumbered TSRs (as defined herein), if any, the 2007 Pledged TSRs or the Unsold Tobacco Receipts.

The amount of 2006 Pledged TSRs received is dependent on many factors, including future domestic cigarette consumption, the financial capability of the PMs (as defined herein), litigation affecting the MSA and related state legislation, enforcement of state legislation related to the MSA, and the tobacco industry. Payments by the PMs (as defined herein) under the MSA are subject to certain adjustments, some of which may be material. Bondholders should assume that future Annual Payments and Strategic Contribution Payments (each as defined herein) may be reduced. See "RISK FACTORS" herein.

Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (*Grand River* and *Freedom Holdings*), that are pending in the U.S. District Court for the Southern District of New York and two cases (*Xcaliber* and *A.B. Coker*) that are pending in the U.S. District Courts in Louisiana. All of these cases are described in "RISK FACTORS" herein. The State is a defendant in the *Grand River* case. The courts in those cases are considering plaintiffs' allegations of an illegal output cartel under the federal antitrust laws and plaintiffs allegations of violations under the Commerce Clause and other provisions of the U.S. Constitution. A determination in any of these cases that the MSA or a defendant state's legislation enacted pursuant to the MSA is void or unenforceable (a) could have a materially adverse effect on the payments by PMs under the MSA and the amount or the timing of receipt of 2006 Pledged TSRs available to the Authority to pay the principal of, Accreted Value and interest on the Series 2008 Bonds and make Turbo Redemptions (herein defined), (b) could lead to a decrease in the market value and/or liquidity of the Series 2008 Bonds, and (c) in certain circumstances could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

Interest on the Series 2008A Bonds will be payable semi-annually on each June 1 and December 1, commencing December 1, 2008. Interest on the Series 2008A Bonds payable on or prior to December 1, 2008 will be capitalized. Interest on the Series 2008B Bonds and the Series 2008C Bonds will not be payable currently and will accrete from the date of issuance and be compounded on December 1, 2008 and thereafter on each June 1 and December 1 until maturity or earlier redemption.

The Series 2008 Bonds consist of Turbo Term Bonds maturing on June 1 in the years as set forth on the inside front cover (each such date, a "**Maturity Date**"). The Series 2008A Bonds are subject to redemption in accordance with the schedule of Sinking Fund Installments therefor. In addition, the Series 2008 Bonds are subject to mandatory redemption to the extent of available Collections as defined herein ("**Turbo Redemptions**"). Turbo Redemptions, if any, will be credited against both Sinking Fund Installments where applicable and Turbo Term Bond Maturities in order of priority, as described below. As a consequence, payment of the Bond Obligation (as defined herein) of the Series 2008 Bonds may be substantially earlier than the scheduled Sinking Fund Installments and Maturity Dates therefor. The Series 2008 Bonds are also subject to optional redemption, mandatory redemption and mandatory clean-up calls, all as described herein.

So long as no Payment Default has occurred, the Series 2006A Bonds are entitled to receive payments from Collections of their Bond Obligation, whether by Sinking Fund Installments, Turbo Redemption or otherwise, prior to the payment of any Bond Obligation due on the Series 2008A Bonds, the Series 2008B Bonds or the Series 2008C Bonds; the Series 2008A Bonds are entitled to receive payment from Collections of their Bond Obligation, whether by Sinking Fund Installments, Turbo Redemption or otherwise, prior to the payment of any Bond Obligation due on the Series 2008B Bonds or the Series 2008C Bonds; and the Series 2008B Bonds are entitled to receive payment from Collections of their Bond Obligation, whether by Turbo Redemption or otherwise, prior to payment of any Bond Obligation due on Series 2008C Bonds. The rules described in this section are hereinafter referred to as the "**Priority of Payment Rules**".

Failure to pay interest when due or the Principal of a Series 2008 Bond on its Maturity Date will constitute a Payment Default, which is an Event of Default under the Indenture. However, failure to pay Sinking Fund Installments or Turbo Redemptions on the Series 2008 Bonds will not constitute an Event of Default under the Indenture unless Collections are sufficient and available therefor. **The ratings for the Series 2008 Bonds address only (i) the payment of interest thereon when due and (ii) the payment of Principal thereof by their respective Maturity Dates. The ratings do not address the payment of Sinking Fund Installments on the Series 2008 Bonds or Turbo Redemptions. See "RATINGS" herein.**

See the Inside Front Cover for Dated Date, Maturity Schedule, Interest Rates and Prices or Yields.

The Series 2008 Bonds are special revenue obligations of the Authority secured solely by and payable solely from the 2006 Pledged TSRs and the other collateral pledged under the Indenture. The Series 2008 Bonds do not directly or indirectly, or contingently, obligate the State or any political subdivision of the State to pay any amounts to the Authority or to the Bondholders, or levy or pledge any form of taxation whatsoever for the Series 2008 Bonds. The Bonds are not a debt or liability of the State or any agency or instrumentality of the State, other than the Authority, either legal, moral or otherwise, and nothing contained in the Act or the Indenture is to be construed to authorize the Authority to incur any indebtedness on behalf of, or in any way obligate the State or any political subdivision of the State. The Authority has no taxing power.

See "RISK FACTORS" for a discussion of certain factors that should be considered in connection with an investment in the Series 2008 Bonds.

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

The Series 2008 Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Dickinson Wright PLLC, Lansing, Michigan, and Dykema Gossett PLLC, Lansing, Michigan, as Co-Bond Counsel. Certain legal matters with respect to the Authority will be passed upon by the State's Attorney General. Certain legal matters will be passed upon for the Underwriters by Miller, Canfield, Paddock and Stone P.L.C., Lansing, Michigan, and Nixon Peabody LLP, New York, New York, as Co-Underwriter's Counsel. It is expected that the Series 2008 Bonds will be available for delivery in book-entry only form through The Depository Trust Company in New York, New York, on or about July 7, 2008.

Citi
Comerica Securities, Inc.
Loop Capital Markets, LLC

DEPFA First Albany Securities LLC

Lehman Brothers
Fifth Third Securities, Inc.
Merrill Lynch & Co.

June 26, 2008

DATED DATE, MATURITY SCHEDULE, INTEREST RATES AND PRICE OR YIELD

$202,408,464.40
Series 2008 Bonds
Dated: Date of Delivery

$114,860,000
Tobacco Settlement Asset-Backed Bonds,
Series 2008A Current Interest Turbo Term Bonds

$114,860,000 6.875% Series 2008A Turbo Current Interest Bonds due June 1, 2042; Yield 7.10%
Expected Final Turbo Redemption Date: June 1, 2024*
Projected Average Life: 15.6 years*
CUSIP No. 594751AK5†

$29,874,650.00
Tobacco Settlement Asset-Backed Bonds,
Series 2008B Taxable Capital Appreciation Turbo Term Bonds

Maturity Date (June 1)	Initial Principal Amount	Initial Principal Amount per $5,000 Accreted Value at Maturity Date	Accreted Value at Maturity	Approximate Yield to Maturity Date	Projected Final Turbo Redemption Date*	Projected Average Life (years)*	CUSIP No.†
2046	$29,874,650.00	$213.20	$700,625,000	8.50%	June 1, 2027	17.3	594751AL3

$57,673,814.40
Tobacco Settlement Asset-Backed Bonds,
Series 2008C Capital Appreciation Turbo Term Bonds

Maturity Date (June 1)	Initial Principal Amount	Initial Principal Amount per $5,000 Accreted Value at Maturity Date	Accreted Value at Maturity	Approximate Yield to Maturity Date	Projected Final Turbo Redemption Date*	Projected Average Life (years)*	CUSIP No.†
2058	$57,673,814.40	$65.60	$4,395,870,000	8.875%	June 1, 2033	21.8	594751AM1

THE CUSIP NUMBERS LISTED ABOVE ARE BEING PROVIDED SOLELY FOR THE CONVENIENCE OF BONDHOLDERS ONLY AT THE TIME OF ISSUANCE OF THE SERIES 2008 BONDS. THE AUTHORITY, THE STATE AND THE UNDERWRITERS DO NOT MAKE ANY REPRESENTATION WITH RESPECT TO SUCH NUMBERS OR UNDERTAKE ANY RESPONSIBILITY FOR THEIR ACCURACY NOW OR AT ANY TIME IN THE FUTURE. THE CUSIP NUMBER FOR A SPECIFIC MATURITY IS SUBJECT TO BEING CHANGED AFTER THE ISSUANCE OF THE SERIES 2008 BONDS AS A RESULT OF VARIOUS SUBSEQUENT ACTIONS INCLUDING, BUT NOT LIMITED TO, A REFUNDING IN WHOLE OR IN PART OF SUCH MATURITY OR AS A RESULT OF THE PROCUREMENT OF SECONDARY MARKET PORTFOLIO INSURANCE OR OTHER SIMILAR ENHANCEMENT BY INVESTORS THAT IS APPLICABLE TO ALL OR A PORTION OF CERTAIN MATURITIES OF THE SERIES 2008 BONDS.

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* Assumes all Turbo Redemptions are made based on the receipt of Surplus Collections (as defined herein) projected in accordance with the Global Insight Base Case Forecast and other structuring assumptions. No assurance can be given that these assumptions will be realized. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION."

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

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

THERE CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES 2008 BONDS WILL DEVELOP OR, IF ONE DEVELOPS, THAT IT WILL CONTINUE FOR THE LIFE OF THE SERIES 2008 BONDS.

The information set forth herein has been furnished by the Authority and Global Insight (as defined herein) and includes information obtained from other sources, all of which are believed to be reliable. Information concerning the tobacco industry and industry participants has been obtained from certain publicly available information provided by certain industry participants and certain other sources. See "DOMESTIC TOBACCO INDUSTRY." The industry participants have not provided any information to the Authority for use in connection with this offering. In certain cases, tobacco industry information provided herein (such as market share data) may be derived from sources that are inconsistent or in conflict with each other. The Authority has not independently verified the information under the caption "DOMESTIC TOBACCO INDUSTRY;" the Authority cannot and does not warrant the accuracy or completeness of this information. The information contained under the caption "THE GLOBAL INSIGHT CONSUMPTION REPORT" and in the Global Insight Consumption Report attached as Appendix A hereto has been included in reliance upon Global Insight as an expert in econometric forecasting, and has not been independently verified for accuracy or appropriateness of assumptions.

The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Offering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority, in the matters covered by the report of Global Insight included as Appendix A to this Offering Circular, or tobacco industry information, since the date hereof, or that the information contained in this Offering Circular is correct as of any date subsequent to the date hereof. Such information and expressions of opinion are made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other person.

This Offering Circular contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the factors that may materially affect the amount of 2006 Pledged TSRs (see "RISK FACTORS," "LEGAL CONSIDERATIONS" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT"), the inclusion in this Offering Circular of such forecasts, projections and estimates should not be regarded as a representation by the Authority, its independent auditors, its financial advisor, Global Insight or the Underwriters that such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

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

THE SERIES 2008 BONDS ARE EXEMPT SECURITIES UNDER SECTION 3(a)(2) OF THE U.S. SECURITIES ACT OF 1933 (THE "SECURITIES ACT") AND HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT, OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OF THE UNITED STATES. THE SERIES 2008 BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION OR ANY OTHER REGULATORY AGENCY, NOR HAS ANY OF THE FOREGOING PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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

TABLE OF CONTENTS

TABLE OF CONTENTS

SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Offering Circular and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Series 2008 Bonds to potential investors is made only by means of the entire Offering Circular. Capitalized terms used in this Summary Statement and not otherwise defined shall have the meanings given such terms in the Indenture and the 2006 Purchase Agreement. See Appendix D —"DEFINITIONS AND SUMMARY OF THE INDENTURE — Definitions" attached hereto. For definitions of certain terms used herein, see also Appendix G — "INDEX OF DEFINED TERMS" attached hereto.

Overview ..... The Michigan Tobacco Settlement Finance Authority (the "**Authority**") is issuing $202,408,464.40 aggregate original principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2008, which are comprised of three series of turbo term bonds – the Tobacco Settlement Asset-Backed Bonds, Series 2008A, which are fixed rate current interest bonds (the "**Series 2008A Bonds**"), the Tobacco Settlement Asset-Backed Bonds, Series 2008B, which are taxable capital appreciation bonds (the "**Series 2008B Bonds**" and the Tobacco Settlement Asset-Backed Bonds, Series 2008C, which are capital appreciation bonds (the "**Series 2008C Bonds**", and together with the Series 2008A Bonds and the Series 2008B Bonds, the "**Series 2008 Bonds**"). The Series 2008 Bonds are to be issued as Senior Bonds, Additional Bonds and Refunding Bonds pursuant to a Trust Indenture, dated as of May 1, 2006 (the "**Trust Indenture**"), between the Authority and The Bank of New York Trust Company, N.A., as successor in interest to J.P. Morgan Trust Company, National Association, as trustee (the "**Indenture Trustee**"), and a Series 2008 Supplement thereto (the "**Series 2008 Supplement;**" the Trust Indenture as so supplemented, the "**Indenture**"), to be entered into between the Authority and the Indenture Trustee in connection with the issuance of the Series 2008 Bonds. The Indenture permits the issuance of Refunding Bonds and Additional Bonds (as such terms are defined herein) subject to the satisfaction of certain conditions described herein. The Series 2008 Bonds, together with the Series 2006 Bonds and any other Refunding Bonds and Additional Bonds to be issued under the Indenture, are referred to herein as the "**Bonds**." See "THE SERIES 2008 BONDS — Additional Bonds" herein.

Under the Master Settlement Agreement entered into by participating tobacco product manufacturers, 46 states and six other U.S. jurisdictions in November 1998 in settlement of certain smoking-related litigation (the "**MSA**"), the State is entitled to receive 4.3519476% of each Annual Payment and 2.5771774% of each Strategic Contribution Payment (as such terms are hereinafter defined) payable by the participating tobacco product manufacturers. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" under the subheadings " — Initial Payments," " — Annual Payments" and " — Strategic Contribution Payments."

Pursuant to the Purchase and Sale Agreement by and between the State of Michigan (the "**State**") and the Authority, dated as of May 1, 2006, which is being amended and restated in connection with the issuance of the Series 2008 Bonds (the "**2006 Purchase Agreement**"), the Authority purchased the right, title and interest in and to 13.34% of (i) all tobacco settlement revenue that is received by the State that is required to be made under the terms of the MSA by tobacco manufacturers to the State, and that is payable to the State on or after April 1, 2008, (ii) all lump sum or partial lump sum payments of tobacco settlement revenue, whenever received, that are allocable to a payment that is payable on or after April 1, 2008 under the terms of the MSA by tobacco manufacturers to the State, and (iii) the State's rights to receive the tobacco settlement revenue referred to in (i) and (ii) under the MSA (such percentage of such payments and rights, as more fully described herein, the "**2006 Sold Tobacco Receipts**"). The 2006 Sold Tobacco Receipts include 13.34% of any amounts due to the State and withheld or deposited in the Disputed Payments Account (as defined herein) on or after April 1, 2008, by the tobacco manufacturers as a result of a dispute as to the amount of a payment required to be made by them under the MSA, and that are subsequently paid by the tobacco manufacturers or released from the Disputed Payments Account, but specifically exclude any right to or interest in amounts withheld or deposited in the Disputed Payments Account before April 1, 2008.

"Disputed Payments Account" means the account into which the disputed portion of payments required to be made by the PMs under the MSA are withheld or deposited pending resolution of the dispute.

The State has also previously sold to the Authority, pursuant to the Purchase and Sale Agreement by and between the State and the Authority, dated as of August 1, 2007 (the "**2007 Purchase Agreement**") the right, title and interest in and to 10.77% of (i) all tobacco settlement revenue that is received by the State that is required to be made, under the terms of the MSA, by tobacco manufacturers to the State, and that is payable to the State on or after April 1, 2010, (ii) all lump sum or partial lump sum payments of tobacco settlement revenue, paid after August 20, 2007, that are allocable to a payment that is payable on or after April 1, 2010 under the terms of the MSA by tobacco manufacturers to the State, and (iii) the State's rights to receive the tobacco settlement revenue referred to in (i) and (ii) under the MSA, and (iv) any amounts due to the State and withheld or deposited in the Disputed Payments Account on or after May 15, 2009, by the tobacco manufacturers as a result of a dispute as to the amount of a payment required to be made by them under the MSA, and that are subsequently paid by the tobacco manufacturers or released from the Disputed Payments Account (such percentage of such payments and rights, the "**2007 Sold Tobacco Receipts**"). The "**2007 Pledged TSRs**" are the right, title and interest of the Authority in and to, initially, 100% of the 2007 Sold Tobacco Receipts. On August 20, 2007 the Authority

issued its $522,991,697.00 initial principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2007 (the "**Series 2007 Bonds**"), which are secured by the 2007 Sold Tobacco Receipts. The 2007 Sold Tobacco Receipts do not secure the Series 2008 Bonds and are not available to the Series 2008 Bondholders. The 2006 Sold Tobacco Receipts will not secure the Series 2007 Bonds and are not available to the Series 2007 Bondholders.

Initially, the right, title and interest of the Authority to 100% of the 2006 Sold Tobacco Receipts will be pledged under the Indenture (the "**2006 Pledged TSRs**"). Pursuant to the Indenture, in connection with the issuance of Additional Bonds or Refunding Bonds, the Authority may reduce the percentage of 2006 Sold Tobacco Receipts pledged under the Indenture as 2006 Pledged TSRs, upon the satisfaction of the conditions to the issuance of Refunding Bonds and Additional Bonds more fully described under "THE SERIES 2008 BONDS — Refunding Bonds and Additional Bonds" herein. Thereafter, the amount of 2006 Sold Tobacco Receipts that are not pledged under the Indenture will constitute "**2006 Unencumbered TSRs**." The 2006 Unencumbered TSRs, together with the amount of 2007 Sold Tobacco Receipts, if any, that are no longer pledged under the Trust Indenture, dated as of August 1, 2007, between the Authority and The Bank of New York Trust Company, N.A. (the "**2007 Indenture Trustee**"), and a Series 2006 Supplement thereto, are collectively referred to herein as the "**Unencumbered TSRs**." The Authority has covenanted in the Indenture that so long as any Series 2008 Bonds are Outstanding under the Indenture, the Authority will not reduce the percentage of 2006 Sold Tobacco Receipts constituting 2006 Pledged TSRs. The Authority has no assets available for payment of the Bonds other than the 2006 Pledged TSRs and the other Collateral (as herein defined). Neither the 2007 Sold Tobacco Receipts nor the Unencumbered TSRs are available to the Authority for payment of the Bonds.

The right of the Indenture Trustee to receive the 2006 Sold Tobacco Receipts is equal to and on a parity with and is not inferior or superior to the right of the 2007 Indenture Trustee to receive the 2007 Sold Tobacco Receipts and the right of the State to receive the portion of the State's tobacco receipts not sold to the Authority by the State (the "**Unsold Tobacco Receipts**").

Use of Proceeds..... The Series 2008 Bonds are being offered for the purpose of (i) refunding the Authority's $70,910,000 outstanding Indexed Floating Rate Turbo Term Bonds, Series 2006B (the "**Series 2006B Bonds**"), and to refund through purchase in the open market and retirement of the Authority's outstanding Capital Appreciation Turbo Term Bonds, Series 2006C (the "**Series 2006C Bonds**", which, together with the Authority's Fixed Rate Turbo Term Bonds, Series 2006A (the "**Series 2006A Bonds**"), are collectively referred to herein as the "**Series 2006 Bonds**"), (ii) making a payment in the amount of $60,000,000 to the State for deposit in the State's General Fund, (iii)

providing for the payment of capitalized interest through December 1, 2008 and (iv) the costs of issuance of the Series 2008 Bonds.

The Authority ..... The Authority is a public body corporate and politic of the State, separate and distinct from the State, exercising public and essential governmental functions and created by the Michigan Tobacco Settlement Finance Authority Act, 2005 PA 226, MCL 129.261 et seq., as may be amended from time to time (the "**Act**").

Securities Offered ..... It is expected that the Series 2008 Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about July 7, 2008 (the "**Closing Date**"). Individual purchases of beneficial ownership interests in the Series 2008A Bonds may be made in the principal amount of $5,000 or any integral multiple thereof and individual purchases of beneficial ownership interests in the Series 2008B Bonds and the Series 2008C Bonds may be made in the principal amount which will accrete to $5,000 or any integral multiple thereof at their Maturity Date (each, respectively, an "**Authorized Denomination**"). Beneficial owners of the Series 2008 Bonds will not receive physical delivery of bond certificates.

Collateral ..... The Bonds are special revenue obligations of the Authority payable solely from and secured solely by (a) the 2006 Pledged TSRs, (b) investment earnings on certain accounts pledged under the Indenture (which earnings, together with the 2006 Pledged TSRs, are referred to herein as the "**Collections**"), (c) all rights to receive the Collections and the proceeds of such rights, (d) amounts held in the Liquidity Reserve Account established under the Indenture, (e) amounts held in certain other accounts established under the Indenture, including the Capitalized Interest Subaccount (such accounts, together with the Liquidity Reserve Account, the "**Pledged Accounts**"), and (f) certain rights of the Authority as specified in the 2006 Purchase Agreement (collectively, the "**Collateral**").

The proceeds of the Series 2008 Bonds, except the amount deposited in the Liquidity Reserve Account and the Capitalized Interest Subaccount, are not pledged to the payment of, and are therefore not available to, the holders of the Series 2008 Bonds.

The Series 2008 Bonds are special revenue obligations of the Authority secured solely by and payable solely from the 2006 Pledged TSRs and the other collateral pledged under the Indenture. The Series 2008 Bonds do not directly or indirectly, or contingently, obligate the State or any political subdivision of the State to pay any amounts to the Authority or to the Bondholders, or levy or pledge any form of taxation whatsoever for the Series 2008 Bonds. The Bonds are not a debt or liability of the State or any agency or instrumentality of the State, other than the Authority, either legal, moral or otherwise, and nothing

contained in the Act or the indenture is to be construed to authorize the Authority to incur any indebtedness on behalf of, or in any way obligate the State or any political subdivision of the State. The Authority has no taxing power.

Master Settlement Agreement ... The MSA was entered into on November 23, 1998, among the attorneys general of 46 states (including the State), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively, the "**Settling States**") and the four largest United States tobacco manufacturers: Philip Morris Incorporated ("**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**") (collectively, the "**Original Participating Manufacturers**" or "**OPMs**").

On January 5, 2004, Reynolds American Inc. ("**Reynolds American**") was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities and operations of B&W with those of Reynolds Tobacco, which occurred on June 30, 2004. References herein to the "Original Participating Manufacturers" or "OPMs" mean, for the period prior to June 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard and for the period on and after June 30, 2004, collectively Philip Morris, Reynolds American and Lorillard. As reported by the OPMs, the OPMs accounted for approximately 86.4%[*] of the U.S. domestic cigarette market in 2007, based upon shipments.

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

[*] Market share information for the OPMs based on domestic industry shipments may be materially different from Relative Market Share for purposes of the MSA and the respective obligations of OPMs to contribute to Annual Payments and Strategic Contribution Payments. See "**SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Annual Payments**" herein. Additionally, aggregate market share information is based on information as reported by Loews Corporation (the parent corporation of Lorillard) and is different from that utilized in the bond structuring assumptions and may differ from the market share information as reported by the OPMs for purposes of their filings with the Securities and Exchange Commission. See "**SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION**" and "**CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY**" herein. The aggregate market share information used in the Cash Flow Assumptions may differ materially from the market share information used by MSA Auditor in calculating the adjustments to Annual Payments and Strategic Contribution Payments. See "**SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Adjustments to Payments**" herein.

"**SUMMARY OF THE MASTER SETTLEMENT AGREEMENT**" herein and Appendix B.

Litigation Regarding MSA and Related Statutes ..... Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (*Grand River and Freedom Holdings*) that are pending in the U.S. District Court for the Southern District of New York and two cases (*Xcaliber* and *A.B. Coker*) that are pending in the U.S. District Courts in Louisiana. All of these cases are described in "RISK FACTORS" herein. The State is a defendant in the *Grand River* case. The plaintiffs in those cases seek, *inter alia*, a determination that the MSA and the state statutes enacted pursuant to the MSA conflict with and are preempted by the federal antitrust laws and that the state statutes enacted pursuant to the MSA violate the Commerce Clause and other provisions of the U.S. Constitution. A determination that the MSA or state legislation enacted pursuant to the MSA is void or unenforceable could have a materially adverse effect on the payments by PMs under the MSA and the amount or the timing of receipt of 2006 Pledged TSRs available to the Authority to pay the Bond Obligation (as defined herein) of and interest, if any, on the Series 2008 Bonds and to make Turbo Redemptions (hereinafter defined), could lead to a decrease of the market value and/or liquidity of the Series 2008 Bonds, and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

Payments Pursuant to the MSA. Under the MSA, the OPMs are required to make the following payments to the Settling States; (i) five initial payments, all of which have been made (the "**Initial Payments**"), (ii) annual payments (the "**Annual Payments**") which are required to be made annually on each April 15, having commenced April 15, 2000, and continuing in perpetuity in the following base amounts (subject to adjustment as described herein):

Year	Base Amount†	Year	Base Amount†
2000	$4,500,000,000	2010	$8,139,000,000
2001	5,000,000,000	2011	8,139,000,000
2002	6,500,000,000	2012	8,139,000,000
2003	6,500,000,000	2013	8,139,000,000
2004	8,000,000,000	2014	8,139,000,000
2005	8,000,000,000	2015	8,139,000,000
2006	8,000,000,000	2016	8,139,000,000
2007	8,000,000,000	2017	8,139,000,000
2008	8,139,000,000	2018	9,000,000,000
2009	8,139,000,000	thereafter	9,000,000,000

and (iii) ten annual payments in the amount of $861 million (the "**Strategic Contribution Payments**"), each of which is subject to adjustment and required to be made on each April 15, and which commenced on April 15, 2008 and will end on April 15, 2017. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Annual Payments" and "— Strategic Contribution Payments"

Under the MSA, each OPM is required to pay an allocable portion of each Annual Payment and Strategic Contribution Payment based on its respective market share of the United States 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 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, which is required, in turn, pursuant to the instructions of the MSA Escrow Agreement, to remit an allocable share of such payments to the parties entitled thereto.

Under the MSA, the Annual Payments and Strategic Contribution Payments due are subject to numerous adjustments, some of which may be material. Such adjustments include, among others, reductions when a PM experiences a loss of market share to NPMs as a result of such PMs' participation in the MSA, reductions for decreased domestic cigarette shipments and to account for those states that settle or have settled their claims against the PMs

† As described herein, the base amounts of Annual Payments are subject to various adjustments which have resulted in reduced Annual Payments in all prior years. See "SUMMARY OF MASTER SETTLEMENT AGREEMENT — Annual Payments," "RISK FACTORS — Other Potential Payment Decreases Under the Terms of the Master Settlement Agreement — Disputed or Recalculated Payments" and "SUMMARY OF MASTER SETTLEMENT AGREEMENT — Annual Payments."

independently of the MSA and increases related to inflation in an amount of not less than 3% per year. See "RISK FACTORS."

Sale of Tobacco Settlement Revenues ..... Pursuant to the 2006 Purchase Agreement, the State sold to the Authority the 2006 Sold Tobacco Receipts. As a result, the Authority is entitled to receive 13.34% of the State's share of (i) all Annual Payments and Strategic Contribution Payments made by the PMs under the MSA on or after April 1, 2008, (ii) all lump sum and partial lump sum payments of tobacco settlement revenue, to the State whenever received, that are allocable to a payment that is payable on or after April 1, 2008 under the terms of the MSA by tobacco manufacturers, (iii) the State's right to receive the tobacco settlement revenue referred to in (i) and (ii). The Authority is also entitled to receive 13.34% of the State's share of any amounts withheld or deposited in the Disputed Payments Account, on or after April 1, 2008, by the tobacco manufacturers as a result of a dispute as to the amount of a payment required to be made by them under the MSA, and that are subsequently paid by the tobacco manufacturers or released from the Disputed Payments Account. The 2006 Sold Tobacco Receipts do not include any right to or interest in amounts withheld or deposited in the Disputed Payments Account before April 1, 2008. Under the Indenture, the Authority has assigned and pledged 100% of the 2006 Sold Tobacco Receipts to the Indenture Trustee as 2006 Pledged TSRs. Pursuant to the Indenture, in connection with the issuance of Additional Bonds or Refunding Bonds, from time to time the Authority may reduce the percentage of 2006 Pledged TSRs upon the satisfaction of certain conditions as more fully set forth under "SECURITY FOR THE BONDS" herein. The pledge will not be reduced in connection with the issuance of the Series 2008 Bonds, and the Authority has covenanted in the Indenture that so long as any Series 2008 Bonds are Outstanding under the Indenture, the Authority will not reduce the percentage of 2006 Sold Tobacco Receipts constituting 2006 Pledged TSRs.

The State will be issuing amended and restated irrevocable instructions in connection with the issuance of the Series 2008 Bonds, informing the MSA Escrow Agent that the 2006 Sold Tobacco Receipts were sold to the Authority and directing the MSA Escrow Agent to disburse the 2006 Pledged TSRs directly to the Indenture Trustee. Accordingly, the money to which the Authority is entitled does not pass through the State and is not subject to State appropriation.

A part of the purchase price paid by the Authority to the State under the 2006 Purchase Agreement consists of a security representing the right to receive 2006 Pledged TSRs and income of the Authority that is in excess of the Authority's requirements to pay various operating expenses, debt service (including mandatory redemptions of the Series 2008 Bonds), or required reserves with respect to the Series 2006 Bonds and the Series 2008 Bonds, and certain other amounts

and contractual rights pursuant to the 2006 Purchase Agreement (the "**Residual Certificate**"). The State owns the sole beneficial interest in the Residual Certificate.

Industry Overview ..... The three OPMs – Philip Morris, Reynolds American and Lorillard – are the largest manufacturers of cigarettes in the United States (based on 2007 domestic market share). The market for cigarettes is highly competitive and is characterized by brand recognition and loyalty. See "DOMESTIC TOBACCO INDUSTRY" herein.

Cigarette Consumption ..... As described in the Global Insight Consumption Report described below, domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980s and 1990s, falling to less than 400 billion cigarettes in 2003 and is estimated to have fallen to 368 billion cigarettes in 2007. A number of factors affect consumption, including, but not limited to, pricing, industry advertising, expenditures, health warnings, restrictions on smoking in public places, nicotine dependence, youth consumption, general population trends and disposable income. See APPENDIX A— "THE GLOBAL INSIGHT CONSUMPTION REPORT."

Global Insight Consumption Report ..... Global Insight (USA), Inc. ("**Global Insight**"), an international econometric and consulting firm has been retained on behalf of the Authority to forecast cigarette consumption in the United States from 2008 through 2058. Global Insight considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effects of the incidence of smoking among underage youth, and qualitative variables that captured the impact of anti-smoking regulations, legislation and health warnings. Global Insight found the following variables to be effective in building an empirical model of adult per capita cigarette consumption: real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places and the trend over time in individual behavior and preferences. Using data from 1965 to 2003 and an analysis of these variables, Global Insight constructed an empirical model of adult per capita cigarette consumption ("**CPC**") for the United States. Using standard multivariate regression analysis to determine the relationship between such variables and CPC along with Global Insight's standard adult population growth statistics and adjustments for non adult smoking, Global Insight projected adult cigarette consumption out to 2058. Global Insight's report, entitled "*A Forecast of U.S. Cigarette Consumption (2008-2058) for Michigan Tobacco Settlement Finance Authority*" (the "**Global Insight Consumption Report**"), is attached hereto as Appendix A and should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The Global Insight Consumption Report is subject to certain disclaimers and qualifications described in Appendix A.

While the Global Insight Consumption Report is based on United States cigarette consumption, MSA payments are computed based in part on cigarette shipments in or to the 50 United States, the District of Columbia and Puerto Rico. The Global Insight Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time. See "THE GLOBAL INSIGHT CONSUMPTION REPORT" herein. The projections and forecasts regarding future cigarette consumption included in the Global Insight Consumption Report are estimates which have been prepared on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of, and no representation or warranty should be inferred from, these projections and forecasts. Actual cigarette consumption will differ from projected cigarette consumption.

Interest ..... Interest on the outstanding principal amount of the Series 2008A Bonds will be payable on each June 1 and December 1, commencing December 1, 2008. Interest on the Series 2008B Bonds and the Series 2008C Bonds will accrete from the Closing Date and be compounded on December 1, 2008 and thereafter on each June 1 and December 1, and will be payable as part of the Accreted Value at the Maturity Date or earlier redemption. See APPENDIX F — "ACCRETED VALUE TABLE."

"Bond Obligation" means, as of any given date of calculation, (i) with respect to any Outstanding Current Interest Bond, the principal amount of such Current Interest Bond, and (ii) with respect to any Outstanding Capital Appreciation Bond or Convertible Capital Appreciation Bond prior to the Conversion Date, the Accreted Value thereof as of such date.

"**Distribution Date**" means each June 1 and December 1, commencing December 1, 2008, or, if such date is not a Business Day, the following Business Day, each additional Distribution Date selected by the Authority or the Indenture Trustee following a Payment Default, and each Distribution Date, to the extent so characterized in a Supplemental Indenture.

All interest on the Series 2008A Bonds payable on and prior to December 1, 2008 will be payable from the Capitalized Interest Subaccount. Interest on the Series 2008A Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. The Liquidity Reserve Account is available to pay interest on the Series 2008A Bonds when due. Failure to pay the full amount of interest on the Bonds when due is a Payment Default, which is an Event of Default. See "DEFINITIONS AND SUMMARY OF THE INDENTURE — Events of Default" in Appendix D.

Principal..... The principal of a Series 2008 Bond must be paid on the stated maturity date thereof (each, a "**Maturity Date**") in order to avoid a Payment Default as described herein. The amount of principal payable on the Series 2008A Bonds, and the Accreted Value of the Series 2008B Bonds and the Series 2008C Bonds on their respective Maturity Dates, is referred to herein as "**Principal**." **The ratings of the Series 2008 Bonds only address each Rating Agency's assessment of the ability of the Authority to pay interest when due and to pay the Principal of the Series 2008 Bonds on their respective Maturity Dates and do not address payment at any earlier time, whether from Sinking Fund Installments or Turbo Redemptions (as described below) or otherwise.** See "RATINGS."

Principal will be paid from Collections and, if necessary in connection with any Senior Bonds that are not Capital Appreciation Bonds, including the Series 2008A Bonds, the Liquidity Reserve Account. A failure by the Authority to pay the Principal of a Series 2008 Bond when due will constitute a Payment Default, which is an Event of Default under the Indenture.

Prior to a Payment Default, money in the Liquidity Reserve Account will not be available to make any payments on the Series 2008B Bonds or the Series 2008C Bonds (or any other Capital Appreciation Bonds issued pursuant to the Indenture).

"Payment Default" means an Event of Default that has occurred as a consequence of the Authority's failure to pay: (a) the Principal of or interest on any Senior Bond, when due or (b) payments (other than Termination Payments), when due, under an Interest Rate Exchange Agreement.

"**Senior Bonds**" means the Series 2008 Bonds and all other Bonds designated as Senior Bonds in the Series Supplement relating thereto.

Sinking Fund Installments..... The "**Sinking Fund Installments**" of the Series 2008 Bonds represent the amount of principal that the Authority will pay as of the specified Distribution Date (as defined herein) to the extent of available Collections as set forth in the schedules under "THE SERIES 2008 BONDS — Sinking Fund Installments" herein. Failure by the Authority to pay the Sinking Fund Installments of the Bonds when scheduled will not constitute an Event of Default. Amounts in the Liquidity Reserve Account will not be available to pay Sinking Fund Installments.

Turbo Redemptions..... **"Turbo Redemptions"** represent the requirement contained in the Indenture to apply 100% of all Collections which are in excess of Indenture requirements for, among other things, the periodic funding of Operating Expenses and the Debt Service Account and replenishment of the Liquidity Reserve Account (such excess, the

"**Surplus Collections**"), to the special mandatory par redemption of the Bonds commencing on June 1, 2008, and on each Distribution Date thereafter (each a "**Turbo Redemption Date**"), in ascending order of Sinking Fund Installments and Turbo Term Bond Maturities, subject to the Priority of Payment Rules described below. The Turbo Redemption of Series 2008 Bonds of a maturity will be applied *pro rata* within the maturity. Turbo Redemptions are not scheduled amortization payments and are only required to be made from Surplus Collections, if any. Amounts in the Liquidity Reserve Account are not available to make Turbo Redemptions. **The ratings of the Series 2008 Bonds do not reflect any assessment by the Rating Agencies of the probability, timing or amount of Turbo Redemptions.**

Priority of Payments ..... **So long as no Payment Default has occurred, the Series 2006A Bonds are entitled to receive payments from Collections of their Bond Obligation, whether by Sinking Fund Installments, Turbo Redemption or otherwise, prior to the payment of any Bond Obligation due on the Series 2008A Bonds, the Series 2008B Bonds or the Series 2008C Bonds; the Series 2008A Bonds are entitled to receive payment from Collections of their Bond Obligation, whether by Sinking Fund Installments, Turbo Redemption or otherwise, prior to the payment of any Bond Obligation due on the Series 2008B Bonds or the Series 2008C Bonds; and the Series 2008B Bonds are entitled to receive payment from Collections of their Bond Obligation, whether by Turbo Redemption or otherwise, prior to payment of any Bond Obligation due on Series 2008C Bonds. The rules described in this section are hereinafter referred to as the "Priority of Payment Rules".**

Payment of the Bonds ..... So long as no Payment Default has occurred, all payments of the Bond Obligation of the Bonds made from Collections will be credited against Sinking Fund Installments and Turbo Term Bond Maturities in chronological order and in order of their priority, as more fully described in the Indenture. The Liquidity Reserve Account is available to pay the Principal of the Series 2008A Bonds on their respective Maturity Dates. Failure to pay the Principal of a Bond on its Maturity Date will constitute a Payment Default, which is an Event of Default under the Indenture, in which case all future payments will be made on a Pro Rata basis. "**Pro Rata**" means, for an allocation of available amounts to any payment of interest, Accreted Value, principal or payments under an Interest Rate Exchange Agreement to be made pursuant to the Indenture, the application of a fraction to such available amounts (a) the numerator of which is equal to the amount due to the respective Holders and any party who has entered into an Interest Rate Exchange Agreement with the Authority to whom such payment is owing, and (b) the denominator of which is equal to the total amount due to all Holders and counterparties to whom such payment is owing.

A Bond will be deemed "**Fully Paid**" only if: (i) such Bond has been canceled by the Indenture Trustee or delivered to the Indenture Trustee for cancellation; or (ii) such Bond will have matured or been called for redemption and, on such Maturity Date or redemption date, money for the payment of the Bond Obligation of, redemption premium, if any, and interest on such Bond is held by the Indenture Trustee in trust for the benefit of the person entitled thereto; or (iii) such Bond is alleged to have been lost, stolen, destroyed, partially destroyed, or defaced and has been replaced as provided in the Indenture; or (iv) such Bond has been defeased as provided in the Indenture (whether as part of a defeasance of all or less than all of the Bonds).

Limitation on Open Market Purchases..... Money in the Pledged Accounts may not be used to make open market purchases of the Bonds.

Actual Payment of Principal..... Due to a number of factors, including actual shipments of cigarettes in the United States, the amount of available Collections may fluctuate from year to year. As a result, Collections received by the Authority may be insufficient to pay Principal or sufficient to pay Principal but insufficient for Sinking Fund Installments or Turbo Redemptions. In either event, the Authority will have no obligation to make Sinking Fund Installments or Turbo Redemptions beyond the amount of available Collections. **If there are no Surplus Collections, failure to make Turbo Redemptions is not an Event of Default**. A failure by the Authority to pay the Principal of a Bond on its applicable Maturity Date will constitute a Payment Default, which is an Event of Default under the Indenture.

Optional Redemption of the Series 2008A Bonds..... The Series 2008A Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid, but as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2018, from any Maturity Date selected by the Authority in its discretion and in either case (x) if redeemed in part, in accordance with DTC's standard procedures, or if such Bonds are not then held by DTC or another Securities Depository, on such basis as the Trustee deems fair and appropriate, including by lot, within a Maturity Date; and (y) at a redemption price equal to 100% of the Principal being redeemed, plus interest accrued to the date fixed for redemption.

"**Projected Turbo Redemption**" means, for a Series of Bonds, each respective Turbo Redemption projected to be made in accordance with the Indenture and the Bond structuring assumptions and methodology set forth under "SUMMARY OF BOND

STRUCTURING ASSUMPTIONS AND AMORTIZATION". See "THE SERIES 2008 BONDS — Turbo Redemptions" herein for the schedule of Projected Turbo Redemptions.

Optional Redemption of the Series 2008B Bonds ..... The Series 2008B Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), on a pro rata basis, at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid but, as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2018, at a redemption price equal to 100% of the Accreted Value being redeemed on the date fixed for redemption.

Optional Redemption of the Series 2008C Bonds ..... The Series 2008C Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid but, as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2033, from any Maturity Date selected by the Authority in its discretion and in either case (x) if redeemed in part, in accordance with DTC's standard procedures, or if such Bonds are not then held by DTC or another Securities Depository, on such basis as the Trustee deems fair and appropriate, including by lot, within a Maturity Date; and (y) at a redemption price equal to 100% of the Accreted Value being redeemed on the date fixed for redemption.

Redemption of Defeased Bonds . In the event of a full or partial defeasance of the Series 2008 Bonds, the defeasance escrow will be structured to redeem the Series 2008 Bonds in accordance with the Projected Turbo Schedule until the date fixed for any optional redemption of the Series 2008 Bonds.

Mandatory Clean-up Calls..... The Outstanding Senior Bonds that are not Capital Appreciation Bonds, including the Series 2008A Bonds, are subject to mandatory redemption in whole at a redemption price equal to 100% of the Bond Obligation being redeemed, plus interest accrued, if any, to the date fixed for redemption, at any time that the available amounts on deposit in the Liquidity Reserve Account equal or exceed the Bond Obligation of, and accrued interest, if any, on all such Outstanding Senior Bonds that are not Capital Appreciation Bonds.

The Bonds are subject to mandatory redemption in whole at a redemption price equal to 100% of the Bond Obligation being redeemed, plus interest accrued to the date fixed for redemption, at any time that the available amounts on deposit in the Pledged Accounts equal or exceed the aggregate Bond Obligation of, and

accrued interest on, all Outstanding Bonds and Parity Payments (each such mandatory redemption, a "**Mandatory Clean-Up Call**").

Liquidity Reserve Account..... Upon the Delivery Date of the Series 2008 Bonds, the reserve account (the "**Liquidity Reserve Account**") will remain funded at its required level of $38,801,532.39 (the "**Liquidity Reserve Requirement**"), which level is required to be maintained for so long as any Series 2008A Bonds, Series 2006A Bonds, or any other Senior Bonds (other than Capital Appreciation Bonds) remain Outstanding. However, the Liquidity Reserve Requirement may be amended by the Authority in connection with the issuance of Refunding Bonds or Additional Bonds.

Prior to a Payment Default, amounts on deposit in the Liquidity Reserve Account will be available to pay the Principal of and interest on the Series 2008A Bonds, the Series 2006A Bonds and any other Senior Bonds that are not Capital Appreciation Bonds to the extent Collections are insufficient for such purpose.

Amounts in the Liquidity Reserve are not available prior to a Payment Default, to pay the Accreted Value of the Series 2008B Bonds or the Series 2008C Bonds or any other Capital Appreciation Bonds. After a Payment Default, money in the Liquidity Reserve Account will be available to pay the Bond Obligation of and interest on all Senior Bonds, including Capital Appreciation Bonds and Convertible Capital Appreciation Bonds. Amounts in the Liquidity Reserve Account will not be available to make Sinking Fund Installments or Turbo Redemptions on any Bonds. Unless a Payment Default has occurred, amounts withdrawn from the Liquidity Reserve Account will be replenished from Collections as described herein.

If a Payment Default has not occurred, money in the Liquidity Reserve Account will be applied to the redemption of Outstanding Bonds in accordance with the provisions described under the heading "THE SERIES 2008 BONDS — Mandatory Clean-Up Calls." Any money remaining in the Liquidity Reserve Account after its application in accordance with the Mandatory Clean-Up Call provisions will be transferred to the Turbo Redemption Account and applied on the succeeding Distribution Date to the Turbo Redemption of any Turbo Term Bonds then Outstanding.

The Indenture provides that, upon Rating Confirmation and with an opinion of nationally recognized bond counsel, if any Tax-Exempt Bonds are Outstanding, the Authority may replace amounts and investments held in the Liquidity Reserve Account with sureties and other "**Cash Equivalents**" (as defined in the Indenture) and then transfer such replaced amounts to the Unencumbered TSR Account, free and clear of the lien of the Indenture. The Authority has covenanted in the Indenture that, so long as any Series 2008 Bonds are outstanding, it will not use a Cash Equivalent for deposit to the

Liquidity Reserve Account to satisfy the Liquidity Reserve Requirement.

Bond Structuring Assumptions and Methodology..... The Series 2008 Bonds were structured on the basis of forecasts, which themselves are based on assumptions, as described herein. Among these are a forecast of United States cigarette consumption contained in the Global Insight Consumption Report and the application of certain adjustments and offsets to payments to be made by the PMs pursuant to the MSA, as well as a forecast of the 2006 Pledged TSRs, the balances in the Pledged Accounts and all earnings on amounts on deposit in the Pledged Accounts. In addition, such assumptions and forecasts were used to project amounts expected to be available to make Turbo Redemptions and the resulting expected average lives of the Series 2008 Bonds.

No assurance can be given, however, that events will occur in accordance with such assumptions and forecasts. Any deviations from such assumptions and forecasts could materially and adversely affect the payment of the Series 2008 Bonds. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

Distributions and Priorities..... Promptly upon receipt, the Indenture Trustee will deposit all 2006 Pledged TSRs in an account established under the Indenture and maintained by the Indenture Trustee (the "**Collection Account**"). Unencumbered TSRs, if any, will be deposited in the Unencumbered TSR Account and may be used by the Authority for any lawful purpose. All Collections that have been identified by an Officer's Certificate as consisting of Partial Lump Sum Payments received by the Indenture Trustee will be promptly (and, in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Partial Lump Sum Payment Account in accordance with the instructions received by the Indenture Trustee pursuant to an Officer's Certificate. All Collections that have been identified by an Officer's Certificate as consisting of Total Lump Sum Payments received by the Indenture Trustee will be promptly (and, in any event, no later than the Business Day immediately preceding the next Distribution Date) applied in the manner described under "*Distribution Date Transfers*" below.

Not later than on each Distribution Date, the Indenture Trustee will deposit in the Collection Account and apply as described below under "*Transfers to Accounts*" all Collections consisting of investment earnings on amounts on deposit with the Indenture Trustee in the Pledged Accounts (excluding amounts in the Partial Lump Sum Payment Account), except that, unless otherwise specified in a Series Supplement relating to a Series of Bonds, (i) all amounts in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement determined to exist pursuant to the valuation procedure described in the Indenture will be transferred to the Debt

Service Account (except as otherwise provided in the Indenture) and (ii) prior to December 1, 2008, all investment earnings in the Capitalized Interest Subaccount not required on such Distribution Date for payment of the interest on Outstanding Senior Bonds will be retained in the Capitalized Interest Subaccount.

"**Lump Sum Payment**" means a final payment from a PM that results in, or is due to, a release of that PM from all of its future payment obligations under the MSA. Any Lump Sum Payment will be applied as Collections. The term "Lump Sum Payment" does not include any payments that are Partial Lump Sum Payments, Total Lump Sum Payments or any non-scheduled prepayments other than a Lump Sum Payment described in the first sentence of this definition.

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

"**Pledged Accounts**" are certain accounts established and maintained by the Indenture Trustee pursuant to the Indenture, including the Collection Account, the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account, and the Turbo Redemption Account, and all subaccounts contained in the named accounts including the Capitalized Interest Subaccount within the Debt Service Account.

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

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

Transfers to Accounts. As soon as is practicable, but in any event no later than the earlier of (x) the fifth Business Day following each Deposit Date, or (y) the Distribution Date following each Deposit Date, the Indenture Trustee shall withdraw the funds on deposit in the Collection Account and transfer such amounts as follows:

(i) to the Operating Account, an amount sufficient to cause the amount therein to equal the amount specified by an Officer's Certificate in order to pay, for the twelve-month period applicable to such Officer's Certificate, (x) the Operating Expenses and Termination Payments to the extent that the amount thereof does not exceed the Operating Cap[*], (y) the Tax Obligations, and (z) Priority Payments;

[*] The "**Operating Cap**" is $200,000 in the Fiscal Year ending September 30, 2006 and adjusted for inflation in subsequent Fiscal Years by the greater of 3% or the percentage increase in the Consumer Price Index for all urban consumers as published by the Bureau of Labor Statistics for the prior year. In addition, the Operating Cap includes amounts required in the applicable Fiscal Year for Tax Obligations and Priority Payments.

(ii) to the Debt Service Account, an amount sufficient to cause the amount therein (taking into account any amounts already on deposit in the Capitalized Interest Subaccount or the Debt Service Account) to equal the sum of (x) interest at the stated rate on Outstanding Fixed Rate Bonds, plus (y) interest at the Applicable Periodic Rate on Outstanding Indexed Floating Rate Bonds through the next Distribution Date, and thereafter, at the Assumed Rate to the next succeeding Distribution Date, and all Parity Payments that will come due (i) in the next succeeding Bond Year, if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, or (ii) in the then-current Bond Year, if the Deposit Date is on or after June 1 and on or before November 30 of any Bond Year, plus (z) any such unpaid interest on the Outstanding Current Interest Bonds and all Parity Payments from prior Distribution Dates (including interest at the stated rate or Applicable Periodic Rate on such unpaid interest, to the extent legally permissible); and the amounts to be so deposited will be calculated assuming that the Bond Obligation of the Outstanding Current Interest Bonds will have been paid as described in clauses (ii), (iii), (iv) and (v) of "*Distribution Date Transfers"* below;

(iii) to the Debt Service Account, an amount sufficient to cause the amount therein to equal the amount specified in clause (ii) above plus the sum of (a) if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, the Serial Bond maturity, Sinking Fund Installment or Term Bond maturities (including Turbo Term Bond Maturities) due in or scheduled for the next succeeding Bond Year, plus (b) any such Serial Bond maturities, Sinking Fund Installment or Term Bond maturities (including Turbo Term Bond Maturities) unpaid from prior Distribution Dates, but the amount of each Sinking Fund Installment will first be adjusted as described under "*Distribution Date Transfers"* below;

(iv) unless a Payment Default has occurred, to the Liquidity Reserve Account an amount sufficient to cause the amount on deposit therein to equal the Liquidity Reserve Requirement. However, if on any Distribution Date on which the amount in the Liquidity Reserve Account (less any amount necessary to be paid in connection with the liquidation of the investment of amounts in the Liquidity Reserve Account, including a Termination Payment) equals or exceeds the Bond Obligation of and interest on all Outstanding Senior Bonds other than Capital Appreciation Bonds, the amount in the Liquidity Reserve Account will be transferred to the Turbo Redemption Account and applied to the Turbo Redemption of all Outstanding Senior Bonds other than Capital Appreciation Bonds, and then of all remaining Outstanding Senior Bonds;

(v) to the Operating Account, the amount, if any, necessary to make the amount therein equal to the amount specified by the Officer's Certificate delivered pursuant to the Indenture in order to

pay, for the twelve-month period applicable to such Officer's Certificate, the Operating Expenses and Termination Payments, if any, in excess of the Operating Cap;

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

(vii) to the Turbo Redemption Account, all amounts remaining in the Collection Account (the **"Surplus Collections"**).

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

"**Deposit Date**" means the date of actual receipt by the Indenture Trustee of any Collections.

"**Operating Expenses**" means the reasonable operating expenses of the Authority, including without limitation, the cost of preparation of accounting and other reports, costs of maintenance of the ratings on the Bonds, insurance premiums, and costs of Authority meetings or other required activity of the Authority, counsel fees, including the fees of the Attorney General of the State, and fees and expenses incurred for consultants and fiduciaries, all costs and expenses incurred by the State and other amounts which are required to be reimbursed or borne by the Authority pursuant to the 2006 Purchase Agreement, and all other Operating Expenses so identified in the Indenture.

"Parity Payments" means payments under an Interest Rate Exchange Agreement not to exceed the applicable Maximum Rate, but does not include any payments under any other Ancillary Facility.

"**Priority Payments**" means fees payable pursuant to Ancillary Facilities that are identified by the Indenture or a Series Supplement as Priority Payments, which will not include payments of or in lieu of interest, Principal, redemption price or purchase price of Bonds.

"**Tax Obligations**" means, with respect to the issuance of Tax-Exempt Bonds, if any, the rebate requirement and any penalties, fines, or other payments required to be made to the United States of America under the arbitrage or rebate provisions of the Internal Revenue Code of 1986, as amended (the "**Code**").

"**Termination Payment"** means any payment made by the Authority with respect to a loss under or the termination of an Interest Rate Exchange Agreement, investment agreement or forward purchase agreement relating to an Account.

"**Turbo Term Bond Maturity**" means the principal payment required to be made upon the final maturity of any Turbo Term Bond, as set forth in the Series Supplement.

Distribution Date Transfers. Unless a Payment Default has occurred and continues, on each Distribution Date the Indenture Trustee is to apply amounts in the various Accounts in the following order of priority:

(i) from the Capitalized Interest Subaccount, the Debt Service Account, the Partial Lump Sum Payment Account, and the Liquidity Reserve Account, in that order, to pay interest at the stated rate on Outstanding Fixed Rate Bonds, interest at the Applicable Periodic Rate on Outstanding Indexed Floating Rate Bonds and all Parity Payments due on such Distribution Date;

(ii) from the Debt Service Account and the Partial Lump Sum Payment Account, in that order, to pay, in the following order, the Serial Bond maturities, if any, Sinking Fund Installments, and parity Term Bond maturities (including Turbo Term Bond Maturities) due on or scheduled for such Distribution Date, provided that (a) the amount of such Sinking Fund Installment first has been adjusted as described in the Indenture, and (b) the Indenture Trustee will not pay a Sinking Fund Installment or a Term Bond maturity (including Turbo Term Bond Maturities) unless the Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date, such interest to be calculated at the stated rate on Outstanding Fixed Rate Bonds and at the Assumed Rate on Outstanding Indexed Floating Rate Bonds through the next succeeding Distribution Date;

(iii) from the Liquidity Reserve Account first to pay the Serial Bond maturities, if any, and Turbo Term Bond Maturities due on or scheduled for such Distribution Date or unpaid from prior Distribution Dates, provided that (a) the amount of such Turbo Term Bond Maturities will first have been adjusted as described in the Indenture and (b) the Indenture Trustee may not pay a Turbo Term Bond Maturity pursuant to this paragraph unless the Liquidity Reserve Account will, after giving effect to such payment, contain sufficient funds to pay interest due on the next succeeding Distribution Date, such interest to be calculated at the stated rate on Outstanding Fixed Rate Bonds and at the Assumed Rate on Outstanding Indexed Floating Rate Bonds through the next succeeding Distribution Date, and then to reimburse the provider of any Eligible Investment provided in lieu of or in substitution for amounts in the Liquidity Reserve Account for any payment under or draw on such investment for a purpose for which the Liquidity Reserve Account is otherwise available;

(iv) from the Turbo Redemption Account, to redeem Turbo Term Bonds on such Distribution Date; and

(v) from the Partial Lump Sum Payment Account, but only as directed in an Officer's Certificate delivered by the Authority and accompanied by Rating Confirmation, to redeem Turbo Term Bonds on such Distribution Date in accordance with the Indenture.

Upon the occurrence of a Payment Default, on each Distribution Date commencing with the Distribution Date following a Payment Default, the Indenture Trustee will apply all Collections and funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account, and the Turbo Redemption Account to pay Pro Rata, first, the accrued interest on the Bonds and all Parity Payments (including, in each case, interest at the stated rate or Applicable Periodic Rate on any unpaid interest, to the extent legally permissible) and, second, the Bond Obligation of all Bonds then Outstanding in their order of priority. For purposes of the clause "first" in this paragraph, from and after its Maturity Date, a Capital Appreciation Bond will accrue interest at a rate per annum equal to the Default Rate therefor set forth in the Series Supplement authorizing the issuance of such Capital Appreciation Bonds.

Upon the receipt of a sum that has been identified by an Officer's Certificate as a Total Lump Sum Payment, the Indenture Trustee shall after making provision for the amounts required to be deposited pursuant to clause (i) of "*Transfers to Accounts"* above, and giving notice of redemption, use all remaining proceeds of such Total Lump Sum Payment to pay Pro Rata, first, the accrued interest on the Bonds and Parity Payments (including interest at the stated rate or Applicable Periodic Rate on any unpaid interest, to the extent legally permissible) and, second, the Bond Obligation of all Bonds then Outstanding in their order of priority.

After making all deposits and payments set forth above, and provided that there are no Outstanding Bonds and no obligations to make payments under an Ancillary Facility, the Indenture Trustee is to deliver any amounts remaining to the holder of the Residual Certificate.

Payment Default..... Upon the occurrence of a Payment Default, all available funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Turbo Redemption Account will be applied to pay first, accrued interest to the date of payment for all Senior Bonds, and second, the principal or, in the case of Capital Appreciation Bonds, the Accreted Value of Outstanding Bonds which will be due and payable and will be paid, in whole or in part on each Distribution Date, Pro Rata among maturities and *pro rata* within a maturity. For a description of Payment Defaults and other Events of Default under the Indenture, see APPENDIX D — "DEFINITIONS AND SUMMARY OF THE INDENTURE — *Events of Default*."

Failure to make any Turbo Redemption or Sinking Fund Installment does not constitute an Event of Default unless Collections were sufficient and available for their payment.

Refunding Bonds and Additional Bonds..... Subsequent to the issuance of the Series 2006 Bonds, additional Series of Bonds (each a "**Series**"), including the Series 2008 Bonds, may be issued either as **"Refunding Bonds"** or as "**Additional Bonds**" at the discretion of the Authority but only if upon the issuance of such Refunding Bonds or Additional Bonds: (A) the amount on deposit in the Liquidity Reserve Account following the issuance of the Refunding Bonds or Additional Bonds will be at least equal to the Liquidity Reserve Requirement; (B) no Event of Default has occurred and is continuing after the date of issuance of such Bonds; (C) the expected weighted average life of each Turbo Term Bond that will remain Outstanding after issuance of the Refunding Bonds or Additional Bonds as computed on the basis of new projections on the date of sale of the Refunding Bonds or Additional Bonds will not exceed (x) the remaining expected weighted average life of each such Turbo Term Bond as computed by the Authority on the basis of new projections, assuming that no such Refunding Bonds or Additional Bonds are issued, plus (y) one year; and (D) a Rating Confirmation is received for any Bonds that will remain Outstanding after the date of issuance of the Additional Bonds or Refunding Bonds which are then rated by a Rating Agency. Refunding Bonds may also be issued under the Indenture to refund all Outstanding Bonds in whole without satisfaction of any of the foregoing conditions.

Pledged TSR Percentage ..... The Authority has reserved the right to reduce the percentage of the 2006 Sold Tobacco Receipts that will constitute the 2006 Pledged TSRs. However, such reduction may only be made in connection with the issuance of Refunding Bonds or Additional Bonds and upon satisfaction of the conditions to the issuance of Refunding Bonds and Additional Bonds more fully described under "THE SERIES 2008 BONDS — Refunding Bonds and Additional Bonds." The pledge will not be reduced in connection with the issuance of the Series 2008 Bonds, and the Authority has covenanted in the Indenture that so long as any Series 2008 Bonds are Outstanding under the Indenture, the Authority will not reduce the percentage of 2006 Sold Tobacco Receipts constituting 2006 Pledged TSRs.

Subordinate Bonds..... One or more Series of Bonds (the "**Subordinate Bonds)**" may be issued for any purpose by the Authority if there is no payment permitted for such bonds until all then outstanding Bonds are Fully Paid. Subordinate Bonds may be issued without satisfying the requirements of the Indenture relating to Additional Bonds and Refunding Bonds.

Covenants of the State and the Authority..... The State has covenanted in the 2006 Purchase Agreement that it (i) will diligently enforce the provisions of the Qualifying Statute, (ii) will enforce the Authority's right to receive the 2006 Pledged TSRs to the full extent permitted by the MSA; (iii) will not amend the MSA in a way that would materially alter the rights of the Bondholders or of those persons and entities that enter into contracts with the Authority; (iv) will not limit or alter the rights of the Authority to fulfill the terms of its agreements with such Bondholders; (v) will not in any way impair the rights and remedies of Bondholders or the security for the Bonds or Ancillary Facilities, or (vi) will not amend, supersede, or repeal the Qualifying Statute in any way that would materially adversely affect the amount of any payment to or materially impair the rights of the Authority or the Bondholders, until the Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Bondholders, are fully paid and discharged. Pursuant to the Indenture, the Authority has pledged and assigned to the Indenture Trustee the Authority's rights and remedies with respect to any breach by the State of any of its covenants, obligations, representations and warranties under the 2006 Purchase Agreement. In addition, the Authority has affirmatively covenanted and agreed in the Indenture to take such action as is necessary or advisable to protect the Collateral, including action to enforce the terms of the 2006 Purchase Agreement, including without limitation the State covenants therein as set forth above. Failure of the Authority to take such actions to enforce the 2006 Purchase Agreement (after notice and an opportunity to cure), including without limitation the State's covenants above, constitutes an Event of Default under the Indenture.

The Authority and the State have each covenanted not to impair the exclusion of interest on the Series 2008 Bonds from gross income for federal income tax purposes. The Authority and the Bondholders may only seek injunctive relief to enforce, or an order to compel specific performance of the covenants of the State contained in the 2006 Purchase Agreement. See "THE INDENTURE" for a summary of the covenants made by the Authority and "THE 2006 PURCHASE AGREEMENT" for a summary of the covenants made by the State.

Ratings ..... The ratings for the Series 2008 Bonds address only (i) the payment of interest on the Series 2008 Bonds when due, and (ii) the payment of Principal of the Series 2008 Bonds by their respective Turbo Term Bond Maturity Dates. The ratings do not address the payment of Sinking Fund Installments or Turbo Redemptions. The Turbo Term Bond Maturities of the Series 2008 Bonds were structured to produce cash flow stress test performance necessary for the Authority to achieve the targeted credit ratings. A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may

be subject to revision or withdrawal at any time. See "RATINGS" herein.

Risk Factors..... Reference is made to "RISK FACTORS" herein for a description of certain considerations relevant to an investment in the Series 2008 Bonds.

Legal Considerations ..... Reference is made to "LEGAL CONSIDERATIONS" herein for a description of certain legal issues relevant to an investment in the Series 2008 Bonds.

Tax Matters…….. ..... In the opinion of the Attorney General of the State of Michigan and in the opinion of Co-Bond Counsel, subject to compliance with certain covenants, under existing law, the interest on the Series 2008A Bonds and the Series 2008C Bonds (1) is excluded from gross income for federal income tax purposes, (2) is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations but is included in the adjusted current earnings of certain corporations for purposes of computing the federal alternative minimum tax imposed on such corporations, and (3) is excluded from taxable income for purposes of the State of Michigan personal income tax. See "TAX MATTERS — The Series 2008A Bonds and the Series 2008C Bonds" herein.

In the opinion of the Attorney General of the State of Michigan and in the opinion of Co-Bond Counsel, under existing law, interest on the Series 2008B Bonds is included in gross income for federal income tax purposes and the Series 2008B Bonds and the interest thereon are not exempt from taxation by the State of Michigan or any political subdivision thereof. The Attorney General of the State of Michigan and Co-Bond Counsel express no opinion regarding any other tax consequence related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2008B Bonds. See "TAX MATTERS — The 2008B Bonds."

ERISA ..... Fiduciaries and other persons investing "plan assets" of employee benefit or other plans subject to the Employees Retirement Income Security Act of 1974, as amended ("ERISA") or Section 4975 of the Internal Revenue Code of 1986, as amended (each, a "Plan") should consider the fiduciary investment standards and prohibited transaction rules of ERISA and Section 4975 of the Code before authorizing an investment of "plan assets" of any Plan in the Series 2008B Bonds. Subject to these considerations, the Series 2008B Bonds are eligible for purchase by persons investing assets of a Plan.

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 and the 2006 Purchase Agreement may be obtained by

written request from the Indenture Trustee at 719 Griswold Street, Detroit, Michigan 48226, Attention: Institutional Trust Services. Any statements in this Offering Circular involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Offering Circular is not to be construed as a contract or agreement among the Authority, the State and the Bondholders.

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$202,408,464.40
Michigan Tobacco Settlement Finance Authority
Tobacco Settlement Asset-Backed Bonds, Series 2008

$114,860,000 Series 2008A
Current Interest Turbo Term Bonds

$29,874,650.00 Series 2008B
Taxable Capital Appreciation Turbo Term Bonds

$57,673,814.40 Series 2008C Bonds
Capital Appreciation Turbo Term Bonds

SOURCES AND USES OF PROCEEDS

The sources and uses of proceeds of the Series 2008 Bonds, together with other available funds, are set forth below:

Sources of Funds:

Sale Proceeds of Series 2008 Bonds	$202,408,464.40
Release from Debt Service Account	3,343,632.53
	$205,752,096.93

Uses of Funds:

Deposit to the State's General Fund	$ 60,000,000.00
Deposit to Refunding Escrow and Open Market Purchase	138,560,320.43
Deposit to Capitalized Interest Subaccount	2,131,272.00
Costs of Issuance[(1)]	1,751,387.90
Original Issue Discount	3,309,116.60
Total	$205,752,096.93

(1) Costs of issuance include underwriters' discount, legal fees, rating agency fees, econometric consultant fees, printing costs and certain other expenses related to the issuance of the Series 2008 Bonds.

OPEN MARKET PURCHASE OF SERIES 2006C BONDS

The Authority has authorized Citigroup Global Markets Inc. as the Broker-Dealer (the **"Broker-Dealer"**) to act on its behalf to negotiate the purchase of outstanding Series 2006C Bonds. The Authority's purpose in offering to purchase the Series 2006C Bonds, and to retire the Series 2006C Bonds that are purchased, is to achieve a debt restructuring and optimal structure. The purchase of all outstanding Series 2006C Bonds is not a condition to the offer to purchase any Series 2006C Bonds, and the Authority's decision to refund Series 2006C Bonds is not conditioned on the purchase of all outstanding Series 2006C Bonds. The purchase price offered was based on several factors, which were applied at the time of pricing the Bonds on June 26, 2008. The CUSIP** for the Series 2006C Bonds is 594751AC3.

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Confirmations to holders of Series 2006C Bonds were delivered on the date of the execution of a bond purchase agreement between the Authority and the underwriters of the Bonds. Holders of Series 2006C Bonds who agree to sell Series 2006C Bonds to the Broker-Dealer received a confirmation providing for settlement on the date of delivery of the Series 2008 Bonds, expected to be on or about July 7, 2008. The Authority has directed the Trustee, in its capacity as Escrow Agent, to purchase Series 2006C Bonds from the proceeds of the Series 2008 Bonds, and the Series 2006C Bonds purchased will be cancelled. Amounts held under the Indenture will not be used to purchase Series 2006C Bonds.

The offer to purchase outstanding Series 2006C Bonds is conditioned upon the issuance of the Series 2008 Bonds. In the event that delivery of all of the Series 2008 Bonds does not occur on or about July 7, 2008, the offer shall be deemed to be rescinded.

RISK FACTORS

The Series 2008 Bonds differ from many other tax-exempt securities in a number of respects. Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2008 Bonds as well as other information contained in this Offering Circular. The following discussion of risks is not meant to be a complete list of the risks associated with the purchase of the Series 2008 Bonds and the order of presentation does not necessarily reflect the relative importance of the various risks. Potential purchasers of the Series 2008 Bonds are advised to consider the following factors, among others, and to review the other information in this Offering Circular in evaluating the Series 2008 Bonds. Any one or more of the risks discussed, and others, could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds, or, in certain circumstances, could lead to a complete loss of a Bondholder's investment. There can be no assurance that other risk factors will not become material in the future.

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation

General Overview. Certain smokers, consumer groups, cigarette importers, cigarette wholesalers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have instituted lawsuits against various PMs, certain of the Settling States and other public entities challenging the MSA and/or the Qualifying Statutes and related legislation. One or more of the lawsuits, several of which remain pending, allege, among other things, that the MSA and/or the Qualifying Statutes and related legislation are void or unenforceable under the Commerce Clause and certain other provisions of the U.S. Constitution and the federal antitrust laws, as described below under *"Grand River, Freedom Holdings and Related Cases"* and *"Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation"* in this subsection. In addition, some of the lawsuits allege that the MSA and/or related state legislation are void or unenforceable under the federal civil rights laws, state constitutions, consumer protection laws, and unfair competition laws. Certain of these lawsuits seek, and, if ultimately successful, could result in, a determination that the MSA and/or the Qualifying Statutes and related legislation are void or unenforceable. Certain of the lawsuits further seek, among other things, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA. 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. The State, by way of example, in the case of *Cutting Edge Enterprises Inc. v.*

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convenience of Bondholders only at the time of issuance of the Bonds and the Authority and Underwriters do not make any representation with respect to such numbers or undertake any responsibility for their accuracy now or at any time in the future.

National Association of Attorneys General, was a defendant along with other state attorneys general in an action in federal court in the Southern District of New York where a PM sought to cause the National Association of Attorneys General and the respective states to list the PM's brands which had been purchased from an NPM on their respective web sites, alleging that their refusal to do so violates federal antitrust laws, the Commerce Clause, and laws prohibiting tortious interference with business relations. The court dismissed this case on March 6, 2007 for lack of personal jurisdiction. To date, challenges to the MSA or related state legislation have not been ultimately successful, although three such challenges (the *Grand River* and *Freedom Holdings* cases in federal court in New York, and the *Xcaliber* case in federal court in Louisiana, all of which are discussed below) have survived initial appellate review of motions to dismiss. Moreover, these three cases and the *A.B. Coker* case in federal court in Louisiana (discussed below) are the only cases challenging the MSA or related legislation that have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact based on extrinsic evidence as to the operation and impact of the MSA and the related statutes. In *Grand River* and *Freedom Holdings*, certain decisions by the U.S. Court of Appeals for the Second Circuit have created heightened uncertainty as a result of that court's interpretation of federal antitrust immunity and Commerce Clause doctrines as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by other courts, which have rejected challenges to the MSA and related statutes. Prior district court and appellate court decisions in Circuits other than the Second Circuit rejecting such challenges (in the Third, Fourth, Fifth, Sixth, Ninth and Tenth Circuits) have concluded that the MSA and related statutes do not violate the Commerce Clause of the U.S. Constitution and/or are protected from antitrust challenges based on established antitrust immunity doctrines. In addition, proceedings are pending or on appeal in certain other cases, including two challenges by certain NPMs in federal court in Louisiana. One case (*Xcaliber*) alleges *inter alia*, that the Louisiana Allocable Share Release Amendment violates the rights of free speech, due process of law, and equal protection of the laws guaranteed under the U.S. Constitution and the Louisiana Constitution and the federal antitrust laws. On March 1, 2006, the U.S. Court of Appeals for the Fifth Circuit vacated the district court's dismissal of the plaintiffs' complaint in this case and remanded the case for reconsideration. The other case (*A.B. Coker*) alleges that the MSA and Louisiana's Complementary Legislation are violations of the Commerce Clause, Due Process Clause and First Amendment of the U.S. Constitution and the Federal Cigarette Labeling and Advertising Act. See "*Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" in this subsection. The MSA and related state legislation may also continue to be challenged in the future. A determination by a court having jurisdiction over the State and the Authority that the MSA or related State legislation is void or unenforceable (a) could have a materially adverse effect on the payments by the PMs under the MSA and the amount and/or the timing of 2006 Pledged TSRs available to the Authority, (b) could lead to a decrease in the market value and/or liquidity of the Series 2008 Bonds, and (c) in certain circumstances could lead to a complete loss of a Bondholder's investment. 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 2008 Bonds. See "LEGAL CONSIDERATIONS" herein.

Qualifying Statute and Related Legislation. Under the MSA's NPM Adjustment, downward adjustments may be made to the Annual Payments and Strategic Contribution Payments payable by a PM if the PM experiences a loss of market share in the United States to NPMs as a result of the PM's participation in the MSA. See "Other Potential Payment Decreases Under the Terms of the MSA–*NPM Adjustment*" below and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–MSA Provisions Relating to Model/Qualifying Statutes" herein. 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 by definition is a Qualifying Statute under the MSA. 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. Legislation has been enacted in at least 44 of the Settling States, including the State, 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 (each an "**Allocable Share Release Amendment**"). A majority of the PMs, including all OPMs, have indicated in writing that the State's Model Statute, as amended by an Allocable Share Release Amendment, will continue to constitute a Qualifying Statute within the meaning of the MSA. In 2004, the State imposed an equity assessment on NPMs selling cigarettes in the State. The purpose of the equity assessment is to fund enforcement and administration of the State's Qualifying Statute and the State's Complementary Legislation (defined below). The assessment is required to be prepaid by March 1 of each year for all cigarettes that are anticipated to be sold in the State in the current calendar year. For each NPM, the prepayment amount is equal to the greater of (i) $10,000 or (2) the number of cigarettes that the Department of Treasury reasonably determines that the NPM will sell in the State in the current calendar year multiplied by 17.5 mills. A similar law in Minnesota, which is not one of the Settling States but is a party to an agreement similar to the MSA, was challenged in Minnesota state court on both state and federal constitutional grounds by three tobacco manufacturers that were not a party to the Minnesota agreement. The legislation was upheld by the Supreme Court of Minnesota on March 16, 2006.

In addition, at least 45 Settling States (including the State) have passed legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making required escrow payments under the states' respective Qualifying Statutes. Pursuant to the State's Qualifying Statute and Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold directly or indirectly in the State is required to certify annually that it is an NPM and is in full compliance with the State's Qualifying Statute. 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 United States Constitution and/or state constitutions and are preempted by federal antitrust laws. The lawsuits seek, among other things, injunctions against the enforcement of the Qualifying Statutes and the related legislation. To date such challenges have not been ultimately successful, although the enforcement of Allocable Share Release Amendments has been preliminarily enjoined in New York and certain other states. Appeals are also possible in certain other cases. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Pending challenges to the Qualifying Statutes and related legislation are described below under "*Grand River, Freedom Holdings and Related Cases*" and "*Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" 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 "Other Potential Payment Decreases Under the Terms of the MSA–*NPM Adjustment*" below, "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–MSA Provisions Relating to Model/Qualifying Statutes" herein and "LEGAL CONSIDERATIONS" herein.

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, target sales in states without Allocable Share Release Amendments, 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" herein.

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" herein.

Grand River, Freedom Holdings and Related Cases. Among the pending challenges to the MSA and/or related state legislation are two lawsuits referred to herein as *Grand River* and *Freedom Holdings*, both of which are pending in the U.S. District Court for the Southern District of New York. The *Grand River* case is currently pending against the attorneys general of 30 states[*], including the State, and alleges, among other things, that: (1) the MSA creates an unlawful output cartel under federal antitrust law, and state legislation enacted pursuant to the MSA mandates or authorizes such cartel and is thus preempted by federal law; and (2) the MSA and related statutes are invalid or unenforceable under the Commerce Clause and other provisions of the U.S. Constitution. The plaintiff in *Grand River* seeks to enjoin the enforcement of the Qualifying Statutes and Complementary Legislation by the *Grand River* Defendant States (defined below), including the State. The *Freedom Holdings* case is pending against the attorney general and the commissioner of taxation and finance of the State of New York and is based on the same purported claims as the Grand River case (including, as discussed below, a Commerce Clause claim asserted by the plaintiffs in their Second Supplemental and Amended Complaint following a Second Circuit ruling on the issue in the Grand River case). The plaintiffs in *Freedom Holdings* seek to enjoin the enforcement of New York's Qualifying Statute and Complementary Legislation. These suits have survived appellate review of motions to dismiss for failure to state a claim upon which relief can be granted and *Grand River* is in the discovery phase of litigation in preparation for the development of a factual record to support possible findings of fact that may be used by the court in its decision as to the pending claims. The discovery deadline has passed in *Freedom Holdings*, and motions for summary judgment were fully submitted to the court on March 7, 2007, which are pending. To date, *Grand River* and *Freedom Holdings*, along with *Xcaliber v. Ieyoub* and *A.B. Coker v. Foti* (both discussed below), are the only cases challenging the MSA or related legislation that have survived initial appellate review of motions to dismiss. Moreover, these four cases are the only cases challenging the MSA or related legislation that have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact based on extrinsic evidence as to the operation and impact of the MSA and the related legislation.

On July 1, 2002, *Grand River Enterprises Six Nations Ltd. v. Pryor* was filed in the U.S. District Court for the Southern District of New York by certain NPMs against current and former attorneys general of 31 states, including the State (the "***Grand River* Defendant States**"). The plaintiffs seek to enjoin the enforcement of the *Grand River* Defendant States' Qualifying Statutes and Complementary Legislation, alleging that such Qualifying Statutes and Complementary Legislation violate the plaintiffs' constitutional rights under the Commerce Clause and other provisions of the U.S. Constitution and also that such Qualifying Statutes and Complementary Legislation conflict with and are therefore preempted by the federal antitrust laws. In September 2003, the District Court held that it lacked personal jurisdiction over the non-New York attorneys general and dismissed the plaintiffs' complaint against them. In addition, the District Court dismissed the plaintiffs' complaint against the New York attorney general, finding that the plaintiffs had failed to state a claim upon which relief could be granted. After the Second Circuit's decision in *Freedom Holdings* (discussed below), however, the District Court granted the plaintiffs' motion in Grand River to reinstate, against the New York attorney general only, that portion of the complaint alleging that New York's Qualifying Statute and New York's Complementary Legislation conflict with antitrust laws and are preempted by federal law.

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[*] The *Grand River* Defendant States are: Alabama, Alaska, Arizona, California, Colorado, Delaware, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, New York, North Carolina, Ohio, Oregon, South Carolina, South Dakota, Tennessee, Washington, Wisconsin, and Wyoming. The complaint was initially filed against 31 defendant states, but by stipulation so-ordered by Judge Keenan on February 26, 2008, plaintiff and the State of Kentucky agreed to a voluntary dismissal of the complaint as against those defendants.

The plaintiffs appealed the dismissal of their other claims to the Second Circuit. On September 28, 2005, the Second Circuit reinstated portions of the Commerce Clause challenge and reinstated the non-New York attorneys general, including the Attorney General of the State, as defendants, finding that a federal court in New York could exercise personal jurisdiction over them, and affirmed the dismissal of certain remaining claims, including the claim that the Qualifying Statute and related legislation violated the Indian Commerce Clause of the U.S. Constitution. The case was remanded to the District Court. On May 31, 2006, the District Court denied Grand River's motion for a preliminary injunction seeking to bar defendants from: (1) enforcing their states' Allocable Share Release Amendments; (2) denying *Grand River's* application to become a party to the Master Settlement Agreement; and (3) banning sales in the defendants' states of *Grand River*-produced cigarettes. The District Court held that *Grand River* failed to show either a likelihood of irreparable injury absent an injunction or a likelihood of success on the merits of its claims. On June 7, 2006, *Grand River* filed an appeal of this decision before the Second Circuit. Separately, *Grand River* also filed a motion for an injunction pending appeal, which the District Court denied on June 29, 2006. On March 6, 2007, the Second Circuit denied Grand River's appeal, solely on the basis that the District Court had not abused its discretion in finding that plaintiff Grand River had failed to show a likelihood of irreparable injury. On June 12, 2007, the Second Circuit issued a judgment confirming its May 23, 2007 order denying plaintiff Grand River's petition for a rehearing.

On October 12, 2005, the defendants filed a petition with the Second Circuit for rehearing with regard to the Second Circuit's ruling on the issue of personal jurisdiction. The plaintiffs filed a petition with the Second Circuit for rehearing on the Indian Commerce Clause ruling. On January 3, 2006, the Second Circuit denied all parties' petitions for rehearing. On April 18, 2006 the non-New York defendants filed a petition for certiorari review with the U.S. Supreme Court challenging the Second's Circuit ruling on the issue of personal jurisdiction. See *King v. Grand River Enterprises Six Nations, Ltd.* On October 10, 2006, the U.S. Supreme Court denied the defendants' petition for certiorari.

With regard to the Commerce Clause challenge, the Second Circuit in *Grand River* noted that because it was reviewing a motion to dismiss, it was required to accept as true the material facts alleged in the complaint and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit held that although each state's Qualifying Statute and Complementary Legislation apply to cigarette sales within such state, the plaintiffs sufficiently stated a possible claim that these statutes together create a national or "interstate" regulatory policy and thereby exert "extraterritorial control" over out-of-state transactions in contravention of the Commerce Clause. The Second Circuit acknowledged that in *Freedom Holdings* (discussed below) it had ruled that plaintiffs failed to state a claim that the state's Complementary Legislation had violated the Commerce Clause, but explained that it did so because plaintiffs there had not sufficiently alleged an extraterritorial effect of that legislation. To date, *A.B. Coker* (discussed below), *Grand River*, and, as a technical matter, *Freedom Holdings* (pursuant to the grant of a motion to amend the complaint in that matter to include a Commerce Clause claim), are the only cases in which a Commerce Clause challenge to the MSA and related statutes has not been dismissed at the pleading stage or at summary judgment. However, other such challenges are currently pending in various jurisdictions. An adverse ruling on Commerce Clause grounds could potentially lead to invalidation of the MSA and the Qualifying Statutes in their entirety and result in the complete loss of a Bondholder's investment.

With regard to the reinstatement of the non-New York defendants, the Second Circuit explained that where an out-of-state defendant has "transacted business" in the State of New York and there is "substantial nexus" between that transaction and the litigation in question, the federal courts in the state can obtain jurisdiction over the defendants. The Second Circuit concluded that by negotiating the MSA in New York, the attorneys' general "transacted business" for the purpose of conferring jurisdiction in federal courts in New York. The Court also held that there was "substantial nexus" between the MSA negotiations and the lawsuit, because although the challenged statutes are discrete acts of each state, they were integral to the operation of the MSA and were negotiated as such.

Grand River remains pending before the U.S. District Court for the Southern District of New York, wherein the defendants filed an answer to the complaint on October 25, 2006. On March 28, 2008, the plaintiff filed an Amended Complaint that included new factual allegations relating to the Sherman Act and Commerce Clause claims. On April 11, 2008, defendants filed their answer to the Amended and Supplemental Complaint. Currently, Grand River Enterprises Six Nations, Ltd. is the only plaintiff in the case. The District Court has ruled that the pre-trial discovery period will conclude in July 2008. Any decision by the Second Circuit in this case would not be subject to appeal as of right to the U.S. Supreme Court. No assurance can be given: (1) that the Supreme Court would choose to hear and determine any appeal relating to the validity or enforceability of MSA or related legislation in this or any other case; or (2) as to the outcome of any petition of writ of certiorari or any appeal, even if heard by the Supreme Court. A Supreme Court decision to affirm or to decline to review a Second Circuit ruling that is adverse to the defendants in *Grand River* or other similar cases, challenging the validity or enforceability of the MSA or related legislation, could ultimately result in the complete cessation of the 2006 Pledged TSRs available to the Authority and, in any event, and could lead to a decrease in the market value and/or liquidity of the Series 2008 Bonds. Moreover, even if ultimately reversed by the Supreme Court, a Second Circuit decision adverse to the defendants in *Grand River* could, unless stayed pending appeal at the discretion of the court, (1) result in the complete cessation of 2006 Pledged TSRs available to make payments on the Series 2008 Bonds; or (2) have a material adverse effect on the secondary market for the Series 2008 Bonds and, as a result, lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds during the pendency of the appeal. Any final ruling by the Second Circuit, or the U.S. Supreme Court on appeal, that is adverse to the defendants in *Grand River* would be binding on the State and could result in the complete cessation of the 2006 Pledged TSRs available to the Authority to make Turbo Redemptions and pay Principal and Sinking Fund Installments of and interest on the Series 2008 Bonds, and could result in the complete loss of a Bondholder's investment.

On April 16, 2002, in *Freedom Holdings, Inc. v. Spitzer*, certain cigarette importers filed an action against the Attorney General and the Commissioner of Taxation and Finance of the State of New York (the "**New York State Defendants**"), challenging New York's Complementary Legislation, alleging in their initial complaint that New York's Complementary Legislation enforces a market-sharing and price-fixing cartel, and allows the OPMs to charge supra-competitive prices for their cigarettes. Plaintiffs also alleged that New York's Complementary Legislation violates the Commerce Clause of the U.S. Constitution and establishes an output cartel in violation of federal antitrust law. The initial complaint also alleged that the legislation is selectively enforced in violation of the Equal Protection Clause of the U.S. Constitution. The Southern District dismissed the action on May 14, 2002.

In its *Freedom Holdings* decision, the Southern District applied two U.S. Supreme Court doctrines known as the "state action" immunity doctrine (based on a U.S. Supreme Court case known as "***Parker***") and the First Amendment based immunity doctrine (based on two U.S. Supreme Court cases known collectively as *Noerr-Pennington* ("***NP***")). The applicability of the *Parker* immunity doctrine requires two levels of analysis. Where a state confers authority on private parties to engage in conduct that would otherwise be per se violative of antitrust laws, cases subsequent to Parker (most notably a U.S. Supreme Court case known as "***MidCal***") have required both a clear articulation of state policy and active supervision by the state of the otherwise anticompetitive conduct for *Parker* immunity to apply. When a state is acting unilaterally, in its capacity as the sovereign, however, no *MidCal* analysis is required, and *Parker* immunity applies directly. *NP* immunity applies to conduct that is protected by the First Amendment, most particularly conduct that constitutes petitioning activity directed at courts or governmental bodies. The Southern District held, among other things, that New York's Complementary Legislation was protected from antitrust challenge by both direct *Parker* immunity and *NP* immunity.

The plaintiffs in *Freedom Holdings* appealed, and on January 6, 2004, the Second Circuit partially reversed the decision of the Southern District. In its reversal, the Second Circuit noted, because

it was reviewing a motion to dismiss, that it was required to accept as true the material facts alleged in the complaint and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit affirmed the Southern District's dismissal of that portion of the complaint that alleged a Commerce Clause violation. The Second Circuit reversed the dismissal of the plaintiffs' Equal Protection claim, based on uncertainty both as to the basis for the district court's ruling and the allegations of the complaint. The Second Circuit remanded the case to allow the plaintiffs to amend their complaint to correct deficiencies in the pleadings. The Second Circuit held, however, that the plaintiffs had alleged facts sufficient to state a claim that New York's Complementary Legislation conflicts with federal antitrust law, and that based on the facts alleged, the legislation was not protected from an antitrust challenge based on either of the Parker or NP immunity doctrines. The Second Circuit determined, on the record before it, that a *MidCal* analysis was required and, on that record and solely for the purpose of reviewing the Southern District's dismissal of the complaint, found insufficient active supervision and insufficient articulation of state policy to support a conclusion that there was antitrust immunity under *Parker* and *MidCal*. On March 25, 2004, the Second Circuit denied the New York State Defendants' petition for a rehearing.

In April 2004, the plaintiffs in *Freedom Holdings* filed an amended complaint, which was supplemented in November 2004 and included requests for: (1) a declaratory judgment that the operation of the MSA, New York's Qualifying Statute, and New York's Complementary Legislation implements an illegal *per se* output cartel in violation of the federal antitrust laws and are thus preempted by federal antitrust law; and (2) injunctive relief enjoining the enforcement of New York's Qualifying Statute and New York's Complementary Legislation. The amended complaint did not seek an injunction enjoining the enforcement or administration of the MSA, was limited only to claims under the federal antitrust laws, and did not allege that the MSA, New York State's Qualifying Statute, or Complementary Legislation violates the Commerce Clause or the Equal Protection Clause of the U.S. Constitution.

On September 14, 2004, the Southern District denied the plaintiffs' motion for a preliminary injunction enjoining New York, during the pendency of the action, from enforcing the MSA, New York's Qualifying Statute and New York's Complementary Legislation. The Southern District held that, based on the evidence presented by the parties, the plaintiffs had failed to establish a likelihood of success on the merits of their claims: (1) that New York's Qualifying Statute and New York's Complementary Legislation authorized or mandated a per se violation of the federal antitrust laws; or (2) that the MSA, New York's Qualifying Statute, and New York's Complementary Legislation would not be entitled to Parker antitrust immunity under a *MidCal* analysis. The Southern District also determined that the plaintiffs had failed to make a showing of irreparable harm sufficient to justify preliminary injunctive relief. The Southern District, however, granted the plaintiffs' motion to enjoin New York from enforcing its Allocable Share Release Amendment, holding that the plaintiffs had established a likelihood of success on their claim that New York's Allocable Share Release Amendment conflicts with the federal antitrust laws and that its enforcement would cause plaintiffs and other NPMs irreparable harm. The plaintiffs appealed the Southern District's denial of their motion for a preliminary injunction as to New York's Qualifying Statute and New York's Complementary Legislation. The plaintiffs did not appeal the denial of their motion for a preliminary injunction to enjoin the enforcement of the MSA and supplemented their amended complaint to state that they do not seek a permanent injunction to enjoin the enforcement of the MSA. The New York State Defendants did not appeal the granting of the plaintiffs' motion to enjoin enforcement of New York's Allocable Share Release Amendment. On May 18, 2005, the Second Circuit affirmed the Southern District's denial of the plaintiffs' request for a preliminary injunction. The Second Circuit held that the plaintiffs failed to satisfy the irreparable harm requirement for a preliminary injunction. The Second Circuit made no determination as to the likelihood of the plaintiffs' ultimate success on the merits. On November 1, 2005, the Southern District denied, without prejudice and upon agreement of the parties, plaintiffs' motion for partial summary judgment which sought a determination that New York's Allocable Share Release Amendment violates federal antitrust law. On December 28, 2005, the Southern District denied the plaintiffs' motion to file an amended complaint to add a Commerce

Clause claim similar to the plaintiffs' claims in *Grand River*, as described above. In its decision, however, the Southern District granted the plaintiffs leave to renew their motion to amend upon the condition that the plaintiffs show what additional discovery would be required to support such additional claims.

On February 6, 2006, the Southern District granted plaintiffs' renewed motion for leave to assert a claim under the Commerce Clause. On February 10, 2006, plaintiffs filed a Second Supplemental and Amended Complaint. The plaintiffs now seek: (1) a declaratory judgment that the operation of the MSA, New York's Qualifying Statute and New York's Complementary Legislation implements an illegal *per se* output cartel in violation of the federal antitrust laws and is preempted thereby; (2) a declaratory judgment that New York's Qualifying Statute and Complementary Legislation, together with the Qualifying Statutes and Complementary Legislation of other states, regulate interstate commerce in violation of the Commerce Clause of the U.S. Constitution; and (3) an injunction permanently enjoining the enforcement of New York's Qualifying Statute and Complementary Legislation. The amended complaint does not seek to enjoin the enforcement or administration of the MSA. On May 2, 2006, plaintiffs filed a motion for summary judgment. On July 12, 2006, defendants filed a motion to dismiss the Second Supplemental and Amended Complaint and cross-moved for summary judgment. A hearing took place on December 11, 2006 to resolve certain discovery issues. The summary judgment motion and cross-motion were fully submitted on March 7, 2007. A final decision by Judge Alvin K. Hellerstein of the Southern District remains pending in *Freedom Holdings*.

Possibility of Conflict Among Federal Courts. Certain decisions by the United States Court of Appeals for the Second Circuit in *Freedom Holdings* have created heightened uncertainty as a result of the court's interpretation of federal antitrust law immunity doctrines, as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by the United States Court of Appeals for the Third Circuit (*A.D. Bedell Wholesale Co. v. Philip Morris, Inc.* and *Mariana v. Fisher*), the Sixth Circuit (*Tritent International Corp. v. Commonwealth of Kentucky* and *S&M Brands Inc. v. Summers*), the Ninth Circuit (*Sanders v. Brown)* and other lower courts which have rejected challenges to the MSA and related statutes. Prior decisions rejecting such challenges have concluded that the MSA and related statutes are protected from an antitrust challenge based on the *Parker* or *NP* doctrines.

An adverse decision by the Second Circuit in *Grand River* regarding the enforceability of the MSA and/or related statutes under federal antitrust law or the Commerce Clause of the U.S. Constitution would be controlling law not only within the Second Circuit but also in each of the *Grand River* Defendant States, including the State, at least as to the plaintiff in *Grand River* and possibly as to other potential plaintiffs as well.

In addition, an adverse decision by the Second Circuit in *Freedom Holdings* regarding the enforceability of the MSA and related statutes under federal antitrust law or the Commerce Clause of the U.S. Constitution would be controlling law only within the Second Circuit, from which no appeal as of right to the U.S. Supreme Court would exist. If, however, the Second Circuit were to make a final determination in *Freedom Holdings* that: (1) the MSA constitutes a *per se* federal antitrust violation, not immunized by the *NP* or *Parker* doctrines, or that New York's Qualifying Statute and Complementary Legislation authorize or mandate such a *per se* violation; or (2) New York's Qualifying Statute and New York's Complementary Legislation operate with the Qualifying Statutes and Complementary Legislation of other states to regulate interstate commerce in violation of the Commerce Clause of the U.S. Constitution, such determination could be considered to be in conflict with decisions rendered by other federal courts that have come to different conclusions on these issues. The existence of a conflict as to the rulings of different federal courts on these 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. No assurance can be given that the U.S. Supreme Court would choose to hear and determine any appeal relating to the substantive merits of *Freedom Holdings*. Any final decision

by the U.S. Supreme Court on the substantive merits of *Freedom Holdings* would be binding everywhere in the U.S., including in the State.

Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation. In addition to *Freedom Holdings* and *Grand River*, other cases remain pending in federal courts that challenge the MSA, the Qualifying Statute, the Complementary Legislation and/or the Allocable Share Release Amendment in California, Louisiana, Oklahoma, Kentucky, Tennessee, Arkansas and Kansas. The issues raised in *Freedom Holdings* or *Grand River* are also raised in many of these other cases, as briefly described below, by way of example only, and not as an exclusive or complete list.

Sixth Circuit Cases. The State is within the Sixth Circuit. In a case brought in U.S. District Court for the Eastern District of Kentucky, *Tritent International Corp. v. Commonwealth of Kentucky*, the plaintiffs seek a declaratory judgment that Kentucky's Qualifying Statute and Complementary Legislation conflict with federal antitrust laws and certain provisions of the U.S. Constitution. On September 8, 2005, the District Court granted Kentucky's motion to dismiss the complaint, and on October 24, 2005, the District Court denied the plaintiffs' subsequent motion for reconsideration. The plaintiffs appealed the dismissal to the Sixth Circuit Court of Appeals. Oral argument occurred on September 20, 2006, and on October 30, 2006, the Sixth Circuit affirmed the District Court's dismissal. On November 13, 2006, the plaintiffs filed a petition for en banc rehearing, which petition was denied in February 2007. The Sixth Circuit's October 30, 2006 decision is controlling law within the Sixth Circuit, which includes the State, and is not subject to appeal as of right to the U.S. Supreme Court. Plaintiffs did not file within the prescribed time period a petition for a writ of certiorari with the U.S. Supreme Court with respect to the Sixth Circuit's rulings in this case and those rulings are final.

Similarly, in the Tennessee case, *S&M Brands, Inc. v. Summers*, the plaintiffs filed suit in the U.S. District Court for the Middle District of Tennessee seeking a declaratory judgment that the Tennessee Qualifying Statute (including the Allocable Share Release Amendment) and Complementary Legislation also conflict with federal antitrust laws and certain provisions of the U.S. Constitution. On June 1, 2005, the Sixth Circuit affirmed the District Court's denial of plaintiffs' motion for a preliminary injunction with respect to the enforcement of Tennessee's Allocable Share Release Amendment. On October 6, 2005, the District Court granted Tennessee's motion to dismiss the complaint except that portion of the complaint that alleges that the state's retroactive enforcement of the state's Allocable Share Release Provision violates plaintiff's constitutional rights, which issue was not raised by the state in its motion and was therefore not addressed by the court. In its opinion, the District Court expressly rejected the Second Circuit's reasoning in sustaining antitrust challenges in the *Freedom Holdings* case and the Third Circuit's rationale for denying state action immunity in the *Bedell* and *Mariana* cases. Instead, *S&M Brands* followed the Sanders and *PTI* line of cases and held that Qualifying Statute and Complementary Legislation are direct state action, entitled to *Parker* immunity without the need for *MidCal* analysis. On December 13, 2005, and in accordance with its October 6, 2005 decision, the District Court entered a final judgment dismissing the claims seeking a declaration that the Tennessee Qualifying Statute violated federal antitrust laws and certain provisions of the U.S. Constitution. On January 3, 2006, plaintiffs filed a notice of appeal of that judgment. On April 19, 2007, the Sixth Circuit Court of Appeals affirmed the District Court's December 12, 2005 final judgment of dismissal. The Sixth Circuit's April 19, 2007 decision is controlling law within the Sixth Circuit, which includes the State, and is not subject to appeal as of right to the U.S. Supreme Court. Plaintiffs did not file within the prescribed period a petition for a writ of certiorari with the U.S. Supreme Court with respect to the Sixth Circuit's April 19, 2007 decision and that decision is final. By separate decision filed November 28, 2005, the District Court also held that the state's retroactive application of its Allocable Share Release Amendment, which was effective as of April 20, 2004, to 2003 cigarette sales was unconstitutional. Defendants' appeal of the District Court's November 28, 2005 decision regarding retroactivity of Tennessee's

Allocable Share Release Amendment was argued before the Sixth Circuit on April 26, 2007 and remains pending.

Other Cases. Similar cases were brought in Arkansas. In three cases in the U.S. District Court for the Western District of Arkansas (*Grand River Enterprises Six Nations Ltd. v. Beebe, International Tobacco Partners Ltd. v. Beebe,* and *Dos Santos v. Beebe*), the plaintiffs sought to enjoin, preliminarily and permanently, Arkansas's enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws and certain provisions of the U.S. Constitution and the Arkansas Constitution. In *International Tobacco Partners Ltd.*, the plaintiffs also sought a declaratory judgment that the MSA and Arkansas's Qualifying Statute and Complementary Legislation are preempted by federal antitrust laws and certain provisions of the U.S. Constitution. The District Court preliminarily enjoined, as against the plaintiffs only, the enforcement of Arkansas's Allocable Share Release Amendment. On August 8, 2005, the court ordered Arkansas to reimburse certain amounts it withheld pursuant to the Allocable Share Release Amendment to International Tobacco Partners Ltd. On March 6, 2006, the District Court issued orders in all three cases: (1) denying Arkansas's motion to dismiss the complaint with respect to the plaintiffs' claim that the retroactive application of the Allocable Share Release Amendment violates the plaintiffs' right to due process of law under the Fourteenth Amendment of the U.S. Constitution; and (2) granting Arkansas's motion to dismiss the complaint in all other respects. Both the *Dos Santos* and *International Tobacco Partners Ltd.* cases have been settled by the parties, and orders dismissing those cases have been entered. On March 14, 2006, the District Court in *Grand River v. Beebe* denied the plaintiffs' motion to preliminarily enjoin the Allocable Share Release Amendment. On April 12, 2006, the plaintiffs filed an appeal to the U.S. Court of Appeals for the Eighth Circuit. On December 4, 2006, the Eighth Circuit affirmed the District Court's decision to deny an injunction.

Two cases are currently pending in Kansas. In the first case filed, *Xcaliber International Limited, LLC v. Kline*, the plaintiffs seek to enjoin, preliminarily and permanently, Kansas's enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws, expressly based on the same facts that were before the District Court in the *Freedom Holdings* case in New York. The complaint challenges only the Allocable Share Amendment but purports to reserve the right to challenge the Kansas Qualifying Statute in its entirety. On February 7, 2006, the District Court granted the state's motion for summary judgment and dismissed the case on its merits and denied the plaintiffs' motion to supplement the record with additional facts. On February 16, 2006, the plaintiffs appealed to the Court of Appeals for the Tenth Circuit. On March 8, 2006, the Tenth Circuit granted *Xcaliber's* motion to consolidate this case with *Xcaliber v. Edmondson* (described below) for oral argument, and oral argument was held in September 2006. In the second case, *International Tobacco Partners Ltd. v. Kline*, the plaintiff seeks a declaratory judgment that the Allocable Share Release Amendment is preempted by federal antitrust laws and certain provisions of the U.S. Constitution and preliminary and permanent injunctions against the enforcement of the Allocable Share Release Amendment. On January 30, 2006, the plaintiff amended the complaint, which now seeks to enjoin the enforcement of Kansas's Complementary Legislation and Kansas's Qualifying Statute in their entirety. Although the complaint asserts that the MSA is also preempted by federal antitrust laws and certain provisions of the U.S. Constitution, it does not specifically seek to enjoin the enforcement thereof. Both parties filed motions for summary judgment, which were denied by the court. Kansas filed a motion to dismiss on February 28, 2006. On April 24, 2006, plaintiff filed a new motion for summary judgment. On February 8, 2007, the court granted Kansas' motion and dismissed the case. On March 9, 2007, the plaintiff appealed this dismissal. The Tenth Circuit has put briefing in this case on hold pending its decision in the appeals of *Xcaliber International Limited, LLC v. Kline* and *Xcaliber v. Edmondson*.

On March 28, 2005, the District Court for the Northern District of California in the California case, *Sanders v. Lockyer*, dismissed an antitrust challenge to the MSA and California's Qualifying Statute and Complementary Legislation brought by a class of California consumers against the State of California

and the OPMs. The District Court, expressly unpersuaded by *Freedom Holdings*, found the MSA to be the sovereign act of the state and further found California's Qualifying Statute and Complementary Legislation to be direct legislative activity entitled to *Parker* immunity without the need for any additional *MidCal* analysis. The District Court also found the MSA and California's Qualifying Statute and Complementary Legislation to be entitled to *NP* immunity. The plaintiffs appealed the dismissal to the Ninth Circuit Court of Appeals. On September 26, 2007, the Ninth Circuit affirmed the District Court ruling that Sanders had failed (i) to show that the MSA implementing statutes are *per se* illegal under the Sherman Act, (ii) to show that any of the defendants are liable under either the Sherman Act or California antitrust law or (iii) to state a claim entitling him to relief. In upholding the district court's dismissal of the plaintiff's claims challenging the MSA, the Ninth Circuit expressly agreed with the Sixth Circuit's reasoning in *Trident* and expressly declined to follow either the Second Circuit's approach in *Freedom Holdings* or the Third Circuit's "hybrid restraint" analysis of the MSA in *Bedell*. A petition for a writ of certiorari to the U.S. Supreme Court was filed in February 2008. On May 12, 2008 the U.S. Supreme Court denied the petition for writ of certiorari.

Two cases are currently pending in Louisiana that challenge the MSA, Qualifying Statutes, and/or related legislation. In *Xcaliber International Limited, LLC v. Ieyoub*, certain NPMs have challenged the state's Allocable Share Release Amendment on both federal and state constitutional grounds. In March 2006, the Fifth Circuit Court of Appeals vacated the District Court's earlier dismissal of the action and remanded the case for further proceedings to review the plaintiffs' allegations that the Louisiana Allocable Share Release Amendment violates the rights of free speech, due process of law, and equal protection of the laws guaranteed under the U.S. Constitution and the Louisiana Constitution. On July 5, 2006, the plaintiff filed an Amended Complaint, which is now pending before U.S. District Court for the Eastern District of Louisiana. The Amended Complaint also alleges that the Louisiana Allocable Share Release Amendment violates federal antitrust laws. On July 19, 2006, defendant filed a motion to dismiss certain claims of the Amended Complaint, which the court denied on October 18, 2006. On October 30, 2006, the defendant filed its answer to the Amended Complaint. A settlement conference was held on February 5, 2007. A final pre-trial conference had been set for September 6, 2007, with a bench trial to follow on September 24, 2007. This schedule, however, has been suspended pending the resolution of certain discovery issues. The court has ordered that dates for a final pre-trial conference and trial be set at a scheduling conference scheduled for May 29, 2008. In *A.B. Coker v. Foti*, filed in August 2005, certain NPMs and cigarette distributors brought an action in a federal district court in Louisiana, 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. On November 2, 2005, the state defendant filed a motion to dismiss the complaint for lack of jurisdiction. On November 9, 2006, the U.S. District Court for the Western District of Louisiana granted in part and denied in part the defendant's motion to dismiss. The court allowed the case to proceed on claims that the MSA and Louisiana's Complementary Legislation are violations of the Commerce Clause, Due Process Clause and First Amendment of the U.S. Constitution, and the Federal Cigarette Labeling and Advertising Act. The court dismissed the claims that alleged violation of the Tenth Amendment of the U.S. Constitution. On December 12, 2006, the state defendant filed its answer to the complaint. The judge has ordered all dispositive motions due by June 13, 2008. A trial date will be set thereafter.

In the Oklahoma case, *Xcaliber International Limited, LLC v. Edmondson*, certain NPMs have challenged Oklahoma's enforcement of its Allocable Share Release Amendment under federal antitrust laws. On May 20, 2005, the District Court granted summary judgment in favor of defendant, holding that the Oklahoma Allocable Share Release Amendment constituted unilateral state action that is directly protected from preemption by the *Parker* immunity doctrine. The plaintiffs have requested that the District Court reconsider its summary judgment order and appealed the order to the U.S. Court of Appeals

for the Tenth Circuit. On August 31, 2005, the District Court denied the motion to reconsider. On October 28, 2005, the Tenth Circuit referred the case for mediation conferencing. Mediation conferencing was subsequently terminated, and appellate briefing was completed in February 2006. Oral argument on the appeal was held on September 25, 2006 and a decision remains pending.

The plaintiffs in *Freedom Holdings* filed a motion with the federal Judicial Panel on Multidistrict Litigation (the "**MDL Panel**") requesting that the Tennessee, Kentucky, and Oklahoma cases described above, together with Grand River, be transferred to the Southern District of New York for coordinated and consolidated pre-trial proceedings with *Freedom Holdings*. On June 16, 2005, the MDL Panel denied this motion. The MDL Panel's denial of this motion is not subject to appeal.

If there is an adverse ruling in one or more of the cases discussed above, it could have a material adverse effect on the amount and/or timing of 2006 Pledged TSRs available to the Authority, and could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds and, in certain circumstances, could lead to a complete loss of a Bondholder's investment. For a description of the opinions of Nixon Peabody LLP, Co-Underwriters' Counsel, addressing such matters, see "LEGAL CONSIDERATIONS–MSA Enforceability" and "LEGAL CONSIDERATIONS–Qualifying Statute Constitutionality" herein.

Litigation Seeking Monetary Relief from Tobacco Industry Participants

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 that smoking has been injurious to their health, and by non-smokers alleging harm from environmental tobacco smoke ("**ETS**"), also known as "secondhand smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of May 1, 2008, there were nine cases on appeal in which verdicts were returned against Philip Morris, including: (1) a $74 billion punitive damages judgment against Philip Morris in the *Engle* class action, which has been overturned on appeal by the Florida Supreme Court; and (2) a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. On December 15, 2005, however, the Illinois Supreme Court reversed the judgment against Philip Morris in *Price* and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission, and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the U.S. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. In January 2006, the plaintiffs filed a motion asking the court to reconsider its decision in *Price*. On May 5, 2006, the Supreme Court of Illinois denied this motion. In October 2006, plaintiffs filed a petition for certiorari with the U.S. Supreme Court. On November 27, 2006, the U.S. Supreme Court denied plaintiff's petition for certiorari. The trial court then entered an order of dismissal in December 2006. In January 2007, the plaintiff filed a motion to vacate the dismissal, which motion was dismissed on August 30, 2007. It has been reported that on May 2, 2007 the state trial court judge in the *Price* case asked the Illinois Fifth District Appellate Court whether he has the authority to reopen the *Price* case, citing possible new evidence presented in a case pending before the U.S. Supreme Court. It has also been reported that on May 17, 2007, Philip Morris petitioned the Illinois Supreme Court for an order that would prevent the trial court judge from reopening the *Price* case. In August 2007, the Illinois Supreme Court granted Philip Morris petition and the trial court dismissed plaintiff's motion to vacate or withhold final judgment. On October 1, 2007, the U.S. Supreme Court denied defendants' petition for certiorari and on October 26, 2007, defendants filed a motion for rehearing of the U.S. Supreme Court's denial of defendants' petition. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY–Civil Litigation" herein.

There are a number of other proposed federal class action suits against manufacturers of "light" cigarettes alleging that the manufacturers falsely represented the cigarettes as "light" to mislead smokers into believing that the cigarettes delivered lower tar and nicotine and therefore were safer than regular cigarettes. For example, on August 31, 2007, the First Circuit issued an opinion in *Good v. Altria Group Inc.* holding that plaintiffs' claims, although similar to those in *Price*, are not preempted by the Federal Cigarette Labeling and Advertising Act (the "**FCLAA**"). The court reasoned that plaintiffs' claims of fraudulent misrepresentation under a Maine fraud statute are neither expressly nor implicitly preempted by the FCLAA. The court also disagreed with those courts, including the *Price* court, which have held that "lights" advertising is authorized by the FTC and therefore beyond the reach of state consumer protection statutes. The First Circuit denied defendant's summary judgment motion and remanded the case to the U.S. District Court for the District of Maine. The U.S. District Court for the District of Maine has stayed proceedings pending the ruling of the U.S. Supreme Court on defendant's petition for writ of certiorari, which the court granted on January 18, 2008. Oral argument has been scheduled for October 6, 2008.

The MSA does not release PMs from liability in either individual or class action cases. Healthcare cost recovery cases have also been brought by governmental and non-governmental healthcare providers seeking, among other things, reimbursement for healthcare expenditures incurred in connection with the treatment of medical conditions allegedly caused by smoking. The PMs are also exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims of the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Pending claims related to tobacco products generally fall within four categories: (1) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants on U.S. airlines alleging injury from exposure to ETS in aircraft cabins (called the *Broin II* cases); (2) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs; (3) health care cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for health care expenditures allegedly caused by cigarette smoking and/or disgorgement of profits; and (4) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act. A February 2007 California Supreme Court decision (*Grisham v. Philip Morris*) regarding a statute of limitations issue in an individual case has held that the plaintiff need not have filed suit when she realized she was addicted, thus permitting her lawsuit to go forward after a lower court had held her claim to be time-barred. This decision could lead to an increase in individual lawsuits in California.

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 a decision by the affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption beyond what is forecast in

the Global Insight Consumption Report. In addition, the financial condition of any or all of the PM defendants could be materially and 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, could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds, and could have a material adverse effect on the amount and/or timing of 2006 Pledged TSRs available to the Authority. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY–Civil Litigation" and "LEGAL CONSIDERATIONS" herein.

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

Smoking Trends. As discussed in the Global Insight Consumption Report, cigarette consumption in the U.S. has declined since its peak in 1981 of 640 billion cigarettes to an estimated 368 billion cigarettes in 2007. Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) has been declining since 1964. The Global Insight Consumption Report forecasts a continued decline in total cigarette consumption at an average annual rate of 1.82% to 144 billion cigarettes in 2058 under the Global Insight Base Case Forecast, as defined herein, which represents a decline in per capita consumption at an average rate of 2.47% per year. These consumption declines are based on historical trends, which may not be indicative of future trends, as well as other factors which may vary significantly from those assumed or forecasted by Global Insight. For a more detailed discussion of the Global Insight methodology, see "GLOBAL INSIGHT CONSUMPTION REPORT" herein and Appendix A – GLOBAL INSIGHT CONSUMPTION REPORT attached hereto.

According to the Global Insight Consumption Report, the pharmaceutical industry is seeking approval from the U.S. Food and Drug Administration (the "**FDA**") for two new smoking cessation products possibly more effective than those now in existence, such as gum and patch nicotine replacement products, and other smoking cessation products such as NicoBloc or Zyban. In June 2006, the FDA has approved Varenicline, a Pfizer product to be 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 then Zyban. Pfizer has introduced Chantix with a novel marketing program, GETQUIT, an integrated consumer support system which emphasizes personalized treatment advice with regular phone and email contact. Pfizer reports that through June 2007, nearly 2.5 million prescriptions have been filled. 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.

Several new drugs may also appear on the market in the near future. On May 14, 2005, Cytos Biotechnology AG, announced that it had successfully completed Phase II testing of a virus based vaccine, which is genetically engineered to cause an immune system response against nicotine and its effects. Novartis has acquired the license to the vaccine and has reported positive results toward Phase III trials. Nabi Biopharmaceuticals has successfully completed its Phase IIB clinical trials for NicVAX, a vaccine to prevent and treat nicotine addiction. It triggers antibodies that bind with nicotine molecules. In 2006, NicVAX received Fast Track Designation from the FDA, which is intended to expedite its review process. Phase III trials are the remaining step before a license application. The Xenova Group is set to begin Phase II testing of its similar vaccine, Ta Nic. Positive results were also reported in July 2006 by Somaxon Pharmaceuticals from a pilot Phase II study of Nalmefene. Nalmefene has been used for over 10 years for the reversal of opioid drug effects. Somaxon Pharmaceuticals is seeking to develop it as a treatment for impulse control disorders. In 2008, Evotec AG announced it would launch a Phase II study of EVT 302, a drug intended to ease smoker's cravings and nicotine withdrawal symptoms after

cigarette deprivation. Global Insight expects that products such as these will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. One SPM has also introduced a cigarette with reportedly little or no nicotine. Future FDA regulation could also include regulation of nicotine content in cigarettes to non addictive levels. Such new products or similar products, if successful, or such FDA regulation, if enacted, could have a material adverse effect on cigarette consumption.

Smokeless Tobacco Products. 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. According to the Global Insight Consumption Report, chewing tobacco and dry snuff consumption has been declining in the U.S. in this decade, but moist snuff consumption has increased at an annual rate of more than 5% since 2002, and by 10.4% in 2006, when over 5 million consumers purchased 1.1 billion cans. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco, is explicitly targeting adult smoker conversion in its growth strategy. The industry is 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. In 2006, the three largest U.S. cigarette manufacturers entered the market. Philip Morris introduced a snuff product, Taboka, Reynolds American acquired Conwood Company, L.P., the nation's second largest smokeless tobacco manufacturer, and introduced Camel Snus, a snuff product, and Lorillard entered into an agreement with Swedish Match North America to develop smokeless tobacco product in the U.S. Product development has continued in 2007, most recently with the introduction by Philip Morris of a Marlboro snus product. In October 2007, Altria announced that it would accelerate the development of snuff and less-harmful cigarettes to counter a decline in smoking. In 2008, Liggett announced it would introduce Grand Prix Snus.

Advocates of the use of snuff as part of a tobacco 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. The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. A May 2008 study using data from the 2000 National Health Interview Survey reports that U.S. men who used smokeless tobacco as a smoking cessation method achieved significantly higher quit rates than those who used other cessation aids. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use. In 2008 a new firm, Fuisz Tobacco, was formed to commercialize a film-based smokeless tobacco product. The thin film strip would be spitless and would dissolve entirely in the cheek.

See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY–Regulatory Issues–*Smokeless Tobacco Products*" herein and Appendix A – GLOBAL INSIGHT CONSUMPTION REPORT.

A decline in the overall consumption of cigarettes beyond the levels forecasted in the Global Insight Consumption Report could have a material adverse effect on the payments by PMs under the MSA and the amount and/or timing of 2006 Pledged TSRs available to the Authority.

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet, and charge state employees who smoke higher health insurance premiums than non-smoking state employees. Five states, Alabama, Georgia, Idaho, Kentucky, and West Virginia, charge higher health insurance premiums to 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, Tribune Co. and Whirlpool are now charging smokers higher health insurance premiums. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the FDA, amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non face to face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress, which would provide the FDA with broad authority to regulate tobacco products. A bi partisan group of lawmakers, Massachusetts Senator Edward M. Kennedy, Texas Senator John Cornyn, California Representative Henry Waxman and Virginia Representative Tom Davis, on February 15, 2007 introduced the Family Smoking Prevention and Tobacco Control Act, legislation aimed at placing tobacco products under the authority of the FDA. The bill would give the FDA broad regulatory authority over the sale, distribution, and advertising of tobacco products. Such legislation would, among other anticipated changes, permit the FDA to regulate tar and other ingredients in cigarettes, permit the FDA to strengthen warning labels, reduce nicotine levels in tobacco products, police false or misleading advertising and marketing aimed at children and would require manufacturers to provide the FDA with lists of ingredients and additives in their products, including nicotine. Philip Morris has indicated its strong support for this legislation. The Senate Health Committee approved the legislation on August 1, 2007 by a 13 to 8 vote, including an amendment requiring that all cigarette packages be half covered by warning labels with colored graphic. A committee of the House of Representatives began holding hearings on October 3, 2007 on whether the FDA should be given the power to regulate tobacco products. On October 12, 2007, the House of Representatives passed a tax bill containing new tax breaks for corporations and a buyout for tobacco farmers, but omitting the FDA broad authority to regulate tobacco products. It has been reported that on April 2, 2008, a bill granting the FDA new power over tobacco-product ingredients and marketing, but not a ban on nicotine, passed the House Energy and Commerce Committee for a vote by the full House of Representatives later in the spring. It has been recently reported that various states have requested the Alcohol Tax and Trade Bureau to categorize "little cigars" as another form of cigarettes that require federal regulation. No assurance can be given that future legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes.

Cigarettes are also currently subject to substantial excise taxes in the U.S. The federal excise tax has remained constant, at $0.39 per pack, since 2002. The U.S. Congress has adopted legislation which would raise the federal excise tax. In August, the Senate and House of Representatives passed bills with $0.61 and $0.45 increases to the tax, respectively. The increase to the federal excise tax is designed to provide funding for the State Children's Health Insurance Program ("**SCHIP**"). On September 25, 2007, the House of Representatives passed a new bill with a $0.61 increase by a vote of 265 to 159. On

September 27, 2007, the Senate voted 67 to 29 to reauthorize and expand SCHIP funded in part by a $0.61 increase in the federal excise tax on cigarettes. On October 3, 2007, the President vetoed the bill, and on October 18, 2007, the House of Representatives failed to override the Presidential veto. Subsequent override attempts in November and in January 2008 also failed. If enacted as proposed above, the federal excise tax would equal $1.00 per pack. According to the Global Insight Consumption Report, should the federal excise tax increase to $1.00 per pack, the resulting price increase, would, according to its model, lead to a sharper, one time, consumption decline of 4.5%, or 15.5 billion cigarettes, by 2010. The difference with Global Insight's Base Case forecast would be somewhat lower over the longer term, because forecast assumptions incorporate the likelihood of significant excise tax increases over time. It is not possible at this time to assess the likelihood that this or any other proposal to increase the federal excise tax will or will not become law.

All states, the District of Columbia, and the Commonwealth of Puerto Rico currently impose taxes at levels ranging from $0.07 per pack in South Carolina to $2.75 per pack in New York. In addition, certain municipalities also impose an excise tax on cigarettes ranging up to $1.50 per pack in New York City and $2.68 per pack in Chicago, which includes the Cook County tax of $2.00 per pack. According to the Global Insight Consumption Report, excise tax increases were enacted in 20 states and in New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee," which has the same effect on consumer prices. The Global Insight Consumption Report considers any such fees as equivalent to excise taxes.

In 2006, Texas passed a budget that raised the state excise tax by $1.00 in January 2007, and Hawaii, New Jersey, North Carolina, and Vermont enacted legislation which raised excise taxes. In the November 2006 elections, referenda passed in Arizona and South Dakota raising excise taxes. In 2007, Connecticut, Delaware, Iowa, Indiana, Maryland, New Hampshire, Tennessee and Wisconsin each increased its excise taxes. These actions increased the average state excise tax to $1.116 in January 2008. New York State in April 2008 enacted an increase of $1.25 per pack, and in May the District of Columbia increased its tax by $1.00 per pack. These increases will raise the weighted average excise tax to $1.197. It is expected that other states will also enact increases in 2008 and in future years. Florida, Georgia, Kansas, Massachusetts, New Hampshire, Pennsylvania and Utah are now considering excise tax increases. In Massachusetts, the House of Representatives has approved an increase of $1.00 per pack. Although California voters rejected a ballot initiative on November 7, 2006 that would have raised the tax from $0.87 to $3.47 per pack, California lawmakers have introduced a bill which would raise the tax by $2.00 per pack.

As mentioned above, at least one state, Minnesota, currently imposes a 75 cent "health impact fee" on tobacco manufacturers for each pack of cigarettes sold. The purpose of this fee is to recover the state's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld by the Minnesota Supreme Court as not in violation of Minnesota's settlement with the tobacco companies. On February 20, 2007, the U.S. Supreme Court declined to hear Philip Morris' appeal of that decision. See "Other Potential Payment Decreases Under the Terms of the MSA–*NPM Adjustment*" below.

According to the Global Insight Consumption Report, all of the states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. The most comprehensive bans have been enacted since 1998 in 30 states and a number of large cities. In 1998, California imposed a comprehensive smoking ban for all indoor workplaces, including restaurants and bars. Delaware followed suit in 2002, and in 2003, Connecticut, Maine, New York, and Florida passed similar comprehensive bans, as did the cities of Boston and Dallas. Since then, Arizona, Arkansas, Colorado, the District of Columbia, Hawaii, Illinois, Iowa, Louisiana, Maryland, Massachusetts,

Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Utah, Vermont, Washington, and Puerto Rico established similar bans, as did the cities of Baltimore, Chicago, Houston, and Philadelphia. The New Mexico, Washington State and Chicago restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. It is expected that these restrictions will continue to proliferate. For example, at least 7 states, Alabama, Kansas, Michigan, Missouri, North Carolina, South Carolina and Tennessee, are considering legislation which would enact comprehensive bans.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of April 1, 2008, there were 2,791 municipalities with local laws that restrict where smoking is allowed, including 1,242 municipalities that restrict smoking in one or more outdoor areas. Of these, 554 local governments required workplaces to be 100% smoke free, and 100% smoke free conditions were required for restaurants by 522 governments, and for bars by 393. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. 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. These numbers grew to 49 for restaurants and 32 for bars in 1998, and doubled again by 2001, to 100 and 74, respectively.

The first extensive outdoor smoking restrictions were instituted in March 2006 in Calabasas, California. The City of Oakland and California municipalities of Belmont, Beverly Hills, Dublin, El Cajon, Emeryville, Hayward, Loma Linda and Santa Monica have also established extensive outdoor restrictions, as have Davis County and the City of Murray in Utah. Burbank, California, is expected to follow suit. In the most restrictive version to date, the California cities, Belmont, and Calabasas have approved ordinances which restrict smoking anywhere in the city except for single-family detached homes. Many landlords and condominium associations have also established smoke-free apartment policies. In May 2008 the California State Senate passed proposed legislation which would allow landlords to prohibit smoking in apartment buildings. The Massachusetts Department of Public Health is conducting a survey of landlords, tenants, and condominium associations to assess the feasibility of making residences smoke-free.

In the past year, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties have banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. The beach restrictions may soon become statewide. Chicago approved beach and parkground smoking restrictions in October 2007. Sarasota County and Boca Raton, Florida have banned smoking on their beaches, and Nassau County, New York and Volusia County, Florida are also considering park and beach bans. At least 43 colleges nationwide now prohibit smoking everywhere on campus. California, Illinois, Michigan and Nevada have banned smoking in state prisons. Arkansas, California, Louisiana, Maine, Puerto Rico, Texas and Rockland County, New York now prohibit smoking in a car where there are children present, and similar legislation has been proposed in Arizona, California, Connecticut, Illinois, Indiana, Iowa, Kansas, Massachusetts, Montana, New Jersey, New York, Oregon, Rhode Island, South Carolina, Utah and West Virginia.

In June 2006, the Office of the Surgeon General released a report, "The Health Consequences of Involuntary Exposure to Tobacco Smoke." It is a comprehensive review of health effects of involuntary exposure to tobacco smoke. It concludes definitively that secondhand smoke causes disease and adverse respiratory effects. It also concludes that policies creating completely smoke-free environments are the most economical and efficient approaches to providing protection to non-smokers. On September 18, 2007, the Office of the Surgeon General released the report, "Children and Secondhand Smoke Exposure," which concludes that many children are exposed to secondhand smoke in the home and that establishing a completely smoke-free home is the only way to eliminate secondhand smoke exposure in

that setting. These reports are expected to strengthen arguments in favor of further smoking restrictions across the country. Further, the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant in 2006.

The attorneys general of the Settling States have obtained agreements from Philip Morris, Reynolds Tobacco and B&W that they will remove product advertisements from various magazines that are circulated in schools for educational purposes.

No assurance can be given that future legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes. Excise tax increases and other legislative or regulatory measures could severely increase the cost of cigarettes, limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes. As a result of these types of initiatives and other measures, the overall consumption of cigarettes nationwide may decrease materially more than forecasted in the Global Insight Consumption Report and thereby could have a material adverse effect on the payments by PMs under the MSA, could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds, and could have a material adverse effect on the amount and/or timing of 2006 Pledged TSRs available to the Authority. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY–Regulatory Issues" herein.

Other Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments. The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material. Such adjustments, offsets and recalculations, could reduce the 2006 Pledged TSRs available to the Authority below the respective amounts required to pay principal or Accreted Value of the Series 2008 Bonds and could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds, which in certain circumstances could lead to a complete loss of a Bondholder's investment. The State has advised the Authority that both the Settling States and 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 2008. No assurance can be given as to the magnitude of the adjustments that may result upon resolution of those disputes. Any such adjustments could trigger the Offset for Miscalculated or Disputed Payments. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" herein.

The assumptions used to project Collections (the source of the payments on the Series 2008 Bonds) are based on the premise that certain adjustments will occur as set forth under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. Actual adjustments could be materially different from what has been assumed and described herein.

Growth of NPM Market Share and Other Factors. The assumptions used to project Collections and structure the Series 2008 Bonds contemplate declining consumption of cigarettes in the U.S. combined with a static relative market share of 5.14%[*] for the NPMs. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. Should the forecasted decline in consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments and Strategic Contribution Payments by the PMs

[*] The aggregate market share of NPMs utilized in the Collection Methodology and Assumptions may differ materially from the market share information utilized by the MSA Auditor when calculating the NPM Adjustments.

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. At least 44 Settling States, including the State, have enacted, and other states are considering enacting, legislation that amends 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 (so called "**Allocable Share Release Legislation**"). The National Association of Attorneys General ("**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 Allocable Share Release Legislation, such Settling State's previously enacted Model Statute or Qualifying Statute will continue to constitute a Model Statute or Qualifying Statute within the meaning of the MSA. Following a challenge by NPMs, the U.S. District Court for the Southern District of New York in September 2004 enjoined New York from enforcing its Allocable Share Release Legislation. NPMs are also currently challenging Allocable Share Release Legislation in the states of California, Arkansas, Kansas, Kentucky, Louisiana, Oklahoma, and Tennessee. It is possible that NPMs will challenge such legislation in other states. See "–Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein. To the extent that either: (1) other jurisdictions do not enact or enforce Allocable Share Release Legislation; or (2) a jurisdiction's Allocable Share Release Legislation is invalidated, NPMs could concentrate sales in such jurisdiction to take advantage of the absence of Allocable Share Release Legislation 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, could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds, and could have a material adverse effect on the amount and/or timing of 2006 Pledged TSRs available to the Authority. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Adjustments to Payments" and "GLOBAL INSIGHT CONSUMPTION REPORT" herein.

NPM Adjustment

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.* The Settling States and the PMs selected The Brattle Group in May 2004 as current economic consultants responsible for making the significant factor determinations for sales years 2003-2005. A new economic consultant will be selected jointly by the Settling States and the PMs for the 2006 significant factor determination.

Application of the NPM Adjustment. The entire NPM Adjustment is ultimately applied to a subsequent year's Annual Payment and Strategic Contribution Payment due to those Settling States: (1) that have been found to have not diligently enforced their Qualifying Statutes throughout the year; or (2) that have enacted a Model Statute or 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 16⅔% 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 16⅔%, 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 shall the amount of an NPM Adjustment applied to any Settling State in any given year exceed the amount of Annual Payments and Strategic Contribution Payments to be received by such Settling State in such year.

Regardless of how the NPM Adjustment is calculated, it is always subtracted from the total Annual Payments and Strategic Contribution Payments due from the PMs and then ultimately allocated on a Pro Rata (as defined in the MSA) basis only among those Settling States: (1) that have been proven to have not diligently enforced their Qualifying Statute; or (2) that have enacted a Model Statute or 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, for any particular Settling State, a resolution is reached regarding the diligent enforcement dispute for such state for such year or until, for all Settling States, a global settlement is reached for all such disputes for such year. If the PMs make a claim for an NPM Adjustment for any particular year and the State is determined to be one of a few states (or the only state) not to have diligently enforced its Model Statute or Qualifying Statute in such year, the amount of the NPM Adjustment applied to the State in the year following such determination could be as great as the amount of Annual Payments and Strategic Contribution Payments that could otherwise have been received by the State in such year, and could have a material adverse effect on the amount and/or timing of 2006 Pledged TSRs available to the Authority.

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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 Share is greater than 16⅔%, the NPM Adjustment will be calculated as follows:

NPM Adjustment = 50% +
[50% / (Base Aggregate Participating Manufacturer Market Share – 16⅔%)]
x [market share loss – 16⅔%]

** 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.

Settlement of Calendar 1999 through 2002 NPM Adjustment Claims. In June 2003, the OPMs and the Settling States settled all NPM Adjustment claims for the years 1999 through 2002, subject, however, under limited circumstances, to the reinstatement of an OPM's right to an NPM Adjustment for the years 2001 and 2002. In connection therewith, the OPMs and the Settling States agreed prospectively that OPMs 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 OPMs have claimed an NPM Adjustment, such OPMs may, in fact, either make a deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Adjustments to Payments" herein.

The State has indicated that the 2005 Annual Payments by the OPMs were made without a diversion of any portion thereof into the Disputed Payments Account for the Settling States. According to the State, however, it has been reported that 11 SPMs paid approximately $84 million of their 2005 Annual Payments into the Disputed Payments Account for the Settling States as a result of alleged disputes, including disputes related to NPM Adjustments. Unlike the OPMs, the SPMs had not agreed, as part of their settlement of calendar 1999 through 2002 NPM Adjustment Claims, to await the finding of a significant factor determination before taking such action. Of this $84 million, approximately $44 million represented payments by six SPMs relating to cigarettes sold in 2003. Following litigation brought by the State of New York challenging such actions, the six SPMs released such $44 million to the Settling States. Such release of money, however, does not represent final settlement of any alleged disputes. In addition, more than $18 million due from various SPMs was withheld on April 15, 2005.

Significant Factor Determination for Calendar Year 2003. On March 27, 2006, The Brattle Group made its final determination, which final determination is publicly available, that the disadvantages experienced as a result of the MSA were a significant factor contributing to the Market Share Loss for calendar year 2003. The MSA Auditor had previously determined that the Market Share Loss in 2003 was 5.95%, reflecting the difference between the PMs' 99.58% 1997 market share and their 91.63% 2003 market share less 2%. Of the total 7.95% differential, The Brattle Group determined that 3% to 3.5% was attributable to the MSA and then compared 3% to 3.5% to 7.95% in making its significant factor determination. In a statement dated March 28, 2006, the Attorneys General of Iowa and Idaho, the co-chairs of the NAAG Tobacco Committee, stated, among other things, that the Settling States believe it would not be appropriate for a PM to withhold any portion of the April 2006 Annual Payment. According to the statement, the Settling States believe that the PMs must still prove to a court that the Settling States have not diligently enforced their Model Statutes and also believe that every Settling State will be found to have diligently enforced its Model Statute in 2003. It has been reported, however, that the general counsel of Reynolds American stated that he believes not all jurisdictions were diligently enforcing their Model Statutes.

Effect of Calendar 2003 NPM Adjustment Claim on 2006 Annual Payments. Philip Morris and Reynolds American believe that the size of the NPM Adjustment attributable to 2003 is approximately $1.2 billion (representing a $1.14 billion NPM Adjustment of approximately 17.85% of the 2004 Annual Payment, with interest). On March 31, 2006, Philip Morris made its full $3.4 billion payment, even though it believes that payment should eventually be subject to downward adjustment by operation of the calendar 2003 NPM Adjustment, and it intends to continue to negotiate with the Settling States' Attorneys General for, and reserved its right to claim, a reduction of its payment. Lorillard paid approximately $558 million of its 2006 Annual Payment on March 31, 2006 and deposited the balance of the 2006 Annual Payment, $108 million, into the Disputed Payments Account pending final non appealable resolution of the diligent enforcement issue with respect to 2003. Additionally, Reynolds

American paid approximately $2.016 billion of its Annual Payment obligation for 2006, of which $647 million was deposited in the Disputed Payment Account pending resolution of the diligent enforcement issue in 2003. According to the co-chairs of the NAAG Tobacco Committee, in a statement released on April 18, 2006, the Annual Payments paid by Lorillard and Reynolds American to the Settling States constitute about 82% of the amount that was due. The three SPMs from whom the largest payments were due made substantial payments. However, one of the three paid a portion of its payment to the Disputed Payments Account, and the other two each withheld a portion of the payment due from them. A majority of the Settling States have given notice to the PMs of each such Settling State's intent to commence enforcement proceedings under the MSA, compelling the PMs to make the 2006 Annual Payment without diminution for any NPM Adjustment so long as there has not yet been a final non-appealable resolution of the diligent enforcement issue for such Settling State for the year in question.

Vibo Corporation d/b/a General Tobacco, an SPM, paid $96 million of its 2006 Annual Payment in April 2006 and paid the balance, $11.5 million, in June 2006. General Tobacco reportedly maintains that it is entitled to a reduction based on the market share loss it experienced after joining the MSA, but has elected to make the full payments pending final adjudication regarding the actual final payments due.

In their April 18, 2006 statement, the co-chairs of the NAAG Tobacco Committee restated that the Settling States believe that no NPM Adjustment would be found to apply and, thus, the Settling States are entitled to receive the full payment due under the MSA. They stated that each Settling State has enacted a Model Statute, that the Settling States all believe they have diligently enforced their Model Statute, and that they will ultimately receive the money in dispute. The statement further stated that the issues of diligent enforcement are not subject to arbitration and will be litigated in the courts of each Settling State. Many of the Settling States (including the State) have initiated legal action in their state courts to ensure full payment. On September 13, 2006, Reynolds American and certain other PMs sent letters to the Settling States that had not yet objected to arbitration of the NPM Adjustment or that had not yet filed legal proceedings relating to the dispute regarding a claimed NPM Adjustment for 2003 in their respective state courts. These letters stated that unless the Settling States indicated otherwise, it would be assumed that these Settling States would not object to such arbitration. All but one of the Settling States that received these letters responded that they would not agree to submit the dispute to arbitration and would oppose any effort to compel arbitration of the dispute. PMs have filed motions in the courts of each of these Settling States (except certain of the Territories) to compel arbitration.

Altria has reported that 38 states have instituted legal proceedings in their respective state courts against the PMs. They each claim that they diligently enforced their Qualifying Statute and request that the respective court enter a declaratory order finding that the 2006 Annual Payment is not subject to a 2003 NPM Adjustment, and that the PMs are not entitled to withhold or pay into the Disputed Payments Account any portion of the 2006 Annual Payment. They also assert that in June 2003, the OPMs unconditionally released the Settling States from all claims that they may have with respect to cigarettes sold or shipped from 1999 through 2002. As previously noted, the OPMs and the Settling States entered into agreements that resolved a variety of disputes relating to cigarette sales and MSA payments from 1999 through 2002. The Settling States maintain that, since an NPM Adjustment for 2003 would be based upon cigarettes sold or shipped in 2002, the release in the June 2003 agreements bars the OPMs from claiming an NPM Adjustment for 2003.

Calendar 2004 NPM Adjustment. In April 2006, the OPMs initiated NPM Adjustment proceedings seeking a downward adjustment of their annual payments under the MSA for 2004. It has been reported that the Brattle Group rendered its final determination on February 12, 2007 to the effect that the disadvantages experienced as a result of the MSA were a "significant factor" contributing to the Market Share Loss for calendar year 2004. Each Settling State may nonetheless avoid a downward adjustment to its share of the PMs' annual payment for 2004 if it establishes that it diligently enforced a qualifying escrow statute during the entirety of 2004. Any downward adjustment is then potentially

re-allocated to states that do not establish such diligent enforcement. It has been reported that the calendar year 2004 NPM Adjustment for the OPMs is approximately $1.14 billion. There is no certainty that the PMs will ultimately receive any adjustment as a result of these proceedings. If the PMs do receive such an adjustment, the adjustment may be applied as a credit against future MSA payments and would be allocated among the PMs pursuant to the MSA's provisions for allocation of the NPM Adjustment among the PMs. On March 30, 2007, Philip Morris reported that it made its full $3.5 billion payment, which amount includes approximately $400 million that Philip Morris disputes it owes by operation of the calendar 2004 NPM Adjustment. Philip Morris stated that it hoped that its full payment will facilitate an expeditious resolution of NPM Adjustment disputes, whether by settlement or by arbitration. Reynolds American and Lorillard, on the other hand, collectively paid approximately $672 million of their aggregate 2007 annual payment into the Disputed Payments Account based on a claim of entitlement to an NPM Adjustment for 2004.

Calendar 2005 NPM Adjustment. The PMs have reported that the Brattle Group on February 7, 2008 made its final "significant factor" determination to the effect that the disadvantages experienced as a result of the MSA were a "significant factor" contributing to the Market Share Loss for calendar year 2005. The Brattle Group determined that the MSA was a significant factor in explaining 3.9% points of a 5.6% point market share loss experienced by the PMs. On April 15, 2008, Philip Morris reported that it made its full $4 billion payment, which amount includes approximately $156 million that Philip Morris disputes it owes by operation of the calendar 2005 NPM Adjustment. On April 15, 2008, Reynolds American made its full $2.251 billion payment and paid approximately $431 million of its 2008 annual payment into the Disputed Payments Account based on a claim of entitlement to an NPM Adjustment for 2005. On April 30, 2008, Lorillard reported that it paid approximately $793 million of its 2008 Annual Payment and deposited $72 million into the Disputed Payments Account pending final non appealable resolution of the diligent enforcement issue with respect to 2005. There is no certainty that the PMs will ultimately receive any calendar year 2005 NPM Adjustment. If the PMs do receive such an adjustment, the adjustment may be applied as a credit against future MSA payments and would be allocated among the PMs pursuant to the MSA's provisions for allocation of the NPM Adjustment among the PMs.

Resolution of Diligent Enforcement Disputes. As previously noted, any Settling State that adopts, maintains and diligently enforces its Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute (which is a Qualifying Statute under the MSA). No provision of the MSA, however, attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. The State's Attorney General's office has stated that the State has been and is diligently enforcing its Model Statute. Pursuant to the 2006 Purchase Agreement, the State has covenanted to diligently enforce the provisions of its Model 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. As of March 5, 2008, 47 of 48 state courts (including the State) that have thus far considered the issue of whether a diligent enforcement dispute should be resolved in state courts or through arbitration have held in favor of the arbitration process. Thirty-three states have final orders compelling arbitration and 12 states have orders to compel arbitration that are at various stages of appellate review, including writs and appeals. Some of these courts have suggested that such an arbitration proceeding should be before a single national panel. On June 7, 2007, the North Dakota Supreme Court reversed the decision of the lower court and ruled that a diligent enforcement dispute should be resolved through arbitration. On the other hand, on May 31, 2007, a Louisiana trial court has concluded that such a dispute is not subject to arbitration. Certain of these decisions, including in the State, are the subject of appeals and, because the time period for taking appeals has not yet expired in all cases, further appeals can be expected. The State's proceeding against the PMs has resulted in a decision that its diligent enforcement dispute should be resolved through national arbitration, although the court did not determine what would constitute a national arbitration. The trial court judge in a similar

proceeding by the State of New York ruled that the State of New York is entitled to its own, separate arbitration on its diligent enforcement dispute with the PMs. The PMs appealed the state court ruling approving a New York-specific arbitration and instead requested that a single nationwide arbitration panel determine the diligent enforcement dispute between the PMs and all Settling States. In May 2008, the New York Appellate Divisions, First Department, ruled in favor of the PMs' request for a single nationwide arbitration panel.

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. At the present time, there are hearings pending in many other states regarding whether arbitration is the appropriate forum for these disputes. The Attorneys General of the Settling States, including the State, continue to believe that the court in each Settling State that retains continuing jurisdiction over the MSA should make the determination as to diligent enforcement of such state's Qualifying Statute. 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.

Effect of Complementary Legislation. At least 45 of the Settling States, including the State, have passed legislation (often termed **"Complementary Legislation"**) to further ensure that NPMs are making required escrow payments under the Qualifying Statutes. Pursuant to the State's Complementary Legislation, every tobacco products manufacturer whose cigarettes are sold, directly or indirectly, in the State, is required to certify annually that it is an NPM and that it is in full compliance with the State's Qualifying Statute. No cigarette tax stamps may be affixed to the cigarettes of any tobacco product manufacturers that do not make such certification. In addition to any other penalties that may be imposed by law, a civil penalty can be imposed on any tobacco product manufacturer who files a false certification or any cigarette tax agent who affixes a cigarette tax stamp in violation of the State's Complementary Legislation and such cigarettes can be seized and are subject to forfeiture.

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

Conclusion. Future NPM Adjustment claims remain possible for calendar year 2006, and all future years. In addition, the "diligent enforcement" exemption afforded a Settling State is based on actual enforcement efforts for the calendar year preceding each Annual Payment, and could be disputed by a PM even after the final resolution of a diligent enforcement dispute related to a prior year. If the other preconditions to an NPM Adjustment exist for a given year, disputes regarding diligent enforcement for such year may be expected if the market share of the NPMs results in an NPM Adjustment that, absent the protection of the Qualifying Statutes, would apply.

The Settling States and the PMs have begun the process of selecting an independent economic consulting firm to make the significant factor determination regarding the PMs' collective loss of market share for the calendar year 2006.

Future NPM Adjustments could be as large as, or larger than, the reported potential $1.2 billion calendar 2003 NPM Adjustment, $1.14 billion calendar 2004 NPM Adjustment, and approximately $659 million or more calendar year 2005 NPM Adjustment. Although a Settling State that diligently enforces its Qualifying Statute is exempt from the NPM Adjustment, many procedural uncertainties, as described above, still remain regarding the resolution of a dispute regarding diligent enforcement. A decision by the PMs to pay the amount of a claimed NPM Adjustment into the Disputed Payments Account or to withhold payment of such an amount pending the resolution of the dispute could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds and could have a material adverse effect on the amounts of 2006 Pledged TSRs available to the Authority to make Turbo Redemptions and other payments on the Series 2008 Bonds during such period. Should a PM be determined with finality to be entitled to an NPM Adjustment in a future year due to an absence of diligent enforcement of the Qualifying Statute by the State, the application of the NPM Adjustment could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds, and could also have a material adverse effect on the amount and/or timing of 2006 Pledged TSRs available to the Authority.

Altria has reported that a resolution of the NPM Adjustment disputes for the calendar years 2003, 2004 and 2005 are unlikely to occur prior to late 2008 or thereafter, and that the resolution of the NPM Adjustment dispute for calendar year 2006 is unlikely to occur prior to 2009 or thereafter. Settlement discussions are currently ongoing between the Attorneys General of the Settling States and the OPMs in an attempt to effect a national settlement of both outstanding and subsequent NPM Adjustment claims, with the goal of replacing the current NPM Adjustment dispute resolution methodology with one that is more predictable and less subjective. Any such settlement in a given Settling State would have to be approved by such Settling State. Pursuant to the Act, the State has covenanted not to amend the MSA in any manner that may materially alter the rights of Bondholders. See *"Disputed or Recalculated Payments"* below. The structuring assumptions for the Series 2008 Bonds do not include any NPM Adjustments, nor do they include withholdings or Disputed Payment Account deposits relating to PM claims of entitlement to NPM Adjustments or any settlement of NPM Adjustment claims. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

Disputed or Recalculated Payments and Disputes under the Terms of the MSA. 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. By way of example, on August 30, 2004, one of the SPMs (Liggett) announced that it had notified the attorneys general of 46 states that it intended to initiate proceedings against the attorneys general for violating the terms of the MSA. It alleged that the attorneys general violated its rights and the MSA by extending unauthorized favorable financial terms to Miami-based Vibo Corporation d/b/a General Tobacco when, on August 19, 2004, the attorneys general entered into an agreement with General Tobacco allowing it to become an SPM. General Tobacco imports discount cigarettes manufactured in Colombia, South America. In the notice sent to the attorneys general, Liggett indicated that it would seek to enforce the terms of the MSA, void the agreement with General Tobacco and enjoin the Settling States and NAAG from listing General Tobacco as a PM on their websites. On August 18, 2005, Liggett and an additional four SPMs filed a motion to enforce the MSA in Kentucky. The Commonwealth of Kentucky filed its opposition, and the SPMs replied. General Tobacco intervened in the case and filed its opposition to the other SPMs' motion. The SPMs replied, and a hearing was held on the issue on November 8, 2005. On January 26, 2006 the court upheld the agreement by which General Tobacco became an SPM. An appeal was filed to the Kentucky Court of Appeals on

February 14, 2006, and oral arguments were heard in March 2006. The Kentucky Court of Appeals, on August 24, 2007, upheld a lower court decision denying a motion that sought to void the 2004 Agreement that permitted General Tobacco to join the MSA.

Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments may result in the application of an offset against subsequent Annual Payments or Strategic Contribution Payments. The diversion of disputed payments to the Disputed Payments Account, the withholding of all or a portion of any disputed amounts or the application of offsets against future payments could lead to a decrease in the market value and/or the liquidity of the Series 2008 Bonds, and could also have a material adverse effect on the amount and/or timing of 2006 Pledged TSRs available to the Authority. 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 Model Statutes, or pursuant to a settlement of the disputes among the Settling States and the PMs. The structuring assumptions for the Series 2008 Bonds do not factor in an offset for miscalculated or disputed payments or any release of funds currently held in the Disputed Payments Account. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Adjustments to Payments–*Offset for Miscalculated or Disputed Payments*" herein.

On June 3, 2005, the State of California filed an application in San Diego County Superior Court seeking an enforcement order against Bekenton USA, Inc. ("**Bekenton**"), to compel Bekenton to comply with its full payment obligations under the MSA. On June 29, 2005, Bekenton filed a motion to file a suit, alleging that the State of California breached the Most Favored Nation ("**MFN**") provisions of the MSA by allowing three other SPMs (Farmer's Tobacco Co., General Tobacco, and Premier Manufacturing Incorporated) to join the MSA under more favorable terms. In a tentative ruling dated November 1, 2005, the Superior Court granted Bekenton's motion to file suit based on this allegation. In its initial complaint, Bekenton had further alleged that: (1) California's agreements with Farmer's Tobacco, General Tobacco and Premier (the "**Three Agreements**"), which required them to make certain back payments (as required by the MSA) as a precondition to joining the MSA, permitted such back payments to be made on an extended time frame; and (2) this time frame effectively "relieved" Farmer's Tobacco, General Tobacco and Premier of certain payment obligations as PMs. Bekenton claimed that it was entitled to a 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 its November 1, 2005 tentative ruling, the Superior Court denied Bekenton's motion to file suit under the Relief Clause, ruling that: (1) because the Three Agreements were preconditions to allowing Farmer's Tobacco, General Tobacco and Premier to become PMs, these companies were not "PMs" for purposes of the Relief Clause; and (2) even if Farmer's Tobacco, General Tobacco and Premier are PMs for purposes of the Relief Clause, the payment schedules in the Three Agreements did not relieve them of any obligations. On March 15, 2006, the Superior Court adopted the November 1, 2005 tentative ruling as its final order.

Bekenton is involved in similar disputes in Kentucky and Iowa. 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 as a consequence of Kentucky's agreement with General Tobacco, which was similar to the agreement described above between the State of California and General Tobacco. On April 14, 2006, the court dismissed Bekenton's claim for a reduction, holding that the Relief Clause was not applicable since the General Tobacco agreement did not relieve General Tobacco 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. On August 11, 2005 an Iowa state

court, finding that the MSA itself provides procedures for the resolution of disputes regarding MSA payments and that such procedures should be followed in this case, enjoined Iowa from "de-listing" Bekenton, permitting Bekenton to continue selling cigarettes in Iowa. In 2005, Bekenton also filed for bankruptcy relief.

"*Nicotine-Free*" Cigarettes. The MSA contemplates that the manufacturers of cigarettes will be either a PM or an NPM. The term **"cigarette"** is defined in the MSA to mean any product that contains tobacco and nicotine, is intended to be burned and is likely to be offered to, or purchased by, consumers as a cigarette and includes "roll-your-own" tobacco. Should a manufacturer develop a "nicotine-free" tobacco product (intended to be burned and likely to be offered to, or purchased by, consumers as a cigarette), such manufacturer would not be a manufacturer for purposes of the MSA. Sales of such a product could cause a reduction in Annual Payments and Strategic Contribution Payments. In addition, if consumers used the 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 are less likely to be subject to frequent litigation than OPMs. Furthermore, the Qualifying Statutes would not cover a manufacturer of such "nicotine-free" products and such manufacturer would not be required to make escrow deposits in the same manner as the NPMs are so required. Vector Group has introduced QUEST, a tobacco product that is reportedly nicotine-free.

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" herein.

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

Reliance on State Enforcement of the MSA and State Non-Impairment. The State may not convey and has not conveyed to the Authority or the Bondholders any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Although the State is entitled to an allocable share of 4.3519476% of each Annual Payment and an allocable share of 2.5771774% of each Strategic Contribution Payment under the MSA and the State has covenanted in the 2006 Purchase Agreement to enforce the provisions of the MSA requiring the payment of the 2006 Sold Tobacco Receipts and the Authority's rights to receive the 2006 Sold Tobacco Receipts to the full extent permitted by the MSA, no assurance can be given that the State will enforce any particular provision of the MSA. The Authority and the Bondholders may only seek injunctive relief to enforce, or an order to compel specific performance of, the State's covenant to enforce the MSA. Failure by the State to enforce the MSA may have a material adverse effect on the Bondholders. It is also possible that the State could attempt to claim some or all of the 2006 Pledged TSRs for itself or otherwise interfere with the security for the Series 2008 Bonds. In that event, the Bondholders, the Indenture Trustee or the Authority may

assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims. See "**LEGAL CONSIDERATIONS**" herein.

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

The only significant source of payment for the Series 2008 Bonds (other than amounts in the Liquidity Reserve Account, the Capitalized Interest Subaccount and interest earnings) is the 2006 Pledged TSRs that are paid by the PMs. Therefore, 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 payments on the Series 2008 Bonds, and Bondholders and beneficial owners of the Series 2008 Bonds could incur losses on their investments. Philip Morris, by way of example, prior to the resolution of the dispute in the *Price* case in Illinois in the spring of 2003 over the size of the required appeal bond, had publicly stated that it would not have been possible for it to post the $12 billion bond initially ordered by the trial judge. Philip Morris also publicly stated at that time that there was a risk that immediate enforcement of the judgment would force a bankruptcy. Certain SPMs, including Cutting Edge Enterprises, Inc. and Carolina Tobacco Company have filed for bankruptcy relief. In the case of *Cutting Edge Enterprises Inc. v. National Association of Attorneys General*, several state attorneys general, including the State, were defendants in an action in federal court in the Southern District of New York where Cutting Edge, a PM, sought to cause the National Association of Attorneys General and the respective states to list the PM's brands which had been purchased from a NPM on their respective web sites, alleging that their refusal to do so violates federal antitrust laws, the Commerce Clause, and laws prohibiting tortious interference with business relations. The court dismissed this case on March 6, 2007 for lack of personal jurisdiction and the appeal period has expired. Having filed a voluntary petition in bankruptcy on April 16, 2007, Cutting Edge as debtor-in-possession has filed similar claims that are now pending against the same defendants in the U.S. Bankruptcy Court for the Middle District of North Carolina. In the bankruptcy case of Carolina Tobacco Company, the court temporarily stayed the enforcement of the states' claims against Carolina Tobacco Company and required that it not be eliminated from the states' Attorney General's list of approved manufacturers. The bankruptcy court has given Carolina Tobacco Company an extension of time to make its past due and current NPM Payments.

In the event of the bankruptcy of a PM, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the Authority, the Indenture Trustee, the Bondholders, or the beneficial owners of the Series 2008 Bonds to collect any 2006 Pledged TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying the 2006 Sold Tobacco Receipts, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of Pledged TSRs. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it. Furthermore, payments previously made to the Bondholders or the beneficial owners of the Bonds could be avoided as preferential payments, so that the Bondholders and the beneficial owners of the Bonds would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection of the State, the Authority, the Indenture Trustee, the Bondholders, or the beneficial owners of the Series 2008 Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy (including provisions regarding the termination of that PM's obligations – see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Termination of Agreement"), such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions or elimination of payments to the Bondholders or the beneficial owners of the Series 2008 Bonds. 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 2006 Pledged TSRs, and thus could have an adverse effect on the liquidity and value of the Series 2008 Bonds. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS" herein.

Uncertainty as to Timing of Turbo Redemption

No assurance can be given as to the timing of Turbo Redemptions with respect to the Series 2008 Bonds. No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2008 Bonds will be as assumed, or that the other assumptions underlying the Series 2008 Bond Structuring Assumptions, as defined herein, 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 2008 Bond Structuring Assumptions, the amount of Collections available to make Turbo Redemptions will be affected and the resulting weighted average lives of the Series 2008 Bonds will vary. Any reinvestment risks from faster amortization or extension risks from slower amortization of the Series 2008 Bonds than anticipated will be borne entirely by the Holders of the Series 2008 Bonds. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. In addition, future increases in the rate of inflation above 3% per annum in the absence of other factors would materially shorten the life of the Series 2008 Bonds. No assurance can be given that these structuring assumptions, upon which the projections of the Series 2008 Bonds' Turbo Redemptions are based, will be realized. The ratings of the Series 2008 Bonds address the payment of interest on the Series 2008 Bonds when due and the payment of Principal of the Series 2008 Bonds by their respective Maturity Dates.

Bonds Secured Solely by the Collateral

The Series 2008 Bonds are neither legal nor moral obligations of the State, and no recourse may be had thereto for payment of amounts owing on the Series 2008 Bonds. The assets of the Authority (other than the 2006 Pledged TSRs) are not pledged to the payment of, nor are they security for, the Series 2008 Bonds. The Authority's only source of funds for payments on the Series 2008 Bonds is the Collections and amounts on deposit in pledged funds and accounts pursuant to the Indenture. The Authority has no taxing power. Investors in the Series 2008 Bonds must look solely to the Collateral for repayment of their investment.

Limited Remedies

The Indenture Trustee is limited under the terms of the Indenture to enforcing the terms of such agreement and to receiving the 2006 Pledged TSRs and applying them in accordance with the Indenture. If an Event of Default occurs, the Indenture Trustee cannot sell or foreclose on the 2006 Pledged TSRs or its rights under the 2006 Purchase Agreement and is limited in its remedies to seeking an injunction to prevent the State from taking actions that are inconsistent with its obligations under the 2006 Purchase Agreement or to seek specific performance to compel the State to comply with its obligations under the 2006 Purchase Agreement.

Limited Liquidity of the Series 2008 Bonds; Price Volatility

There is currently a limited secondary market for securities such as the Series 2008 Bonds. The Underwriters are under no obligation to make a secondary market. There can be no assurance that a secondary market for the Series 2008 Bonds will develop, or if a secondary market does develop, that it will provide Bondholders with liquidity or that it will continue for the life of the Series 2008 Bonds. Tobacco settlement securitization bonds generally have also exhibited greater price volatility than traditional municipal bonds. Any purchaser of the Series 2008 Bonds must be prepared to hold such securities for an indefinite period of time or until redemption or final payment thereof.

Limited Nature of the Rating of the Series 2008 Bonds; Reduction, Suspension or Withdrawal of a Rating

Any rating assigned to the Series 2008 Bonds by a Rating Agency will reflect such Rating Agency's assessment of the likelihood of the payment of the maturity value of such Bonds by their Maturity Date. Any such rating will not address the likelihood that the Turbo Redemptions will be made according to the projected Turbo Redemption schedule. The ratings of the Series 2008 Bonds will not be a recommendation to purchase, hold or sell such Bonds and such rating will not address the marketability of such Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by 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 2008 Bonds.

Moody's currently indicates that its ratings on all tobacco settlement securitizations are "on watch direction uncertain." Fitch's view of the tobacco industry is a key factor in its ratings of tobacco settlement securitizations. Fitch recently revised its outlook on the unsecured credit profile of the tobacco industry from negative to stable. See "RATINGS" herein.

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal issues that could affect the Series 2008 Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the 2006 Pledged TSRs to be reduced or eliminated. References in the discussion to various opinions of Nixon Peabody LLP are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions.

Bankruptcy of a PM May Delay or Reduce Payments

Because the only significant source of payment for the Series 2008 Bonds (other than amounts in the Liquidity Reserve Account, the Capitalized Interest Subaccount and interest earnings) is the 2006 Pledged TSRs paid by the PMs, if one or more PMs were to become a debtor in a case under the Bankruptcy Code, there could be delays or reductions in or elimination of payments on the Series 2008 Bonds. See "RISK FACTORS — Bankruptcy of a PM May Delay, Reduce, or Eliminate Payments of 2006 Pledged TSRs" herein.

In the event of a bankruptcy of a PM (unless approval of the bankruptcy court was obtained), the automatic stay provisions of the Bankruptcy Code could prevent (unless approval of the bankruptcy court was obtained) any action by the State, the Authority, the Indenture Trustee, the Bondholders, or the beneficial owners of the Bonds to collect any 2006 Pledged TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue making the required payments to the State pursuant to the MSA, 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 such further payments. Nixon Peabody LLP will render an opinion to the Rating Agencies that, subject to all the assumptions, qualifications, and limitations set forth therein, if a PM were to become the debtor in a case under the Bankruptcy Code, and the matter were properly briefed and presented to a federal court with jurisdiction over such bankruptcy case, the court, exercising reasonable judgment after full consideration of all relevant factors, would hold that the MSA is an "executory contract" under Section 365 of the Bankruptcy Code. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Nixon

Peabody LLP can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that a particular court would not hold that the MSA is not an executory contract, thus resulting in delays or reductions in, or elimination of, payments on the Series 2008 Bonds.

If the MSA is an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it, thus resulting in delays or reductions in, or elimination of, payments to Bondholders.

Furthermore, payments previously made to the Bondholders and the beneficial owners of the Bonds could be avoided as preferential payments, so that the Bondholders and the beneficial owners of the Bonds would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection, of the State, the Authority, the Indenture Trustee, the Bondholders or the beneficial owners of the Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy, such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions in, or elimination of, payments on the Series 2008 Bonds. 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 liquidity or value of the Series 2008 Bonds.

MSA Enforceability

Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. However, if any OPM does not agree to the substitute terms, the MSA would terminate in all Settling States affected by the court's ruling. Even if substitute terms are agreed upon, payments under such terms may be less than payments under the MSA and could reduce the amount available to pay the Bond Obligations of and interest on the Series 2008 Bonds.

Certain cigarette manufacturers, cigarette importers, cigarette distributors, Native American tribes and smokers' rights organizations have filed actions against some, and in certain cases all, of the signatories to the MSA alleging, among other things, that the MSA violates provisions of the United States Constitution, federal antitrust laws, federal civil rights laws, state constitutions, state consumer protection laws and unfair competition laws, which actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any money 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, such challenges have not been ultimately successful, although four cases (*Grand River, Freedom Holdings, Xcaliber and A.B. Coker*) have survived pre-trial motions to dismiss and have proceeded to a stage of litigation where the ultimate outcome may be determined in part by findings of fact based on extrinsic evidence as to the operation and impact of the MSA and appeals are pending or still possible in certain other cases. The terms of the MSA are currently being challenged and may continue to be challenged in the future. A determination by a court that a non-severable provision of the MSA is void or voidable would, in the absence of an agreement to a substitute term as described above, result in the termination of the MSA in any Settling States affected by the court's ruling. Accordingly, in the event of an adverse court ruling, Bondholders could incur a complete loss of their

investment. See "RISK FACTORS — Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

In rendering the opinions described below, Nixon Peabody LLP considered the claims asserted in the federal and state actions described above under the caption "RISK FACTORS — Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" that it believes are representative of the legal theories that an opponent of the MSA would advance in an attempt to invalidate the MSA. Subject to the assumptions and qualifications set forth below, Nixon Peabody LLP will render an opinion to the Authority that, subject to all the assumptions, qualifications and limitations set forth therein, and although there can be no assurances that a court applying existing legal principles would not hold otherwise, a court applying existing legal principles to the facts would find the MSA to be a valid and enforceable agreement among the states and the tobacco companies who are parties thereto. This opinion as to the enforceability of the MSA and the obligations of the aforementioned signatories is also subject to the effect of bankruptcy, insolvency, and other laws affecting creditors' rights or remedies and general principles of equity, regardless of whether such enforceability is considered in a proceeding in equity or at law.

Qualifying Statute Constitutionality

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 federal and state constitutions or are preempted by federal antitrust laws. The lawsuits seek, among other things, injunctions against the enforcement of the Qualifying Statutes and related legislation. To date such challenges have not been ultimately successful, although the enforcement of Allocable Share Release Amendments has been preliminarily enjoined in New York and certain other states. Appeals are pending or still possible in certain cases. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Although a determination that the Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA, such a determination could have an adverse effect on payments to be made under the MSA if an NPM were to gain market share in the future and there occurred the requisite impact on the market share of PMs under the MSA. See "RISK FACTORS — Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

In rendering the opinions described below, Nixon Peabody LLP considered the claims asserted in the federal and state actions described above under the caption "RISK FACTORS — Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" that it believes are representative of the legal theories that an opponent of the Qualifying Statute would advance in an attempt to invalidate the Qualifying Statute. Subject to the assumptions and qualifications set forth below, Nixon Peabody LLP will render an opinion to the Authority that, subject to all the facts, assumptions and qualifications set forth therein, and although there can be no assurance that a court applying existing legal principles would not hold otherwise, if the matter were properly briefed and presented to a court, the court applying existing legal principles to the facts would find the State's Qualifying Statute to be constitutional and that the court applying existing legal principles to the facts would also find the State's Qualifying Statute to be enforceable and not violative of the antitrust laws. In rendering its opinion, Nixon Peabody LLP will rely upon a letter dated July 15, 2003, from counsel to the OPMs confirming that the OPMs would not dispute that the State's Qualifying Statute constitutes a "model statute" under the MSA.

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

A court's decision regarding the matters upon which a lawyer is opining would be based on such court's own analysis and interpretation of the factual evidence before it and of applicable legal principles. Thus, if a court reached a result different from that expressed in an opinion, such as that the MSA is void or voidable or that the State's Qualifying Statute is unenforceable, it would not necessarily constitute reversible error or be inconsistent with that opinion. An opinion of counsel is not a prediction of what a

particular court (including any appellate court) that reached the issue on the merits would hold, but, instead, is the opinion of such counsel as to the proper result to be reached by a court applying existing legal rules to the facts as properly found after appropriate briefing and argument and, in addition, is not a guarantee, warranty or representation, but rather reflects the informed professional judgment of such counsel as to specific questions of law. Opinions of counsel are not binding on any court or party to a court proceeding. The descriptions of the opinions set forth herein are summaries, do not purport to be complete and are qualified in their entirety by the opinions themselves.

Enforcement of Rights to 2006 Pledged TSRs

It is possible that the State could in the future attempt to claim some or all of the 2006 Pledged TSRs for itself, or otherwise interfere with the security for the Series 2008 Bonds. In that event, the Series 2008 Bondholders, the Indenture Trustee, or the Authority, could assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims.

Contractual Remedies. The Act provides that the State pledges and agrees with the Authority and the owners of the Bonds that it will, among other things: enforce the Authority's right to receive the 2006 Sold Tobacco Receipts to the full extent permitted by the terms of the MSA; not amend the MSA in any manner that would materially impair the rights of the owners of the Bonds; not limit or alter the rights of the Authority to fulfill the terms of its agreements with owners of the Bonds; not in any way impair the rights and remedies of owners of the Bonds or the security for the Bonds, except that the State is not precluded from regulating smoking, and the taxation and regulation of the sale of cigarettes or other tobacco products; enforce the State's Qualifying Statute; and not amend, supersede, or repeal the State's Qualifying Statute in any way that would materially adversely affect the amount of any payment to, or materially impair the right of, the Authority or the owners of the Bonds. The Act authorizes the inclusion of the foregoing pledge and agreement in the 2006 Purchase Agreement and in the Indenture.

The State in the 2006 Purchase Agreement has covenanted with the Authority (subject to the limitations set forth therein) that it will not take any action that impairs the rights and remedies of the Series 2008 Bondholders or the security for the Series 2008 Bonds. The State has also so covenanted with the Authority that it will enforce the provisions of the MSA that require payment of the 2006 Pledged TSRs to the Authority and the Authority's right to receive payment of the 2006 Pledged TSRs, and that it will diligently enforce the provisions of the Qualifying Statute. The Indenture Trustee, as assignee under the Indenture of certain of the Authority's rights under the 2006 Purchase Agreement, could seek to compel the State to enforce its payment rights under the MSA if the State failed to do so contrary to its covenant in the 2006 Purchase Agreement to enforce the MSA.

In the Indenture, the Authority covenants that it will, from time to time, execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to (i) maintain or preserve the lien and pledge and assignment (and the priority thereof) of the Indenture; (ii) perfect, publish notice of or protect the validity of any pledge and assignment made or to be made by the Indenture; (iii) preserve and defend title to the Collateral pledged under the Indenture and the rights of the Indenture Trustee and the Bondholders in such Collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of the Indenture or the Act; (iv) enforce the 2006 Purchase Agreement; (v) pay any and all taxes lawfully levied or assessed upon all or any part of the Collateral pledged under the Indenture; or (vi) carry out more effectively the purposes of the Indenture.

The Authority and the Bondholders may only seek injunctive relief to enforce, or an order to compel specific performance of, the State's covenant to enforce the MSA.

Constitutional Claims. The Series 2008 Bondholders are further entitled to the benefit of the prohibitions in the United States Constitution's Contract Clause (the "**Contract Clause**") against any state's impairment of the obligation of contracts. This prohibition, although not absolute, is particularly strong when applied to a state's attempt to evade its own obligations.

Generally, 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), a state must justify the exercise of its inherent police powers to safeguard the vital interests of its people before it may enact legislation that substantially impairs contractual relationships. 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 for the State to justify legislation that substantially impairs the contractual rights of the Series 2008 Bondholders to be paid from the 2006 Pledged TSRs, the State must not only 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*.

No Assurance as to the Outcome of Litigation

With respect to all matters of litigation that have been brought and may in the future be brought against the PMs, or involving the enforceability of the MSA or constitutionality of the State Qualifying Statute or the enforcement of the right to the 2006 Pledged TSRs or otherwise filed in connection with the tobacco industry, the outcome of such litigation, in general, cannot be determined 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) on 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 amounts available to the Authority to pay the Bond Obligation of and the interest on the Series 2008 Bonds and make Turbo Redemptions.

Act Prohibits Bankruptcy of Authority

The Act provides that while any Bonds remain Outstanding, the Authority is prohibited from filing a voluntary petition under Chapter 9 of the United States Bankruptcy Code and a public official or organization, entity, or other person shall not authorize the Authority to be or become a debtor under Chapter 9 of the United States Bankruptcy Code while any Bonds remain Outstanding.

THE SERIES 2008 BONDS

The following summary describes certain terms of the Series 2008 Bonds. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Series 2008 Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee.

The Series 2008 Bonds will initially be represented by one or more bond certificates registered in the name of The Depository Trust Company, New York, New York ("**DTC**"), or its nominee. DTC will act as securities depository for the Series 2008 Bonds. Individual purchases of beneficial ownership

interests in (a) the Series 2008A Bonds may be made for principal amounts of $5,000 or any integral multiple thereof and (b) the Series 2008B Bonds and the Series 2008C Bonds may be made for principal amounts which will accrete to $5,000 or any multiple thereof at their Maturity Date (each, respectively, an "**Authorized Denomination**"). Except under the limited circumstances described herein, no Beneficial Owner (as defined herein) of the Series 2008 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Bonds. See APPENDIX E — "BOOK-ENTRY ONLY SYSTEM" herein.

For each Distribution Date, payments will be made to registered owners of the Series 2008 Bonds (the "**Holders**") as of the last Business Day of the calendar month immediately preceding the calendar month in which a Distribution Date occurs (the "**Record Date**"). The Indenture Trustee and the Authority may establish special record dates for the determination of the Holders for various purposes of the Indenture, including giving consent or direction to the Indenture Trustee.

Payments of Interest

Series 2008A Bonds. Interest on the outstanding principal amount of the Series 2008A Bonds will be payable on each June 1 and December 1, commencing December 1, 2008 until the Maturity Date or earlier redemption of such Bond. Interest will accrue from and including the Closing Date, or from and including the most recent Distribution Date on which interest has been paid to, but excluding the subsequent Distribution Date on which interest is payable. Interest on the Series 2008A Bonds payable on and prior to December 1, 2008 will be payable from the Capitalized Interest Subaccount. Interest on the Series 2008A Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. Amounts on deposit in the Liquidity Reserve Account are available to make payments of interest on the Series 2008A Bonds. Failure to pay the full amount of interest payable on any Distribution Date is a Payment Default, which is an Event of Default. If on any Distribution Date there are insufficient funds to pay all interest then due on the Senior Bonds, available amounts will be allocated Pro Rata among all Senior Bonds for which interest is due.

Series 2008B Bonds and Series 2008C Bonds. Interest on the Series 2008B Bonds and the Series 2008C Bonds is not payable on a current basis. Interest on the Series 2008B Bonds and the Series 2008C Bonds will accrete from the dated date thereof and will be compounded on each Distribution Date, commencing December 1, 2008 through and including the Maturity Date or earlier redemption of such Bond. Interest will accrete from and including the Closing Date, or from and including the most recent Distribution Date to, but excluding the subsequent Distribution Date. Interest on the Series 2008B Bonds and the Series 2008C Bonds will accrete on the basis of a 360-day year consisting of twelve 30-day months. Failure to pay the Accreted Value of the Series 2008B Bonds or the Series 2008C Bonds on the Maturity Date is a Payment Default, which is an Event of Default. If a Payment Default occurs, interest on the Series 2008B Bonds and the Series 2008C Bonds will continue to accrete to their respective Maturity Dates and thereafter, the Series 2008B Bonds and the Series 2008C Bonds will bear interest at the Default Rate, in the case of the Series 2008B Bonds, at 8.50% per annum and, in the case of the Series 2008C Bonds, at 8.875% per annum.

Payments of Principal

The Series 2008 Bonds are all issued as Turbo Term Bonds, subject to special mandatory and optional redemption as provided in "Sinking Fund Installments," "Turbo Redemptions" and "Optional Redemption" below. Failure to pay the Principal of a Bond on its Maturity Date will constitute a Payment Default, which is an Event of Default under the Indenture, in which case all future payments will be made on a Pro Rata basis. So long as no Payment Default has occurred, all payments of Bond Obligations of the Series 2008 Bonds made from Collections will be credited against Sinking Fund Installments and Turbo Term Bond Maturities in chronological order, as more fully described under

"Effect of Redemptions on Sinking Fund Installments and Turbo Term Bond Maturities" below. The Liquidity Reserve Account is available to pay the Principal of the Series 2008A Bonds on their respective Maturity Dates. Prior to a Payment Default, money in the Liquidity Reserve Account will not be available to make any payments on the Series 2008B Bonds or the Series 2008C Bonds.

If less than all of the Series 2008 Bonds of any maturity are to be redeemed, the Holders of the Series 2008 Bonds of such maturity will be paid as described under the heading "Partial Redemptions" below.

Sinking Fund Installments for the Series 2006A Bonds and the Series 2008A Bonds

The Series 2006A Bonds maturing on June 1, 2034 and the Series 2008A Bonds maturing on June 1, 2042 are subject to mandatory redemption from Sinking Fund Installments to the extent of available Collections in the amounts and on the dates set forth below, at a redemption price equal to 100% of the Bond Obligation being redeemed, plus interest accrued to the date fixed for redemption. To the extent that more than one Sinking Fund Installment is scheduled for the same date, payments shall be credited against such Sinking Fund Installments on a *pro rata* basis. The Indenture provides that the Indenture Trustee will not pay a Sinking Fund Installment unless, after giving effect to such payment, the Debt Service Account will contain sufficient funds to pay interest due on the next succeeding Distribution Date. Failure by the Authority to pay a Sinking Fund Installment when scheduled will not constitute an Event of Default under the Indenture. Amounts available in the Liquidity Reserve Account will not be available to pay Sinking Fund Installments.

Sinking Fund Installments for
Series 2006A Taxable Fixed Rate Turbo Term Bonds
Maturing June 1, 2034

June 1	Principal Amount	June 1	Principal Amount
2011	$ 4,050,000	2023	$13,610,000
2012	4,855,000	2024	14,655,000
2013	5,545,000	2025	15,805,000
2014	6,275,000	2026	17,040,000
2015	7,060,000	2027	18,370,000
2016	7,935,000	2028	19,790,000
2017	8,925,000	2029	21,325,000
2018	9,515,000	2030	22,975,000
2019	10,250,000	2031	24,750,000
2020	11,025,000	2032	26,650,000
2021	11,885,000	2033	28,705,000
2022	12,805,000	2034	30,915,000

Sinking Fund Installments for
Series 2008A Current Interest Turbo Term
Bonds Maturing June 1, 2042

June 1	Principal Amount
2035	$14,340,000
2036	14,360,000
2037	14,360,000
2038	14,360,000
2039	14,360,000
2040	14,360,000
2041	14,360,000
2042	14,360,000

Priority of Payments

So long as no Payment Default has occurred, the Series 2006A Bonds are entitled to receive payments from Collections of their Bond Obligation, whether by Sinking Fund Installments, Turbo Redemption or otherwise, prior to the payment of any Bond Obligation due on the Series 2008A Bonds, the Series 2008B Bonds or the Series 2008C Bonds; the Series 2008A Bonds are entitled to receive payment from Collections of their Bond Obligation, whether by Sinking Fund Installments, Turbo Redemption or otherwise, prior to the payment of any Bond Obligation due on the Series 2008B Bonds or the Series 2008C Bonds; and the Series 2008B Bonds are entitled to receive payment from Collections of their Bond Obligation, whether by Turbo Redemption or otherwise, prior to payment of any Bond Obligation due on Series 2008C Bonds. The rules described in this section are hereinafter referred to as the "**Priority of Payment Rules**".

Turbo Redemptions

The Authority has covenanted to apply 100% of all Surplus Collections, if any, in the Turbo Redemption Account to the special mandatory redemption ("**Turbo Redemption**") of the Bonds, including the Series 2008 Bonds. Turbo Redemption of Series 2008A Bonds will be at a redemption price equal to 100% of the Bond Obligation to be redeemed, plus interest accrued to the date fixed for redemption. Turbo Redemptions of the Series 2008B Bonds and the Series 2008C Bonds will be applied

to redeem such Series 2008B Bonds or Series 2008C Bonds at their Accreted Value as of the date fixed for redemption, without premium. Money available for each such Turbo Redemption will be credited against both Sinking Fund Installments and Turbo Term Bond maturities for the Turbo Term Bonds in chronological order. Turbo Redemptions are not scheduled amortization payments and are to be made only from Surplus Collections, if any. Turbo Redemptions may also be made from amounts on deposit in the Partial Lump Sum Payment Account with confirmation from each Rating Agency that no rating then in effect with respect to the Bonds from such Rating Agency will be withdrawn, reduced or suspended. Failure to pay Turbo Redemptions on Turbo Term Bonds will not constitute an Event of Default. Amounts in the Liquidity Reserve Account will not be available to make Turbo Redemptions.

The outstanding amounts of the Series 2006A, Series 2008A, Series 2008B and Series 2008C Bonds shown in the table below have been projected based on current balances, outstanding Series 2006A interest rates, assumed Series 2008 Bonds interest rates and accretion rates, the terms of the Series 2006 Bonds and Series 2008 Bonds and 2006 Pledged TSRs reflecting the Global Insight Base Case Consumption Forecast and Cash Flow Assumptions and other Bond Structuring Assumptions outlined under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION". The table also reflects the refunding of the Series 2006B Bonds and the open market purchase of the Series 2006C Bonds.

Projected Turbo Schedule for Series 2006 and Series 2008 Bonds*

Turbo Redemption Date (June 1)	Series 2006A Fixed Rate Turbo Term Bonds Maturing June 1, 2034	Series 2008A Current Interest Turbo Term Bonds Maturing June 1, 2042*	Series 2008B Taxable Capital Appreciation Turbo Term Bonds Maturing June 1, 2046*	Series 2008C Capital Appreciation Turbo Term Bonds Maturing June 1, 2058*	Total
2009	$11,675,000	$0	$0	$0	$11,675,000
2010	12,825,000	0	0	0	12,825,000
2011	14,325,000	0	0	0	14,325,000
2012	15,930,000	0	0	0	15,930,000
2013	17,645,000	0	0	0	17,645,000
2014	19,475,000	0	0	0	19,475,000
2015	21,425,000	0	0	0	21,425,000
2016	23,620,000	0	0	0	23,620,000
2017	25,975,000	0	0	0	25,975,000
2018	30,715,000	0	0	0	30,715,000
2019	33,615,000	0	0	0	33,615,000
2020	36,710,000	0	0	0	36,710,000
2021	40,095,000	0	0	0	40,095,000
2022	43,305,000	0	0	0	43,305,000
2023	7,380,000	39,300,000	0	0	46,680,000
2024		75,560,000	14,159,194	0	89,719,194
2025		0	53,620,189	0	53,620,189
2026		0	54,318,407	0	54,318,407
2027		0	3,530,839	51,498,658	55,029,496
2028		0	0	55,759,241	55,759,241
2029		0	0	56,501,246	56,501,246
2030		0	0	57,255,863	57,255,863
2031		0	0	58,020,823	58,020,823
2032		0	0	58,771,346	58,771,346
2033				41,227,179	41,227,179

* Turbo Redemptions of the Series 2006A Bonds and the Series 2008A Bonds are shown at the principal amount thereof, while Turbo Redemptions of the Series 2008B Bonds and the Series 2008C Bonds are shown at the Accreted Value on the projected redemption date. Assumes Turbo Redemptions are made based upon the receipt of Surplus Collections (as defined herein) in accordance with the Global Insight Base Case Forecast and other structuring assumptions. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. No assurance can be given that these structuring assumptions will be realized.

Limitations on Open Market Purchases

Money in the Pledged Accounts will not be used to make open market purchases of Bonds.

Optional Redemption

Series 2008A Bonds. The Series 2008A Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid, but as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2018, from any Maturity Date selected by the Authority in its discretion and in either case (x) if redeemed in part, in accordance with DTC's standard procedures, or if such Bonds are not then held by DTC or another Securities Depository, on such basis as the Trustee deems fair and appropriate, including by lot,

within a Maturity Date; and (y) at a redemption price equal to 100% of the Principal being redeemed, plus interest accrued to the date fixed for redemption.

"**Projected Turbo Redemption**" means, for a Series of Bonds, each respective Turbo Redemption projected to be made in accordance with the Indenture and the Bond structuring assumptions and methodology set forth under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION". See "THE SERIES 2008 BONDS — Turbo Redemptions" herein for the schedule of Projected Turbo Redemptions.

Series 2008B Bonds. The Series 2008B Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), on a pro rata basis, at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid but, as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2018, at a redemption price equal to 100% of the Accreted Value being redeemed on the date fixed for redemption.

Series 2008C Bonds. The Series 2008C Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid but, as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2033, from any Maturity Date selected by the Authority in its discretion and in either case (x) if redeemed in part, in accordance with DTC's standard procedures, or if such Bonds are not then held by DTC or another Securities Depository, on such basis as the Trustee deems fair and appropriate, including by lot, within a Maturity Date; and (y) at a redemption price equal to 100% of the Accreted Value being redeemed on the date fixed for redemption.

Redemption of Defeased Bonds

In the event of a full or partial defeasance of the Series 2008 Bonds, the defeasance escrow will be structured to redeem the Series 2008 Bonds in accordance with the Projected Turbo Schedule until the date fixed for any optional redemption of the Series 2008 Bonds.

Effect of Redemptions on Sinking Fund Installments and Turbo Term Bond Maturities

All redemptions of Series 2008 Bonds made under the Indenture from Collections will be credited as follows:

(1) the amount of any Turbo Redemptions will be credited against both Sinking Fund Installments and Turbo Term Bond Maturities in order of priority and within a priority in chronological order as set forth in the Series 2008 Supplement; and

(2) the amount of any Sinking Fund Installments made will be credited against Turbo Term Bond Maturities in order of priority and within a priority in chronological order as set forth in the Series 2008 Supplement; provided, however, that Sinking Fund Installments scheduled for the same date will be credited *pro rata* regardless of the maturity date of the related Term Bond maturity.

Partial Redemptions

If less than all of the Series 2008A Bonds and the Series 2008C Bonds of a maturity are to be redeemed, the Series 2008A Bonds or the Series 2008C Bonds within such maturity to be redeemed will be redeemed on such basis as the Indenture Trustee will deem fair and appropriate, including by lot.

If less than all of the Series 2008B Bonds of a maturity are to be redeemed, the Series 2008B Bonds within such maturity to be redeemed will be redeemed pro rata.

So long as Cede & Co. is the registered owner of the Series 2008 Bonds, as nominee of DTC, all notices of redemption, including partial redemptions, will go only to DTC. In the case of a partial redemption of the Series 2008 Bonds, DTC will determine the amount of the interest of each Direct Participant to be redeemed.

Mandatory Clean-Up Calls

The Outstanding Senior Bonds that are not Capital Appreciation Bonds, including the Series 2008A Bonds, are subject to mandatory redemption in whole at a redemption price equal to 100% of the Bond Obligation being redeemed, plus interest accrued to the date fixed for redemption, at any time that the available amounts on deposit in the Liquidity Reserve Account equal or exceed the Bond Obligation of, and accrued interest on, all such Senior Bonds.

The Bonds are subject to mandatory redemption in whole or at a redemption price equal to 100% of the Bond Obligation being redeemed, plus interest accrued to the date fixed for redemption, at any time that the available amounts on deposit in the Pledged Accounts equal or exceed the Bond Obligations of, and accrued interest on, all Outstanding Bonds and Parity Payments (each such mandatory redemption, a "**Mandatory Clean-Up Call**").

Notice of Redemption

When a Bond is to be redeemed prior to its stated Maturity Date, the Indenture Trustee will give notice to the Holder thereof in the name of the Authority, which notice will identify the Bond to be redeemed, state the date fixed for redemption, and state that such Bond will be redeemed at the Corporate Trust Office of the Indenture Trustee or a Paying Agent. The notice will further state that on such date there will become due and payable upon each Bond to be redeemed the redemption price thereof, together with interest accrued to the date fixed for redemption, and that money therefor having been deposited with the Indenture Trustee or Paying Agent, from and after such date, interest on Current Interest Bonds to be redeemed will cease to accrue and the value of Capital Appreciation Bonds and Convertible Capital Appreciation Bonds to be redeemed will cease to accrete. The Indenture Trustee will give at least 15 days' notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions under the Indenture, to the registered owners of any Bonds which are to be redeemed, at their addresses shown on the registration books of the Authority. Such notice may be waived by any Holders holding Bonds to be redeemed. Failure by a particular Holder to receive notice, or any defect in the notice of such Holder, will not affect the redemption of any other Bond. Any notice of redemption given pursuant to the Indenture may be rescinded by Written Notice to the Indenture Trustee by the Authority no later than five days prior to the date specified for redemption. The Indenture Trustee will give notice of such rescission as soon thereafter as practicable in the same manner and to the same persons, as notice of such redemption was given as described above. In making the determination as to how much money will be available in the Turbo Redemption Account on any Distribution Date for the purpose of giving notice of redemption, the Indenture Trustee will take into account investment earnings which it reasonably expects to be available for application.

Refunding Bonds and Additional Bonds

Subsequent to the issuance of the Series 2006 Bonds, additional Series of Bonds (each a "**Series**"), including the Series 2008 Bonds, may be issued as either **"Refunding Bonds"** or "**Additional Bonds**" at the discretion of the Authority but only if upon the issuance of such Refunding Bonds or Additional Bonds: (A) the amount on deposit in the Liquidity Reserve Account following the issuance of the Refunding Bonds or Additional Bonds will be at least equal to the Liquidity Reserve Requirement; (B) no Event of Default has occurred and is continuing after the date of issuance of such Bonds; (C) the expected weighted average life of each Turbo Term Bond that will remain Outstanding after issuance of the Refunding Bonds or Additional Bonds as computed on the basis of new projections on the date of sale of the Refunding Bonds or Additional Bonds will not exceed (x) the remaining expected weighted average life of each such Turbo Term Bond as computed by the Authority on the basis of new projections, assuming that no such Refunding Bonds or Additional Bonds are issued, plus (y) one year; and (D) a Rating Confirmation is received for any Bonds that will remain Outstanding after the date of issuance of the Additional Bonds or Refunding Bonds which are then rated by a Rating Agency. Refunding Bonds may also be issued under the Indenture to refund all Outstanding Bonds in whole without satisfaction of any of the foregoing conditions.

Subordinate Bonds

One or more Series of Bonds (the "**Subordinate Bonds**") may be issued for any purpose by the Authority if there is no payment permitted for such bonds until all then outstanding Bonds are Fully Paid. Subordinate Bonds may be issued without satisfying the requirements of the Indenture relating to Additional Bonds and Refunding Bonds.

SECURITY FOR THE BONDS

Pledge of Collateral

Pursuant to the Indenture, the Bonds will be secured by a pledge and assignment of the "**Collateral**," consisting of all of the: (i) the Collections, (ii) all rights to receive the Collections and the proceeds of such rights, (iii) the Pledged Accounts and money and investments on deposit in or credited to the Pledged Accounts, (iv) subject to the terms and provisions of the Indenture and the 2006 Purchase Agreement, all rights and remedies with respect to any breach by the State of any of its covenants, obligations, representations, and warranties under the 2006 Purchase Agreement and all interests in the 2006 Pledged TSRs of the Authority under the 2006 Purchase Agreement, and (v) any and all other property of every kind and nature from time to time hereafter, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture. The pledge and assignment of the collateral is not subject or subordinate to any other pledge, assignment or encumbrance. Collateral does not include the Unsold Tobacco Receipts or the Unencumbered TSRs.

The right of the Indenture Trustee to receive the 2006 Pledged TSRs is equal to and on a parity with, and is not inferior or superior to, the right of the Authority to receive the 2007 Sold Tobacco Receipts and the Unencumbered TSRs, the right of the 2007 Indenture Trustee to receive the 2007 Pledged TSRs, and the right of the State to receive the Unsold Tobacco Receipts. The Indenture Trustee will have no right to any 2007 Sold Tobacco Receipts, Unsold Tobacco Receipts or Unencumbered TSRs under any circumstances, including a deficiency in the 2006 Pledged TSRs.

Except as specifically provided in the Indenture, the assignment and pledge described above does not include: (i) the rights of the Authority pursuant to provisions for consent or other action by the Authority, notice to the Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Bondholders or other Beneficiaries or (ii) any right or power reserved

to the Authority pursuant to the Act or other law; nor does the Indenture preclude the Authority's enforcement of its rights under and pursuant to the 2006 Purchase Agreement for the benefit of the Holders as provided in the Indenture.

In the Indenture, the Authority covenants that it will implement, protect and defend the pledge and assignment of the Collateral by all appropriate action for the benefit of the Holders of the Bonds, the cost of which are Operating Expenses.

None of the proceeds of the Bonds or any earnings therefrom, unless deposited in the Pledged Accounts, will in any way be pledged to the payment of the Bonds or be part of the Collateral.

Amounts in the Operating Account and the Unencumbered TSR Account are not pledged as security for the Bonds under the Indenture.

2006 Sold Tobacco Receipts

The "**2006 Sold Tobacco Receipts**" consist of the right, title and interest in and to 13.34% of (i) all tobacco settlement revenue that is received by the State that is required to be made under the terms of the MSA by tobacco manufacturers to the State, and that is payable to the State on or after April 1, 2008, (ii) all lump sum or partial lump sum payments of tobacco settlement revenue, whenever received, that are allocable to a payment that is payable on or after April 1, 2008 under the terms of the MSA by tobacco manufacturers to the State, and (iii) the State's rights to receive the tobacco settlement revenue referred to in (i) and (ii) under the MSA. The 2006 Sold Tobacco Receipts include 13.34% of any amounts due to the State and withheld or deposited in the Disputed Payments Account (as defined herein) on or after April 1, 2008, by the tobacco manufacturers as a result of a dispute as to the amount of a payment required to be made by them under the MSA, and that are subsequently paid by the tobacco manufacturers or released from the Disputed Payments Account, but specifically exclude any right to or interest in amounts withheld or deposited in the Disputed Payments Account before April 1, 2008.

Percentage of 2006 Pledged TSRs

The 2006 Sold Tobacco Receipts pledged under the Indenture (the "**2006 Pledged TSRs**") represent the right, title and interest of the Authority in and to, initially, 100% of the 2006 Sold Tobacco Receipts. From time to time, in connection with the issuance of Additional Bonds or Refunding Bonds, the Authority may reduce the percentage of 2006 Sold Tobacco Receipts constituting 2006 Pledged TSRs (and correspondingly increase the percentage of 2006 Sold Tobacco Receipts constituting Unencumbered TSRs), by delivering to the Indenture Trustee an Officer's Certificate of the Authority setting forth the revised percentage of 2006 Sold Tobacco Receipts constituting 2006 Pledged TSRs. The pledge will not be reduced in connection with the issuance of the Series 2008 Bonds, and the Authority has covenanted in the Indenture that so long as any Series 2008 Bonds are Outstanding under the Indenture, the Authority will not reduce the percentage of 2006 Sold Tobacco Receipts constituting 2006 Pledged TSRs.

The right of the Indenture Trustee to receive the 2006 Pledged TSRs is equal to and on a parity with, and is not inferior or superior to, the right of the Authority to receive the 2007 Sold Tobacco Receipts and the Unencumbered TSRs, the right of the 2007 Indenture Trustee to receive the 2007 Pledged TSRs, and the right of the State to receive the Unsold Tobacco Receipts. The Indenture Trustee will have no right to any 2007 Sold Tobacco Receipts, Unsold Tobacco Receipts or Unencumbered TSRs under any circumstances, including a deficiency in the 2006 Pledged TSRs.

Accounts

All of the following funds and accounts will be established and held by the Indenture Trustee for the benefit of the holders of the Bonds. All money on deposit in the following accounts will be invested in Eligible Investments as defined in the Indenture.

Collection Account. Under the Indenture, the Indenture Trustee will establish and hold a segregated trust account (the "**Collection Account**") into which the Indenture Trustee will deposit all Collections. Funds on deposit in the Collection Account will be transferred to various other accounts under the Indenture and applied to certain other purposes as described below.

Bond Fund. Under the Indenture, the Indenture Trustee will establish and hold a segregated trust fund (the "**Bond Fund**") which will include the Debt Service Account, the Capitalized Interest Subaccount, the Liquidity Reserve Account, the Partial Lump Sum Payment Account, and the Turbo Redemption Account.

Debt Service Account. Under the Indenture, the Indenture Trustee will establish and hold within the Bond Fund a segregated trust account (the "**Debt Service Account**") into which the Indenture Trustee will deposit amounts transferred from the Collection Account in respect of interest on and Principal of the Bonds and from which the Indenture Trustee will make payments on the Bonds in accordance with the priority of payments as described below under "Application of Collections."

Liquidity Reserve Account. Upon the Delivery Date of the Series 2008 Bonds, the Liquidity Reserve Account will remain funded at its required level of $38,801,532.39 (the "**Liquidity Reserve Requirement**"), which level is required to be maintained for so long as any Series 2008A Bonds, Series 2006A Bonds or any other Senior Bonds that are not Capital Appreciation Bonds remain Outstanding. However, the Authority may amend the Liquidity Reserve Requirement in connection with the issuance of Refunding Bonds or Additional Bonds.

Prior to a Payment Default, amounts on deposit in the Liquidity Reserve Account will be available to pay the Bond Obligation of and interest on the Series 2008A Bonds, the Series 2006A Bonds and any other Senior Bonds (other than Capital Appreciation Bonds) to the extent Collections are insufficient for such purpose. Money in the Liquidity Reserve Account is not available prior to a Payment Default to make any payments on the Series 2008B Bonds, the Series 2008C Bonds or any other Capital Appreciation Bonds. After a Payment Default, money in the Liquidity Reserve Account will be available to pay Pro Rata the Bond Obligations of and interest on all Senior Bonds, including Capital Appreciation Bonds. Amounts in the Liquidity Reserve Account will not be available to make Sinking Fund Installments or Turbo Redemptions on any Series 2008 Bonds. Unless a Payment Default has occurred, amounts withdrawn from the Liquidity Reserve Account will be replenished from Collections as described herein.

A Bond will be deemed "**Fully Paid**" only if: (i) such Bond has been canceled by the Indenture Trustee or delivered to the Indenture Trustee for cancellation; or (ii) such Bond will have matured or been called for redemption and, on such Maturity Date or redemption date, money for the payment of the Bond Obligation of, redemption premium, if any, and interest on such Bond is held by the Indenture Trustee in trust for the benefit of the person entitled thereto; or (iii) such Bond is alleged to have been lost, stolen, destroyed, partially destroyed, or defaced and has been replaced as provided the Indenture; or such Bond has been defeased as provided in the Indenture (whether as part of a defeasance of all or less than all of the Bonds).

Unless a Payment Default has occurred, on any Distribution Date on which the amount on deposit in the Liquidity Reserve Account (less any amount necessary to be paid in connection with the liquidation

of the investments of amounts in the Liquidity Reserve Account, including a Termination Payment) equals or exceeds the Bond Obligation of and interest on all Outstanding Senior Bonds other than Capital Appreciation Bonds, the amount in the Liquidity Reserve Account will be transferred to the Turbo Redemption Account and applied to the Turbo Redemption of all Outstanding Senior Bonds other than Capital Appreciation Bonds, and then of all remaining Outstanding Senior Bonds.

The Indenture provides that, upon Rating Confirmation and with an opinion of nationally recognized bond counsel if any Tax-Exempt Bonds are Outstanding, the Authority may replace amounts and investments held in the Liquidity Reserve Account with sureties and other "**Cash Equivalents**" (as defined in the Indenture) and then transfer such replaced amounts to the Unencumbered TSR Account, free and clear of the lien of the Indenture. The Authority has covenanted in the Indenture that, so long as any Series 2008 Bonds are outstanding, it will not use a Cash Equivalent for deposit to the Liquidity Reserve Account to satisfy the Liquidity Reserve Requirement.

Partial Lump Sum Payment Account. Under the Indenture, the Indenture Trustee will hold a segregated trust account (the "**Partial Lump Sum Payment Account**") into which the Indenture Trustee will deposit all 2006 Pledged TSRs consisting of Partial Lump Sum Payments. The Indenture Trustee will apply amounts in the Partial Lump Sum Payment Account to pay interest on and principal of Bonds due on any Distribution Date to the extent of any insufficiency of amounts available in the Debt Service Account. Amounts will be transferred from the Partial Lump Sum Payment Account to the Turbo Redemption Account at the written direction of the Authority, accompanied by a Rating Confirmation.

Turbo Redemption Account. Under the Indenture, the Indenture Trustee will hold a segregated trust account (the **"Turbo Redemption Account"**) into which the Indenture Trustee will deposit all Surplus Collections. The Indenture Trustee will make Turbo Redemptions of the Series 2008 Bonds from the Turbo Redemption Account. Money in the Turbo Redemption Account may not be applied to the open market purchase of Turbo Term Bonds.

Application of Collections

The Indenture Trustee will deposit all 2006 Pledged TSRs in the Collection Account, except as described below. Unencumbered TSRs, if any, will be deposited in the Unencumbered TSR Account and used by the Authority for any lawful purposes. As used herein, the term "**Deposit Date**" means the date of actual receipt by the Indenture Trustee of any Collections.

All Collections that have been identified by an Officer's Certificate as consisting of Partial Lump Sum Payments received by the Indenture Trustee will be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Partial Lump Sum Payment Account. All Collections that have been identified by an Officer's Certificate as consisting of Total Lump Sum Payments received by the Indenture Trustee will be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) applied pursuant to the Indenture, as described below.

Not later than on each Distribution Date the Indenture Trustee will deposit in the Collection Account and apply as described in the next paragraph all Collections consisting of investment earnings on amounts on deposit with the Indenture Trustee in the Pledged Accounts (excluding amounts in the Partial Lump Sum Payment Account), except that, unless otherwise specified in a Series Supplement relating to a Series of Senior Bonds, (i) all amounts in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement determined to exist pursuant to the valuation procedure described in the Indenture will be transferred to the Debt Service Account (except as otherwise provided in the Indenture) and (ii) prior to December 1, 2008 all investment earnings in the Capitalized Interest Subaccount not

required on such Distribution Date for the payment of interest on Outstanding Senior Bonds will be retained in the Capitalized Interest Subaccount.

As soon as is practicable, but in any event no later than the earlier of (x) the fifth Business Day following each Deposit Date, or (y) the Distribution Date following each Deposit Date, the Indenture Trustee will withdraw the funds on deposit in the Collection Account and transfer such amounts as follows:

(i) to the Operating Account, an amount sufficient to cause the amount therein to equal the amount specified by an Officer's Certificate in order to pay, for the twelve-month period applicable to such Officer's Certificate, (x) the Operating Expenses and Termination Payments to the extent that the amount thereof does not exceed the Operating Cap[*], (y) the Tax Obligations, and (z) Priority Payments;

(ii) to the Debt Service Account, an amount sufficient to cause the amount therein (taking into account any amounts already on deposit in the Capitalized Interest Subaccount or the Debt Service Account) to equal the sum of (x) interest at the stated rate on Outstanding Fixed Rate Bonds, plus (y) interest at the Applicable Periodic Rate on Outstanding Indexed Floating Rate Bonds through the next Distribution Date, and thereafter, at the Assumed Rate to the next succeeding Distribution Date, and all Parity Payments that will come due (i) in the next succeeding Bond Year, if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, or (ii) in the then-current Bond Year, if the Deposit Date is on or after June 1 and on or before November 30 of any Bond Year, plus (z) any such unpaid interest on the Outstanding Current Interest Bonds and all Parity Payments from prior Distribution Dates (including interest at the stated rate or Applicable Periodic Rate on such unpaid interest, to the extent legally permissible); and the amounts to be so deposited will be calculated assuming that the Bond Obligation of the Outstanding Current Interest Bonds will have been paid as described in clauses (ii), (iii), (iv) and (v) of the following paragraph;

(iii) to the Debt Service Account, an amount sufficient to cause the amount therein to equal the amount specified in clause (ii) above plus the sum of (a) if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, the Serial Bond maturity, Sinking Fund Installment or Term Bond maturities (including Turbo Term Bond Maturities) due in or scheduled for the next succeeding Bond Year, plus (b) any such Serial Bond maturities, Sinking Fund Installment or Term Bond maturities (including Turbo Term Bond Maturities) unpaid from prior Distribution Dates, but the amount of each Sinking Fund Installment will first be adjusted as described in the Indenture;

(iv) unless a Payment Default has occurred, to the Liquidity Reserve Account an amount sufficient to cause the amount on deposit therein to equal the Liquidity Reserve Requirement; provided that on any Distribution Date on which the amount in the Liquidity Reserve Account (less any amount necessary to be paid in connection with the liquidation of the investment of amounts in the Liquidity Reserve Account, including a Termination Payment) equals or exceeds the Bond Obligation of and interest on all Outstanding Senior Bonds other than Capital Appreciation Bonds, the amount in the

[*] The "**Operating Cap**" is $200,000 in the Fiscal Year ending September 30, 2006 and adjusted for inflation in subsequent Fiscal Years by the greater of 3% or the percentage increase in the Consumer Price Index for all urban consumers as published by the Bureau of Labor Statistics for the prior year. In addition, the Operating Cap includes amounts required in the applicable Fiscal Year for Tax Obligations and Priority Payments.

Liquidity Reserve Account will be transferred to the Turbo Redemption Account and applied to the Turbo Redemption of all then Outstanding Senior Bonds other than Capital Appreciation Bonds, and then of all remaining Outstanding Senior Bonds;

(v) to the Operating Account, the amount, if any, necessary to make the amount therein equal to the amount specified by the Officer's Certificate delivered pursuant to the Indenture in order to pay, for the twelve-month period applicable to such Officer's Certificate, the Operating Expenses and Termination Payments, if any, in excess of the Operating Cap;

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

(vii) to the Turbo Redemption Account, all amounts remaining in the Collection Account (the **"Surplus Collections"**).

Unless a Payment Default has occurred and continues, on each Distribution Date the Indenture Trustee will apply amounts in the various Accounts in the following order of priority:

(i) from the Capitalized Interest Subaccount, the Debt Service Account, the Partial Lump Sum Payment Account, and the Liquidity Reserve Account, in that order, to pay interest at the stated rate on Outstanding Fixed Rate Bonds, interest at the Applicable Periodic Rate on Outstanding Indexed Floating Rate Bonds and all Parity Payments due on such Distribution Date;

(ii) from the Debt Service Account and the Partial Lump Sum Payment Account, in that order, to pay, in the following order, the Serial Bond maturities, Sinking Fund Installments, and parity Term Bond maturities (including Turbo Term Bond Maturities) due on or scheduled for such Distribution Date, provided that (a) the amount of such Sinking Fund Installment will first have been adjusted as described in the Indenture, and (b) the Indenture Trustee will not pay a Sinking Fund Installment or a Term Bond maturity (including Turbo Term Bond Maturities) unless the Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date, such interest to be calculated at the stated rate on Outstanding Fixed Rate Bonds and at the Assumed Rate on Outstanding Indexed Floating Rate Bonds through the next succeeding Distribution Date;

(iii) from the Liquidity Reserve Account first to pay the Serial Bond maturities and Turbo Term Bond Maturities due on or scheduled for such Distribution Date or unpaid from prior Distribution Dates, provided that (a) the amount of such Turbo Term Bond Maturities will first have been adjusted as described in the Indenture and (b) the Indenture Trustee shall not pay a Turbo Term Bond Maturity pursuant to this paragraph unless the Liquidity Reserve Account will, after giving effect to such payment, contain sufficient funds to pay interest due on the next succeeding Distribution Date, such interest to be calculated at the stated rate on Outstanding Fixed Rate Bonds and at the Assumed Rate on Outstanding Indexed Floating Rate Bonds through the next succeeding Distribution Date, and then to reimburse the provider of any Eligible Investment provided in lieu of or in substitution for amounts in the Liquidity Reserve Account for any payment under or draw on such investment for a purpose for which the Liquidity Reserve Account is otherwise available;

(iv) from the Turbo Redemption Account, to redeem Turbo Term Bonds on such Distribution Date; and

(v) from the Partial Lump Sum Payment Account, but only as directed in an Officer's Certificate delivered by the Authority and accompanied by Rating Confirmation, to redeem Turbo Term Bonds on such Distribution Date in accordance with the Indenture.

Upon the occurrence of a Payment Default, on each Distribution Date commencing with the Distribution Date following a Payment Default, the Indenture Trustee will apply all Collections and funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account, and the Turbo Redemption Account to pay Pro Rata, first, the accrued interest on the Bonds and all Parity Payments (including, in each case, interest at the stated rate or Applicable Periodic Rate on any unpaid interest, to the extent legally permissible) and, second, the Bond Obligation of all Bonds then Outstanding in their order of priority. For purposes of the clause "first" in this paragraph, from and after its Maturity Date, a Capital Appreciation Bond will accrue interest at a rate per annum equal to the Default Rate therefor set forth in the Series Supplement authorizing the issuance of such Capital Appreciation Bonds.

Upon the receipt of a sum that has been identified by an Officer's Certificate as a Total Lump Sum Payment, the Indenture Trustee will, after making provision for the amounts required to be deposited as described above and giving notice of redemption, use all remaining proceeds of such Total Lump Sum Payment to pay, subject to the Priority of Payment Rules, Pro Rata, first, the accrued interest on the Bonds and Parity Payments (including interest at the stated rate or Applicable Periodic Rate on any unpaid interest, to the extent legally permissible) and, second, the Bond Obligation of all Bonds then Outstanding in their order of priority.

After making all deposits and payments set forth above, and provided that there are no Outstanding Bonds and no obligations to make payments under an Ancillary Facility, the Indenture Trustee will deliver any amounts remaining to the holder of the Residual Certificate.

Money in the Operating Account will be applied by the Indenture Trustee in accordance with an Officer's Certificate, first, to pay Operating Expenses, Tax Obligations and Priority Payments, and then to pay Termination Payments.

2006 Sold Tobacco Receipts; State Covenant

The State has provided through the 2006 Purchase Agreement for the Authority's ownership and receipt of the 2006 Sold Tobacco Receipts. Under the Indenture, the Authority acknowledges that the MSA and the 2006 Purchase Agreement constitute important security provisions of the Bonds and waives any right to assert any claim to the contrary.

The Authority includes in the Indenture the pledges made by the State in the Act and the 2007 Purchase Agreement. For a description of certain of such covenants of the State contained in the Indenture, see "THE 2006 PURCHASE AGREEMENT—Covenants of the State" below.

No Indebtedness or Funds of the State

The Indenture does not create indebtedness of the State for any purpose, including constitutional or statutory limitations. The Authority's revenues are not funds of the State.

THE AMENDED AND RESTATED 2006 PURCHASE AGREEMENT

The following summary describes certain terms of the Indenture and the 2006 Purchase Agreement. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the 2006 Purchase Agreement. Copies of the

Indenture and the 2006 Purchase Agreement may be obtained upon written request to the Indenture Trustee.

Conveyance of 2006 Sold Tobacco Receipts

The State sold to the Authority, without recourse (subject to the obligations in the 2006 Purchase Agreement), all right, title and interest of the State in and to the 2006 Sold Tobacco Receipts.

The purchase price paid by the Authority to the State under the 2006 Purchase Agreement in connection with the issuance of the Series 2006 Bonds consisted of: (i) the sum of $400,000,000 and (ii) a security representing the right to receive 2006 Sold Tobacco Receipts and income of the Authority that is in excess of the Authority's requirements to pay various expenses, debt service or required reserves with respect to the Series 2006 Bonds, and certain other amounts. In connection with the issuance of the Series 2008 Bonds, the Authority will pay to the State (i) the sum of $60,000,000 for deposit to the State's General Fund and (ii) a security representing the right to receive 2006 Sold Tobacco Receipts and income of the Authority that is in excess of the Authority's requirements to pay various expenses, debt service or required reserves with respect to the Series 2006 Bonds and the Series 2008 Bonds, and certain other amounts (the "**Residual Certificate**"). The State will own the sole beneficial interest in the Residual Certificate.

Notification of Transfer

The State has notified the Escrow Agent that the State sold the 2006 Sold Tobacco Receipts to the Authority. In connection with the issuance of the Series 2008 Bonds, the State will issue amended and restated instructions irrevocably instructing the Escrow Agent to pay the 2006 Sold Tobacco Receipts directly to the Indenture Trustee until the Escrow Agent receives a direction from the owner of the Residual Certificate to the effect that all Bonds issued under the Indenture have been paid in full.

Covenants of the State

Protection of MSA and Qualifying Statute. The State will enforce the provisions of the MSA requiring the payment of the 2006 Sold Tobacco Receipts and the Authority's rights to receive the same to the full extent permitted by the terms of the MSA. The State will not amend the MSA in any manner that would materially impair the rights of the Holders of the Series 2008 Bonds. The State will diligently enforce the provisions of the Qualifying Statute and it will not amend, supersede, or repeal the Qualifying Statute in any way that would materially adversely affect the amount of any payment to, or materially impair the rights of, the Authority or the Holders of the Series 2008 Bonds.

Non-Impairment Covenant. The State will not limit or alter the rights of the Authority to fulfill the terms of its agreements with Holders of the Series 2008 Bonds. The State will not in any way impair the rights and remedies of Holders of the Series 2008 Bonds or the security for the Series 2008 Bonds or Ancillary Facilities, subject to the provisions of the Act, until such Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Holders, are fully paid and discharged.

Further Actions. Upon request of the Authority or the Indenture Trustee, the State will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of the 2006 Purchase Agreement. The State will promptly pay over to the Indenture Trustee the proceeds of any 2006 Sold Tobacco Receipts received by the State in error.

Amendment

The 2006 Purchase Agreement may be amended by written agreement of the State and the Authority.* In connection with the issuance of the Series 2008 Bonds, the 2006 Purchase Agreement will be amended and restated to provide for the refunding of certain outstanding Bonds and the sale by the State to the Authority of residual interests in the 2006 Sold Tobacco Receipts sufficient to provide $60,000,000 of net proceeds to the State.

Assignment and Pledge by the Authority

The State has acknowledged and consented to the pledge and assignment by the Authority to the Indenture Trustee for the benefit of the Bondholders of any and all right, title and interest of the Authority in, to and under the 2006 Sold Tobacco Receipts or the assignment of any or all of the Authority's rights and obligations thereunder to the Indenture Trustee.

Limitation of Liability of the State

Except with respect to the enforcement of the State's covenant to pay over to the Indenture Trustee any 2006 Sold Tobacco Receipts received in error, the Authority and the Bondholders may only seek injunctive relief to enforce, or an order to compel specific performance of, the covenants of the State contained in the 2006 Purchase Agreement.

Notwithstanding anything in the 2006 Purchase Agreement to the contrary, no officer or employee of the State will have any liability for the representations, warranties, covenants, agreements or other obligations of the State in the 2006 Purchase Agreement or in any of the certificates, notices or agreements delivered pursuant to the 2006 Purchase Agreement.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

The following is a brief summary of certain provisions of the MSA. This summary is not complete and is subject to, and qualified in its entirety by reference to, the copy of the MSA, as amended, which is attached hereto as Appendix B. Several amendments have been made to the MSA which are not included in Appendix B. Except for those amendments pursuant to which certain tobacco companies became SPMs (as defined below), such amendments involve technical and administrative provisions not material to the summary below.

General

The MSA is an industry-wide settlement of litigation between the Settling States 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 cigarette consumers. Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking-related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions and funding educational programs, all in accordance with the terms and conditions

* The Authority in the Indenture has limited its rights to amend the 2006 Purchase Agreement. See APPENDIX D — "DEFINITIONS AND SUMMARY OF THE INDENTURE."

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 the National Association of Attorneys General ("**NAAG**"), as of June 10, 2008, 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 10, 2008:

OPMs	SPMs	
Lorillard Tobacco Company	Bekenton, S.A.*	Lignum-2, Inc.
Philip Morris, USA (formerly Philip Morris Incorporated)	Canary Islands Cigar Co.	Mac Baren Tobacco Company A/S
Reynolds American, Inc. (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.)
	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	Sherman's 1400 Broadway N.Y.C. Inc.
	Imperial Tobacco Limited/ITL (UK)	Societe National d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)
	Imperial Tobacco Mullingar (Ireland)	Tabacalera del Este, S.A. (TABESA)
	Imperial Tobacco Polska S.A. (Poland)	Top Tobacco, LP
	Imperial Tobacco Production Ukraine	U.S. Flue-Cured Tobacco Growers, Inc.
	Imperial Tobacco Sigara ve Tutunculuk Sanayi Ve Ticaret S.A. (Turkey)	Van Nelle Tabak Nederland B.V. (Netherlands)
	International Tobacco Group (Las Vegas), Inc.	Vector Tobacco Inc. (formerly Vector Tobacco Inc. and Medallion Company, Inc.)
	Japan Tobacco International USA, Inc.	Virginia Carolina Corporation, Inc.
	King Maker Marketing	Von Eicken Group
	Konci G&D Management Group (USA) Inc.	Wind River Tobacco Company, LLC
	Kretek International	VIP Tobacco USA, LTD. (formerly Winner Sales Company)
	Lane Limited	ZNF International, LLC (no current brands)
	Liberty Brands, LLC*	
	Liggett Group, Inc.	

The MSA restricts PMs from transferring their tobacco product brands, cigarette product formulas and cigarette businesses (unless they are being transferred exclusively for use outside the United States) to any entity that is not a PM under the MSA, unless the transferee agrees to assume the obligations of the transferring PM under the MSA related to such brands, formulas or businesses. The

* Has filed for bankruptcy relief.

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" herein.

Scope of Release

Under the MSA, the PMs and the other "Released Parties" (defined below) are released from:

- claims based on past conduct, acts or omissions (including any future damages arising therefrom) in any way relating to the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, or exposure to, or research statements or warnings regarding, tobacco products; and

- monetary claims based on future conduct, acts or omissions in any way relating to the use of or exposure to tobacco products manufactured in the ordinary course of business, including future claims for reimbursement of healthcare costs.

This release is binding upon each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions. The MSA is further stated to be binding on the following persons, to the full extent of the power of the signatories to the MSA to release past, present and future claims on their behalf: (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 Michigan Attorney General does not have the power or authority to bind any of the Releasing Parties in Michigan, 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, Annual Payments and Strategic Contribution Payments.* See "— Initial Payments," "— Annual Payments" and "—Strategic Contribution Payments" below. These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "−Adjustments to Payments" and "−Subsequent Participating Manufacturers" below. SPMs were not required to make Initial Payments. Thus far, the OPMs have made all of the Initial Payments, and the PMs have made the Annual Payments for 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007 and 2008 (subject to certain withholdings described in "RISK FACTORS — Other Potential Payment Decreases Under the Terms of the MSA" herein). The 2006 Sold Tobacco Receipts do not include any payments made before April 1, 2008. See "— Payments Made to Date" below. Strategic Contribution Payments began on April 15, 2008 and will continue through April 15, 2017.

Payments required to be made by the OPMs are calculated by reference to the OPM's domestic shipments of cigarettes, with the amount of the payments adjusted annually roughly in proportion to the changes in total volume of cigarettes shipped by the OPMs in the United States in the preceding year. Payments to be made by the PMs are recalculated each year, based on the United States market share of each individual PM for the prior year, with consideration under certain circumstances, for the profitability of each OPM. The Annual Payments and Strategic Contribution Payments required to be made by the SPMs are based on increases in their shipment market share. See "−Subsequent Participating Manufacturers" below. Pursuant to an escrow agreement (the "**MSA Escrow Agreement**") established in conjunction with the MSA, remaining Annual Payments and Strategic Contribution Payments are to be made to Citibank, N.A., as escrow agent (the "**MSA Escrow Agent**"), which in turn will disburse the funds to the Settling States.

Beginning with the payments due in the year 2000, PricewaterhouseCoopers LLP (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), the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the PMs and among the Settling States. *This information is not publicly available and, the MSA Auditor has agreed to maintain the confidentiality of all such information, except that the MSA Auditor may provide such information to PMs and the Settling States as set forth in the MSA.*

Initial Payments

Initial Payments were made only by the OPMs. In December 1998, the OPMs collectively made an up-front Initial Payment of $2.40 billion. The 2000 Initial Payment, which had a scheduled base amount of $2.47 billion, was paid in December 1999 in the approximate amount of $2.13 billion due to various adjustments. The 2001 Initial Payment, which had a scheduled base amount of $2.55 billion, was paid in December 2000 in the approximate amount of $2.04 billion after taking into account various adjustments and an earlier overpayment. The 2002 Initial Payment, which had a scheduled base amount of $2.62 billion, was paid in December 2001, in the approximate amount of $1.89 billion after taking into account various adjustments and a deposit made to the Disputed Payments Account. Approximately $204 million, which was substantially all of the money previously deposited in the Disputed Payments Account for payment to the Settling States, was distributed to the Settling States with the Annual Payment due April 15, 2002. The 2003 Initial Payment, which had a scheduled base amount of $2.70 billion, was

* 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 Authority, and consequently are not discussed here.

paid in December 2002 and January 2003, in the approximate aggregate amount of $2.14 billion after taking into account various adjustments.

Annual Payments

The OPMs and the other PMs are required to make Annual Payments on each April 15 in perpetuity. The PMs made the first eight Annual Payments due April 15 in each of the years 2000 through 2008, the scheduled base amounts of which (before adjustments discussed below) were $4.5 billion, $5.0 billion, $6.5 billion, $6.5 billion, $8.0 billion, $8.0 billion, $8.0 billion, $8.0 billion and $8.139 billion, respectively. After application of the adjustments, the Annual Payment made (i) in April 2000 was approximately $3.5 billion, (ii) in April 2001 was approximately $4.1 billion, (iii) in April 2002 was approximately $5.2 billion, (iv) in April 2003 was approximately $5.1 billion, (v) in April 2004 was approximately $6.2 billion, (vi) in April 2005 was approximately $6.3 billion, (vii) in April 2006 was approximately $5.8 billion, and (viii) in April 2007 was approximately $6.0 billion. It has been reported that in April 2008, the aggregate amount of Annual Payments made was approximately $6.2 billion. The scheduled base amount (before adjustments discussed below) of each Annual Payment, subject to adjustment, is set forth below:

Annual Payments

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

* The 2000 through 2008 Annual Payments have been made. However, subsequent adjustments to these Annual Payments may impact subsequent Annual Payments and Strategic Contribution Payments.

The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM's Relative Market Share during the preceding calendar year. The base annual payments in the above table will be increased by at least the minimum 3% Inflation Adjustment, adjusted by the Volume Adjustment, reduced by the Previously Settled States Reduction, and further adjusted by the other adjustments described below. Each SPM has Annual Payment and Strategic Contribution Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share. 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.

"**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. (or any successor acceptable to all the OPMs and a majority of the attorneys general of the Settling States who are also members of the NAAG executive committee). The term "**cigarette**" is defined in the MSA to mean any product that contains nicotine, is intended to be burned, contains tobacco

and is likely to be offered to, or purchased by, consumers as a cigarette and includes “roll-your-own” tobacco.

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

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

Application of these adjustments resulted in a material reduction of the Annual Payments made to the State from the scheduled base amounts of the Annual Payments made by the PMs in April of the years 2000 through 2008, as discussed below under the heading "— Payments Made to Date."

Strategic Contribution Payments

The OPMs are also required to make Strategic Contribution Payments on April 15, 2008 and on April 15 of each year thereafter through 2017. The base amount of each Strategic Contribution Payment is $861 million. It has been reported that in April 2008, the aggregate amount of Strategic Contribution Payments made was approximately $793.5 million. The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM’s Relative Market Share during the preceding calendar year. The SPMs will be required to make Strategic Contribution Payments in accordance with formula provided for Annual Payments. See "— *Overview of Payments by Participating Manufacturers*."

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

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

Adjustments to Payments

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

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

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

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

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

Previously Settled States Reduction. The base amounts of the Annual Payments (as adjusted by the Inflation Adjustment and the Volume Adjustment, if any) are subject to a reduction reflecting the four states that 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 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 the Strategic Contribution Payments, if any, due from the PMs shall be

reduced to account for the absence of such state. This adjustment has no effect on the amounts to be collected by states which remain a party to the MSA, and the reduction is therefore not detailed.

Non-Participating Manufacturers Adjustment. The NPM Adjustment 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. 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 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 a Model Statute or 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:

NPM Adjustment = 50% +
[50% / (Base Aggregate Participating Manufacturer Market Share – 16⅔%)]
x [market share loss – 16⅔%]

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

The NPM Adjustment is also state-specific, in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute. Any Settling State that adopts and diligently enforces a Model Statute or 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 a Model Statute or 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 a Model Statute or a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM

Adjustment. At all times, a state's protection from the NPM Adjustment is conditioned upon the diligent enforcement of its Model Statute or Qualifying Statute, as the case may be. See "RISK FACTORS—Other Potential Payment Decreases Under the Terms of the MSA" above and "—MSA Provisions Relating to Model/Qualifying Statutes" below.

The MSA provides that if any Settling State resolves claims against any NPM that are comparable to any of the claims released in the MSA on overall terms more favorable to such NPM 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.

Offset for Miscalculated or Disputed Payments. If the MSA Auditor receives notice of a miscalculation of an Initial Payment made by an OPM, an Annual Payment made by a PM within four years or a Strategic Contribution Payment made by a PM within four years, the MSA Auditor will recalculate the payment and make provisions for rectifying the error (the "**Offset for Miscalculated or Disputed Payments**"). There are no time limits specified for recalculations although the MSA Auditor is required to determine amounts promptly. Disputes as to determinations by the MSA Auditor may be submitted to binding arbitration governed by the Federal Arbitration Act. In the event that mispayments have been made, they will be corrected through payments with interest (in the event of underpayments) or withholdings with interest (in the event of overpayments). Interest will be at the prime rate, except where a party fails to pay undisputed amounts or fails to provide necessary information readily available to it, in which case a penalty rate of prime plus 3% applies. If a PM disputes any required payment, it must determine whether any portion of the payment is undisputed and pay that amount for disbursement to the Settling States. The disputed portion is required to be paid into the Disputed Payments Account pending resolution of the dispute. Failure to pay such disputed amounts into the Disputed Payments Account can result in liability for interest at the penalty rate if the disputed amount was in fact properly due and owing. See "RISK FACTORS—Other Potential Payment Decreases Under the Terms of the MSA" herein.

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 Payments which are made at the same times as the Annual Payments and Strategic Contribution Payments to be made by OPMs. Annual Payments and Strategic Contribution Payments for SPMs are calculated differently, however, from Annual Payments and Strategic Contribution Payments for OPMs. Each SPM's payment obligation is determined according to its market share if, and only if, its "**Market Share**" (defined in the MSA to mean a manufacturer's share, expressed as a percentage, of the total number of cigarettes sold in the United States in a given year, as measured by excise taxes (or similar taxes, in the case of Puerto Rico)), for the year preceding the payment exceeds its "**Base Share**," defined as the higher of its 1998 Market Share or 125% of its 1997 Market Share. If an SPM executes the MSA after February 22, 1999, its 1997 or 1998 Market Share, as applicable, is deemed to be zero. Fourteen of the current 52 SPMs signed the MSA on or before the February 22, 1999 deadline.

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

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, the PMs have made the first nine Annual Payments and the first Strategic Contribution Payment, and the MSA Escrow Agent has disbursed to the State its allocable portions thereof and certain other amounts under the MSA totaling $2,587,383,086 to date. Amounts received prior to April 1, 2008 are not pledged to payment of the Series 2008 Bonds. Under the MSA, the computation of Initial Payments, Annual Payments and Strategic Contribution Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA. The sources of information regarding the computation and amount of such payments include the reports and accountings furnished to the Authority by the State.

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

	Base Payment Allocable to the State*	The State's Actual Receipts**
Up-Front Initial Payment	$104,446,742	
2000 Initial Payment	107,580,145	$201,045,641†
2000 Annual Payment	171,455,856	150,490,639
2001 Initial Payment	110,807,549	84,307,619
2001 Annual Payment	190,506,506	179,098,186
2002 Initial Payment	114,131,775	87,067,157
2002 Annual Payment	247,658,458	238,876,379
2003 Initial Payment	117,555,729	93,138,676
2003 Annual Payment	247,658,458	232,882,802
2004 Annual Payment	304,810,410	273,582,058
2005 Annual Payment	304,810,410	277,437,301
2006 Annual Payment	304,810,410	253,835,450
2007 Annual Payment	304,810,410	264,170,266
2008 Annual Payment	310,859,617	251,450,913‡
2008 Strategic Contribution Payment	22,189,497	

* The amounts shown are based on estimates prepared by NAAG during April, 1999.

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

† The Up-Front Payment and the 2000 Initial Payment were paid together.

‡ Payment for 2008 includes all funds received through April 2008, including amounts attributable to the 2008 Strategic Contribution Payment.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the headings "Initial Payments" and "Annual Payments" and "Adjustment to Payments." The State has advised the Authority that both the Settling States and 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 2008. In addition, subsequent revisions in the information delivered to the MSA Auditor (on which the MSA Auditor's calculations of the Initial and Annual Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

"Most Favored Nation" Provisions

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

In the event that any Settling State should reach a settlement of released claims with NPMs that provides more favorable terms to the 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 – Disputed or Recalculated Payments and Disputes under the Terms of the MSA" herein.

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. If any Settling State failed to achieve State Specific Finality on or before December 31, 2001, its participation in the MSA would automatically terminate. State-Specific Finality for the State was achieved on December 11, 1998. As of December 12, 2000 all Settling States had achieved State Specific Finality.

"**Final Approval**" marked 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 shall be processed in the normal course. Challenges will be submitted to binding arbitration. The information provided by the MSA Auditor to the State with respect to calculations of amounts to be paid by PMs is confidential under the terms of the MSA and may not be disclosed to the Authority or the Holders.

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

Advertising and Marketing Restrictions; Educational Programs

The MSA prohibits the PMs from certain advertising, marketing and other activities that may promote the sale of cigarettes and smokeless tobacco products ("**Tobacco Products**"). Under the MSA, the PMs are generally prohibited from targeting persons under 18 years of age within the Settling States in the advertising, promotion or marketing of Tobacco Products and from taking any action to initiate, maintain or increase smoking by underage persons within the Settling States. Specifically, the PMs may not: (i) use any cartoon characters in advertising, promoting, packaging or labeling Tobacco Products; (ii) distribute any free samples of Tobacco Products except in a restricted facility where the operator thereof is able to ensure that no underage persons are present; or (iii) provide to any underage person any

item in exchange for the purchase of Tobacco Products or for the furnishing of proofs-of-purchase coupons. The PMs are also prohibited from placing any new outdoor and transit advertising, and are committed to remove any existing outdoor and transit advertising for Tobacco Products in the Settling States. Other examples of prohibited activities include, subject to limited exceptions: (i) the sponsorship of any athletic, musical, artistic or other social or cultural event in exchange for the use of tobacco brand names as part of the event; (ii) the making of payments to anyone to use, display, make reference to or use as a prop any Tobacco Product or item bearing a tobacco brand name in any motion picture, television show, theatrical production, music performance, commercial film or video game; (iii) the sale or distribution in the Settling States of any non-tobacco items containing tobacco brand names or selling messages; and (iv) the sale of packs of cigarettes containing fewer than 20 cigarettes until at least December 31, 2001.

In addition, the PMs have agreed under the MSA to provide funding for the organization and operation of a charitable foundation (the "**Foundation**") and educational programs to be operated within the Foundation. The main purpose of the Foundation will be to support programs to reduce the use of Tobacco Products by underage persons and to prevent diseases associated with the use of Tobacco Products. On March 31, 1999, and on March 31 of each subsequent year for a period of nine years thereafter, each OPM was required to pay its Relative Market Share of $25,000,000 (which is not subject to any adjustments, offsets or reductions pursuant to the MSA) to fund the Foundation. In addition, each OPM is required to pay its Relative Market Share of $250,000,000 on March 31, 1999, and $300,000,000 on March 31 of each of the subsequent four years to fund the Foundation. Furthermore, each PM may be required to pay its Relative Market Share of $300,000,000 on April 15, 2004, and on April 15 of each year thereafter in perpetuity if, during the year preceding the year when payment is due, the sum of the Market Shares of the PMs equals or exceeds 99.05%. The Foundation may also be funded by contributions made by other entities.

Remedies upon the Failure of a PM to Make a Payment

Each PM is obligated to pay when due the undisputed portions of the total amount calculated as due from it by the MSA Auditor's final calculation. Failure to pay such portion shall render the PM liable for interest thereon from the date such payment is due to (but not including) the date paid at the prime rate published from time to time by *The Wall Street Journal* or, in the event *The Wall Street Journal* is no longer published or no longer publishes such rate, an equivalent successor reference 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 Agreement

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 the Strategic Contribution Payments are subject to, among other adjustments and reductions, the NPM Adjustment, which may reduce the amount of money that a Settling State receives pursuant to the MSA. The NPM Adjustment will reduce payments of a PM if such PM experiences certain losses of market share in the United States as a result of participation in the MSA.

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**") 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 – Other Potential Payment Decreases under the Terms of the MSA – NPM Adjustment" and "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statute and Related Legislation" herein.

If a Settling State continuously has a Qualifying Statute in full force and effect and diligently enforces the provisions of such statute, the MSA states that the payments allocated to such Settling State will not be subject to a reduction due to the NPM Adjustment. Furthermore, the MSA dictates that the aggregate amount of the NPM Adjustment is to be allocated, in a Pro Rata manner, among all Settling States that do not adopt and enforce a Qualifying Statute. In addition, if the NPM Adjustment allocated to a particular Settling State exceeds its allocated payment, that excess is to be reallocated equally among the remaining Settling States that have not adopted and enforced a Qualifying Statute. Thus, Settling States that do not adopt and enforce a Qualifying Statute will receive reduced allocated payments if an NPM Adjustment is in effect. The MSA provides an economic incentive for most states to adopt and

diligently enforce a Qualifying Statute. The State has enacted a Model Statute, which is a Qualifying Statute.

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

Summary of the Model Statute. One of the objectives of the MSA (as set forth in the Findings and Purpose section of the Model Statute) is to shift the financial burdens of cigarette smoking from the Settling States to the tobacco product manufacturers. The Model Statute provides that any tobacco manufacturer who does not join the MSA 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 it sells into an escrow account (which amount increases on a yearly basis, as set forth in the Model Statute).

The State's Qualifying Statute defines "**units sold**" as the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, during the year in question, as measured by excise taxes collected by the State on packs bearing the excise tax stamp or imprint of the State, or on roll-your-own tobacco.

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 at least 44 of the Settling States, including the State, 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 a 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**").

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 — Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

State's Qualifying Statute. Both houses of the Michigan Legislature passed a Qualifying Statute, codified as Sections 2051-2052 of Chapter 445 of the Trade and Commerce Law, which was signed by the Governor on December 28, 1999 and became effective on such date. By letter dated July 15, 2003, counsel to the OPMs confirmed that the OPMs will not dispute that the Michigan Qualifying Statute constitutes a Model Statute under the MSA.

In January 2004, the State enacted an Allocable Share Release Amendment to amend the Qualifying Statute by eliminating the provision authorizing an NPM to obtain the release of the amount by which its annual escrow deposit exceeds 4.3519476% of the total payments that the NPM would have made as a PM for that year. Under the State's Allocable Share Release Amendment, an NPM would have been entitled to the release of its escrow deposit only to the extent that it exceeded the total amount that the NPM would have paid as a PM. A majority of the PMs, including all three OPM's had indicated in writing that in the event a Settling State enacted legislation substantially in the form of the Allocable Share Release Amendment, the Settling State's previously enacted Qualifying Statute would continue to constitute a Model Statute and a Qualifying Statute within the meaning of the MSA.

As discussed above under the caption "RISK FACTORS — Litigation Challenging the MSA, the Qualifying Statute and Related Legislation — *Grand River, Freedom Holdings* and Related Cases," the Southern District granted the plaintiffs' request for an injunction to enjoin the State of New York from enforcing its Allocable Share Release Amendment.

Complementary Legislation. Pursuant to the State's Complementary Legislation, each tobacco product manufacturer whose cigarettes are sold in the State is required to annually certify that (i) it is an

NPM and (ii) it is in full compliance with the State's Qualifying Statute. No cigarette tax stamps may be affixed to the cigarettes of any tobacco product manufacturers that do not make such certification. In addition to any other penalties that may be imposed by law, a civil penalty can be imposed on any tobacco product manufacturer who files a false certification or any cigarette tax agent who affixes a cigarette tax stamp in violation of the Complementary Legislation, and such cigarettes can be seized and are subject to forfeiture.

DOMESTIC TOBACCO INDUSTRY

*The following description of the domestic tobacco industry has been compiled from certain publicly available documents of the tobacco companies and their 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 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). The following information does not, nor is it intended to, provide a comprehensive description of the domestic tobacco industry, the business, legal and regulatory environment of the participants therein, or the financial performance or capability of such participants. Although the Authority has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Authority has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. To the extent that reports submitted to the MSA Auditor by the PMs pursuant to the requirements of the MSA provide information that is pertinent to the following discussion, including market share information, the Attorney General of the State has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2008 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2008 Bonds is consistent with their investment objectives.*

MSA payments are computed based in part on cigarette shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The Global Insight Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the 50 states of the United States, the District of Columbia and Puerto Rico may not match at any given point in time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

Retail market share information, based upon shipments or sales as reported by the OPMs for purposes of their filings with the SEC, may be different from Relative Market Share for purposes of the MSA and the respective obligations of the PMs to contribute to Annual Payments and Strategic Contribution Payments. The Relative Market Share information reported is confidential under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Overview of Payments by the Participating Manufacturers; MSA Escrow Agent," "–Annual Payments" and "–Strategic Contribution Payments" herein. Additionally, aggregate market share information, based upon shipments as reported by Loews Corporation and Philip Morris and reflected in the chart below entitled "Manufacturers' Domestic Market Share Based on Shipments" is different from that utilized in the bond structuring assumptions. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

Industry Overview

According to publicly available documents of Loews Corporation, the parent company of Lorillard, Inc., the three leading manufacturers of tobacco products in the U.S. in 2007 collectively accounted for approximately 86.4% of the domestic cigarette retail industry when measured by shipment

volume. The market for cigarettes in the U.S. divides generally into premium and discount sales, approximately 72.8% and 27.2%, respectively, measured by volume of all domestic cigarette sales for calendar year 2007, as reported by Loews Corporation.

Philip Morris USA Inc. ("**Philip Morris**"), a wholly-owned subsidiary of Altria Group, Inc. ("**Altria**"), is the largest tobacco company in the U.S. Prior to a name change on January 27, 2003, the Altria Group, Inc. was named Philip Morris Companies Inc. In its Form 10-K filed with the SEC for calendar year 2007, Altria reported that Philip Morris's domestic retail market share for calendar year 2007 was 50.6% (based on sales), which represents an increase of 0.3 share points from its reported domestic retail market share (based on sales) of 50.3% for calendar year 2006. In its Form 10-Q filed with the SEC for the three-month period ended March 31, 2008, Altria reported that Philip Morris's domestic retail share for the three months ended March 31, 2008 was 50.9% (based on sales), an increase of 0.5 share points when compared to the first three months of 2007. Philip Morris's major premium brands are Marlboro, Virginia Slims and Parliament. Its principal discount brand is Basic. Marlboro is the largest selling cigarette brand in the U.S., with approximately 41.0% of the U.S. domestic retail share for calendar year 2007, up from 40.5% from the calendar year 2006, and has been the world's largest-selling cigarette brand since 1972. Philip Morris's market share information is based on data from the IRI/Capstone Total Retail Panel ("**IRI/Capstone**"), which was designed to measure market share in retail stores selling cigarettes, but was not designed to capture Internet or direct mail sales.

Reynolds American Inc. ("**Reynolds American**"), is the second largest tobacco company in the U.S. Reynolds American became the parent company of R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") on July 30, 2004, following a transaction that combined Reynolds Tobacco and the U.S. operations of Brown & Williamson Tobacco Corp. ("**B&W**"), previously the third largest tobacco company in the U.S., under the Reynolds Tobacco name. In connection with this merger, Reynolds American assumed all pre-merger liabilities, costs and expenses of B&W, including those related to the MSA and related agreements and with respect to pre-merger litigation of B&W. Reynolds American is also the parent company of Lane Limited, a manufacturer and marketer of specialty tobacco products, and Santa Fe Natural Tobacco Company, Inc., both of which are SPMs.

In its Form 10-K filed with the SEC for calendar year 2007, Reynolds American reported that its domestic retail market share for calendar year 2007 was 29.0% (measured by sales volume), which represents a decrease of 0.8 share points from the 29.8% for calendar year 2006 combined domestic retail market share of Reynolds Tobacco and B&W. In its Form 10-Q filed with the SEC for the three-month period ended March 31, 2008, Reynolds American reported that its domestic retail market share for the three months ended March 31, 2008 was 28.0% (measured by sales volume), a decrease of 1.4 share points when compared to the first three months of 2007. Reynolds American's major premium brands are Camel, Kool, Winston and Salem. Its discount brands include Doral and Pall Mall. Reynolds American's market share information is based on IRI/Capstone data.

Lorillard, Inc. ("**Lorillard**"), a wholly-owned subsidiary of Loews Corporation, is the third largest tobacco company in the U.S. On February 6, 2002, in an initial public offering, Loews Corporation issued shares of Carolina Group stock, which is intended to reflect the economic performance of Loews Corporation's stock in Lorillard. Carolina Group is not a separate legal entity. On December 17, 2007, the Loews Corporation announced that its Board of Directors had approved a plan to spin-off its entire ownership interest in Lorillard to holders of Carolina Group stock and Loews Corporation common stock. As a result of the transaction, the Carolina Group, and all of the Carolina Group stock, will be eliminated and Lorillard will become a separate publicly traded company. No timetable has been announced for this transaction.

In its Form 10-K filed with the SEC for calendar year 2007, Loews Corporation reported that Lorillard's domestic retail market share for calendar year 2007 was 10.0% (measured by shipment

volume), which represents an increase of 0.4 share points from its reported domestic retail market share of 9.6% (measured by shipment volume) for calendar year 2006. In its Form 10-Q filed with the SEC for the three-month period ended March 31, 2008, Loews Corporation reported that Lorillard's domestic retail market share for the three months ended March 31, 2008 was 10.5% (measured by shipment volume), an increase of 0.4 share points when compared to the first three months of 2007. Lorillard's principal brands are Newport, Kent, True, Maverick, and Old Gold. Its largest selling brand is Newport, which accounted for approximately 91.8% of Lorillard's unit sales for the calendar year 2007. Market share data reported by Lorillard is based on data made available by Management Science Associates, Inc. ("**MSAI**"), an independent third-party database management organization that collects wholesale shipment data.

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market for calendar year 2007 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, Inc. ("**Liggett**"), a wholly-owned subsidiary of Vector Group Ltd. ("**Vector**"). Liggett, the operating successor to the Liggett & Myers Tobacco Company, is the fourth largest tobacco company in the U.S. In its Form 10–K filed with the SEC for calendar year 2007, Vector reported that Liggett's domestic retail market share in 2007 was 2.5% (measured by shipment volume), which represents an increase of 0.1 share points from its self-reported 2006 domestic retail market share of 2.4%. All of Liggett's unit volume for the calendar year 2007 was in the discount segment. Its brands include Liggett Select, Grand Prix, Eve, Pyramid and USA. In November 2001, Vector Group launched OMNI, which Vector Group claims is the first reduced-carcinogen cigarette that tastes, smokes and burns like other premium cigarettes. Additionally, Vector Group announced that it has introduced three varieties of a low nicotine cigarette in eight states, one of which is reported to be virtually nicotine free, under the brand name QUEST. Vector has determined to postpone the national launch of QUEST indefinitely. Liggett and Vector Group Ltd. are SPMs under the MSA. In February 2008, Liggett announced that it will begin selling a smokeless tobacco product under its Grand Prix brand.

Shipment Trends

The following table sets forth the approximate comparative positions of the leading producers in the U.S. domestic tobacco industry, each of which is an OPM under the MSA, based upon cigarette shipments. Individual domestic OPM shipments are as reported in the publicly available documents of the OPMs. Total industry shipments are based on data made available by MSAI, as reported in publicly available documents of Loews Corporation.

Effective in June of 2004, MSAI changed the way it reports market share information to include actual units shipped by Commonwealth Brands, Inc. ("**CBI**"), an SPM who markets deep discount brands, and implemented a new model for estimating unit sales of smaller, primarily deep discount marketers. MSAI has restated its reports to reflect these changes as of January 1, 2001. As a result of these changes, market shares for the three OPMs are lower than had been reflected under MSAI's prior methodology and market shares for CBI and other low volume companies are higher. All industry volume and market share information herein reflects MSAI's revised reporting data. Despite the effects of MSAI's new estimation model for deep discount manufacturers, Lorillard management has indicated that it continues to believe that volume and market share information for the deep discount manufacturers are understated and, correspondingly, market share information for the larger manufacturers are overstated by MSAI.

Manufacturers' Domestic Market Share Based on Shipments*

Manufacturer	2004	2005	2006	2007
Philip Morris	47.4%	48.6%	48.7%	49.0%
Reynolds American**	28.8	28.1	27.6	27.4
Lorillard	8.8	9.2	9.6	10.0
Other***	15.0	14.1	14.1	13.6

* Aggregate market share as reported by Loews Corporation (or as derived from such reports) is different from that utilized in the bond structuring assumptions and may differ from the market share information reported by the OPMs for purposes of their filings with the SEC.

** Prior to July 2004, represents the combined market share of Reynolds Tobacco and B&W.

*** The market share based on shipments of the tobacco manufacturers, other than the OPMs, has been determined by subtracting the total retail market share percentages of the OPMs as reported in the publicly available documents of Loews Corporation from 100%. Results may not total 100% due to rounding.

One of the OPMs reported that first quarter 2008 results indicate that industry shipments may fall by 3% in calendar year 2008.

The following table sets forth the industry's cigarette shipments in the U.S. for the four years ended December 31, 2007. The MSA payments are calculated in part on shipments by the OPMs in or to the U.S. rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)*
2004	394.5
2005	381.7
2006	376.0
2007	357.2

* As reported in SEC filings and other publicly available documents of the Loews Corporation, based on MSAI data.

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

Consumption Trends

According to the October 24, 2007 estimates of the U.S. Department of Agriculture (the "**USDA**") Economic Research Service ("**USDA-ERS**"), smokers in the U.S. consumed 372 billion cigarettes in 2006, which represents a decrease of approximately 1.1% from the previous year. USDA-ERS attributes declining cigarette use to a combination of higher consumer costs due to tax and price increases, restrictions on where people can smoke and greater awareness of the health risks associated with smoking. Annual per capita consumption (per adult over 18) has dropped from 2,445 cigarettes in 1996 to 1,691 in 2006 (based on October 24, 2007 USDA-ERS). The following chart sets forth domestic cigarette consumption from 2001 through 2007, according to the USDA:

Years Ended December 31	U.S. Domestic Consumption (Billions of Cigarettes)*
2001	425
2002	415
2003	400
2004	388
2005	376
2006	372
2007	360**

* USDA-ERS. The USDA has discontinued this service, publishing its final report on October 24, 2007. The MSA Payments are calculated in part based on domestic industry shipments rather than consumption. The Global Insight Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the 50 states of the U.S., the District of Columbia and Puerto Rico may not match at any given time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

** Estimated.

Distribution, Competition and Raw Materials

Cigarette manufacturers sell tobacco products to wholesalers (including distributors), large retail organizations, including chain stores, and the armed services. They and their affiliates and licensees also market cigarettes and other tobacco products worldwide, directly or through export sales organizations and other entities with which they have contractual arrangements.

The market for tobacco products is highly competitive and is characterized by brand recognition and loyalty, with product quality, price, marketing and packaging constituting the significant methods of competition. Promotional activities include, in certain instances, allowances, the distribution of incentive items, price reductions and other discounts. Considerable marketing support, merchandising display and competitive pricing are generally necessary to maintain or improve a brand's market position. Increased selling prices and taxes on cigarettes have resulted in additional price sensitivity of cigarettes at the consumer level and in a proliferation of discounts and of brands in the discount segment of the market. Generally, sales of cigarettes in the discount segment are not as profitable as those in the premium segment.

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

Grey Market

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

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet, and charging state employees who smoke higher health insurance premiums than non-smoking state employees. Five states, Alabama, Georgia, Idaho, Kentucky 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, Tribune Co. and Whirlpool, are now charging smokers higher premiums. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the U.S. Food and Drug Administration (the "**FDA**"), amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire-safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non-face-to-face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress which would provide the FDA with authority to broadly regulate tobacco products. A bi-partisan group of lawmakers, Massachusetts Senator Edward M. Kennedy, Texas Senator John Cornyn, California Representative Henry Waxman and Virginia Representative Tom Davis, on February 15, 2007 introduced the Family Smoking Prevention and Tobacco Control Act, legislation aimed at placing tobacco products under the authority of the FDA. The bill would give the FDA broad regulatory authority over the sale, distribution, and advertising of tobacco products. Such legislation would, among other anticipated changes, permit the FDA to regulate tar and other ingredients in cigarettes, permit the FDA to strengthen warning labels, reduce nicotine levels in tobacco products, police false or misleading advertising and marketing aimed at children and would require manufacturers to provide the FDA with lists of ingredients and additives in their products, including nicotine. Philip Morris has indicated its strong support for this legislation. The Senate Health Committee approved the legislation on August 1, 2007 by a 13 to 8 vote, including an amendment requiring that all cigarette packages be half-covered by warning labels with colored graphic. A committee of the House of Representatives began holding hearings on October 3, 2007 on whether the FDA should be given the power to regulate tobacco products. It has been reported that on April 2, 2008, a bill granting the FDA new power over tobacco-product ingredients and marketing, but not a ban on nicotine, passed the House Energy and Commerce Committee for a vote by the full House of Representatives later in the spring.

In 1964, the Report of the Advisory Committee to the Surgeon General of the U.S. Public Health Service concluded that cigarette smoking was a health hazard of sufficient importance to warrant appropriate remedial action. Since 1966, federal law has required a warning statement on cigarette packaging. Since 1971, television and radio advertising of cigarettes has been prohibited in the U.S. Cigarette advertising in other media in the U.S. is required to include information with respect to the "tar" and nicotine yield of cigarettes, as well as a warning statement.

During the past four decades, various laws affecting the cigarette industry have been enacted. In 1984, Congress enacted the Comprehensive Smoking Education Act. Among other things, the Smoking Education Act:

- establishes an interagency committee on smoking and health that is charged with carrying out a program to inform the public of any dangers to human health presented by cigarette smoking;
- requires a series of four health warnings to be printed on cigarette packages and advertising on a rotating basis;
- increases type size and area of the warning required in cigarette advertisements; and
- requires that cigarette manufacturers provide annually, on a confidential basis, a list of ingredients added to tobacco in the manufacture of cigarettes to the Secretary of Health and Human Services.

Since the initial report in 1964, the Secretary of Health, Education and Welfare (now the Secretary of Health and Human Services) and the Surgeon General have issued a number of other reports that find the nicotine in cigarettes addictive and that link cigarette smoking and exposure to cigarette smoke with certain health hazards, including various types of cancer, coronary heart disease and chronic obstructive lung disease. These reports have recommended various governmental measures to reduce the incidence of smoking. In 1992, the federal Alcohol, Drug Abuse and Mental Health Act was signed into law. This act requires states to adopt a minimum age of 18 for purchases of tobacco products and to establish a system to monitor, report and reduce the illegal sale of tobacco products to minors in order to continue receiving federal funding for mental health and drug abuse programs. Federal law prohibits smoking in scheduled passenger aircraft, and the U.S. Interstate Commerce Commission has banned smoking on buses transporting passengers interstate. Certain common carriers have imposed additional restrictions on passenger smoking.

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

Several states have enacted or have proposed legislation or regulations that would require cigarette manufacturers to disclose the ingredients used in the manufacture of cigarettes. In September 2003, the Massachusetts Department of Public Health ("**MDPH**") announced its intention to hold public hearings on amendments to its tobacco regulations. The proposed regulations would delete any ingredients-reporting requirement. (The U.S. Court of Appeals for the Second Circuit previously affirmed a ruling that the Massachusetts ingredient-reporting law was unconstitutional.) MDPH has proposed to inaugurate extensive changes to its regulations requiring tobacco companies to report nicotine yield rating for cigarettes according to methods prescribed by MDPH. Because MDPH withdrew its notice for a public hearing in November 2003, it is impossible to predict the final form any new regulations will take or the effect they will have on the PMs.

On May 21, 1999, the OPMs filed lawsuits in the U.S. District Court for the District of Massachusetts to enjoin implementation of certain Massachusetts attorney general regulations concerning the advertisement and display of tobacco products. The regulations went beyond those required by the MSA, and banned outdoor advertising of tobacco products within 1,000 feet of any school or playground, as well as any indoor tobacco advertising placed lower than five feet in stores within the 1,000–foot zone.

The district court ruled against the industry on January 25, 2000, and the U.S. Court of Appeals for the First Circuit affirmed. The U.S. Supreme Court granted the industry's petition for writ of certiorari on January 8, 2001, and ruled in favor of RJR Tobacco and the rest of the industry on June 28, 2001. The U.S. Supreme Court found that the regulations were preempted by the Federal Cigarette Labeling and Advertising Act, which precludes states from imposing any requirement or prohibition based on smoking and health with respect to the advertising or promotion of cigarettes labeled in conformity with federal law.

In June 2000, the New York state legislature passed legislation charging New York's Office of Fire Prevention and Control ("**OFPC**") with developing standards for "fire-safe" or self-extinguishing cigarettes. On December 31, 2003, OFPC issued a final standard with accompanying regulations that requires all cigarettes offered for sale in New York State after June 28, 2004 to achieve specified test results when placed on 10 layers of filter paper in controlled laboratory conditions. Reynolds American's operating companies that sell cigarettes in New York State have provided written certification to both the OFPC and the Office of the Attorney General for New York that each of their cigarette brand styles currently sold in New York has been tested and has met the performance standards set forth in the OFPC's regulations. Design and manufacturing changes were made for cigarettes manufactured for sale in New York to comply with the standard. Similar laws have been enacted in twenty-six other states. A number of other states are also considering similar legislation. Varying standards from state to state could have an adverse effect on the PMs.

According to the Global Insight Consumption Report, all of the states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. The most comprehensive bans have been enacted since 1998 in 30 states and a number of large cities. In 1998, California imposed a comprehensive smoking ban for all indoor workplaces, including restaurants and bars. Delaware followed suit in 2002, and in 2003, Connecticut, Maine, New York, and Florida passed similar comprehensive bans, as did the cities of Boston and Dallas. Since then, Arizona, Arkansas, Colorado, the District of Columbia, Hawaii, Illinois, Iowa, Louisiana, Maryland, Massachusetts, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Utah, Vermont, Washington, and Puerto Rico established similar bans, as did the cities of Baltimore, Chicago, Houston, and Philadelphia. The New Mexico, Washington State and Chicago restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. It is expected that these restrictions will continue to proliferate. For example, at least 7 states, Alabama, Kansas, Michigan, Missouri, North Carolina, South Carolina and Tennessee, are considering legislation which would enact comprehensive bans.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of April 1, 2008, there were 2,791 municipalities with local laws that restrict where smoking is allowed, including 1,242 municipalities that restrict smoking in one or more outdoor areas. Of these, 554 local governments required workplaces to be 100% smoke free, and 100% smoke free conditions were required for restaurants by 522 governments, and for bars by 393. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. 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. These numbers grew to 49 for restaurants and 32 for bars in 1998, and doubled again by 2001, to 100 and 74, respectively.

The first extensive outdoor smoking restrictions were instituted in March 2006 in Calabasas, California. The City of Oakland and California municipalities of Belmont, Beverly Hills, Dublin, El Cajon, Emeryville, Hayward and Santa Monica have also established extensive outdoor restrictions, as have Davis County and the City of Murray in Utah. Burbank, California, is expected to follow suit. In

the most restrictive version to date, the California cities, Belmont, and Calabasas have approved ordinances which restrict smoking anywhere in the city except for single-family detached homes. Many landlords and condominium associations have also established smoke-free apartment policies. In May 2008, the California State Senate passed proposed legislation which would allow landlords to prohibit smoking in apartment buildings. The Massachusetts Department of Public Health is conducting a survey of landlords, tenants, and condominium associations to assess the feasibility of making residences smoke-free.

In the past year, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties have banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. The beach restrictions may soon become statewide. Chicago approved beach and parkground smoking restrictions in October 2007. Sarasota County and Boca Raton, Florida have banned smoking on their beaches, and Nassau County, New York and Volusia County, Florida are also considering park and beach bans. At least 50 colleges nationwide now prohibit smoking everywhere on campus. California, Illinois, Michigan and Nevada have banned smoking in state prisons. Arkansas, California, Louisiana, Puerto Rico, Texas and Rockland County, New York now prohibit smoking in a car where there are children present, and similar legislation has been proposed in Arizona, California, Connecticut, Illinois, Indiana, Iowa, Kansas, Massachusetts, Montana, New Jersey, New York, Oregon, Rhode Island, South Carolina, Utah, West Virginia, and in Bangor, Maine.

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

In August 2007, the President's Cancer Panel issued a report which included a series of recommendations to reduce Americans' cancer risk. These include FDA regulation of the tobacco industry, increased federal and state excise taxes on tobacco, increased funding of tobacco prevention and cessation programs, and the enactment in all states of smoke free laws which cover restaurants and bars.

Smokeless Tobacco Products. 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. According to the Global Insight Consumption Report, chewing tobacco and dry snuff consumption has been declining in the U.S. in this decade, but moist snuff consumption has increased at an annual rate of more than 5% since 2002, and by 10.4% in 2006, when over 5 million consumers purchased 1.1 billion cans. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco, is explicitly targeting adult smoker conversion in its growth strategy. The industry is 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. In 2006, the three largest U.S. cigarette manufacturers entered the market. Philip Morris introduced a snuff product, Taboka, Reynolds American acquired Conwood Company, L.P., the nation's second largest smokeless-tobacco manufacturer, and introduced Camel Snus, a snuff product, and Lorillard entered into an agreement with Swedish Match North America to develop

smokeless products in the United States. Product development has continued in 2007, with the introduction by Philip Morris of a Marlboro snus product. In October 2007, Altria announced that it would accelerate the development of snuff and less-harmful cigarettes to counter a decline in smoking. In 2008, Liggett announced it would introduce Grand Prix snus.

Advocates of the use of snuff as part of a tobacco 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. The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. A May 2008 study using data from the 2000 National Health Interview Survey reports that U.S. men who used smokeless tobacco as a smoking cessation method achieved significantly higher quit rates than those who used other cessation aids. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use. In 2008 a new firm, Fuisz Tobacco, was formed to commercialize a film-based smokeless tobacco product. The thin film strip would be spitless and would dissolve entirely in the cheek.

Voluntary Private Sector Regulation. In recent years, many employers have initiated programs restricting or eliminating smoking in the workplace and providing incentives to employees who do not smoke, including charging higher health insurance premiums to employees who smoke, and many common carriers have imposed restrictions on passenger smoking more stringent than those required by governmental regulations. Similarly, many restaurants, hotels and other public facilities have imposed smoking restrictions or prohibitions more stringent than those required by governmental regulations, including outright bans.

International Agreements. On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force on February 27, 2005 for the first forty countries, including the U.S., that had ratified the treaty prior to November 30, 2004. As of April 27, 2005, 168 countries signed and 64 countries ratified the FCTC. On June 29, 2004 the FCTC was closed for signature, but there is no deadline for ratification. It has been reported that as of December 20, 2006, at least 191 countries had ratified the FCTC.

Excise Taxes. Cigarettes are also currently subject to substantial excise taxes in the U.S. The federal excise tax has remained constant, at $0.39 per pack, since 2002. The U.S. Congress has adopted legislation which would raise the federal excise tax. In August, the Senate and House of Representatives passed bills with $0.61 and $0.45 increases to the tax, respectively. The increase to the federal excise tax is designed to provide funding for the State Children's Health Insurance Program ("**SCHIP**"). On September 25, 2007, the House of Representatives passed a new bill with a $0.61 increase by a vote of 265 to 159. On September 27, 2007, the Senate voted 67 to 29 to reauthorize and expand SCHIP funded in part by a $0.61 increase in the federal excise tax on cigarettes. On October 3, 2007, the President vetoed the bill, and on October 18, 2007, the House of Representatives failed to override the Presidential veto. Subsequent override attempts in November and in January 2008 also failed. If enacted as proposed above, the federal excise tax would equal $1.00 per pack. According to the Global Insight Consumption Report, should the federal excise tax increase to $1.00 per pack, the resulting price increase, would, according to its model, lead to a sharper, one time, consumption decline of 4.5%, or 15.5 billion cigarettes, by 2010. The difference with Global Insight's Base Case forecast would be somewhat lower

over the longer term, because forecast assumptions incorporate the likelihood of significant excise tax increases over time. It is not possible at this time to assess the likelihood that this or any other proposal to increase the federal excise tax will or will not become law.

All states, the District of Columbia, and the Commonwealth of Puerto Rico currently impose taxes at levels ranging from $0.07 per pack in South Carolina to $2.75 per pack in New York. In addition, certain municipalities also impose an excise tax on cigarettes ranging up to $1.50 per pack in New York City and $2.68 per pack in Chicago, which includes the Cook County tax of $2.00 per pack. According to the Global Insight Consumption Report, excise tax increases were enacted in 20 states and in New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee," which has the same effect on consumer prices. The Global Insight Consumption Report considers any such fees as equivalent to excise taxes.

In 2006, Texas passed a budget that raised the state excise tax by $1.00 in January 2007, and Hawaii, New Jersey, North Carolina, and Vermont enacted legislation which raised excise taxes. In the November 2006 elections, referenda passed in Arizona and South Dakota raising excise taxes. In 2007, Connecticut, Delaware, Iowa, Indiana, Maryland, New Hampshire, Tennessee and Wisconsin each increased its excise taxes. These actions increased the average state excise tax to $1.116 in January 2008. New York State in April 2008 enacted an increase of $1.25 per pack, and in May the District of Columbia increased its tax by $1.00 per pack. These increases will raise the weighted average excise tax to $1.197. It is expected that other states will also enact increases in 2008 and in future years. Florida, Georgia, Kansas, Massachusetts, New Hampshire, Pennsylvania and Utah are now considering excise tax increases. In Massachusetts, the House of Representatives has approved an increase of $1.00 per pack. Although California voters rejected a ballot initiative on November 7, 2006 that would have raised the tax from $0.87 to $3.47 per pack, California lawmakers have introduced a bill which would raise the tax by $2.00 per pack.

At least one state, Minnesota (a Previously-Settled State), currently imposes a 75-cent "health impact fee" on tobacco manufacturers for each pack of cigarettes sold. The purpose of this fee is to recover the state's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld by the Minnesota Supreme Court as not in violation of Minnesota's settlement with the tobacco companies. On February 20, 2007, the U.S. Supreme Court declined to hear Philip Morris' appeal of that decision. See "RISK FACTORS–Other Potential Payment Decreases Under the Terms of the MSA–NPM Adjustment" herein. These tax increases and other legislative or regulatory measures could severely increase the cost of cigarettes, limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes.

Civil Litigation

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 that smoking has been injurious to their health, and by non-smokers alleging harm from environmental tobacco smoke, also known as "secondary smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of May 1, 2008, there were nine cases on appeal in which verdicts were returned against Philip Morris, including (i) a $74 billion (out of total a verdict of $145 billion) punitive damages judgment against Philip Morris in the Engle class action, which has been overturned on appeal by the Florida Supreme Court; and (ii) a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. The Supreme Court of Illinois subsequently reversed the verdict in *Price* and instructed the trial court to dismiss the case in its entirety. In January 2006 the plaintiffs filed a motion asking the court to reconsider its decision. On May

5, 2006, the Supreme Court of Illinois denied this motion. In October 2006, plaintiffs filed a petition for certiorari with the U.S. Supreme Court. On November 27, 2006, the U.S. Supreme Court denied plaintiff's petition for certiorari. In December 2006, the trial court entered an order of dismissal. In January 2007, the plaintiff filed a motion to vacate the dismissal. It has been reported that on May 2, 2007 the state trial court judge in the *Price* case asked the Illinois Fifth District Appellate Court whether he has the authority to reopen the *Price* case, citing possible new evidence presented in a case pending before the U.S. Supreme Court. On May 17, 2007, Philip Morris petitioned the Illinois Supreme Court for an order that would prevent the trial court judge from reopening the *Price* case. In August 2007, the Illinois Supreme Court granted the petition and the trial court dismissed plaintiff's motion to vacate or withhold final judgment. See "— Class Action Lawsuits" below. The MSA does not release PMs from liability in either individual or class action cases. Healthcare cost recovery cases have also been brought by governmental and non-governmental healthcare providers seeking, among other things, reimbursement for healthcare expenditures incurred in connection with the treatment of medical conditions allegedly caused by smoking. The PMs are also exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims of the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Pending claims related to tobacco products generally fall within four categories: (1) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants alleging injury from exposure to ETS in aircraft cabins (the *Broin II* cases, discussed below); (2) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs; (3) healthcare cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for healthcare expenditures allegedly caused by cigarette smoking and/or disgorgement of profits; and (4) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act. A recent California Supreme Court decision (*Grisham v. Philip Morris*) regarding a statute of limitations issue in an individual case has held that the plaintiff need not have filed suit when she realized she was addicted, thus permitting her lawsuit to go forward after a lower court had held her claim to be time-barred. This decision could lead to an increase in individual lawsuits in California.

According to Altria, since January 1999 and through May 1, 2008, verdicts have been returned in 45 smoking and health cases, Lights/Ultra Lights cases and healthcare cost recovery cases in which Philip Morris was a defendant. Verdicts in favor of Philip Morris and other tobacco industry defendants were returned in 28 of these cases. Verdicts in favor of plaintiffs were returned in 17 cases. Appeals or post-trial motions by defendants and by plaintiffs are pending in many of these cases. Of the 17 cases in which verdicts were returned in favor of plaintiffs, the *Carter* case (discussed below) was the first to reach final resolution in March 2001, when the plaintiff received payments from a trust in the full amount of the judgment and Brown & Williamson's petition for review of the judgment against it was denied by the U.S. Supreme Court. In addition, eight of the 17 cases have reached final resolution with respect to Philip Morris. A $17.8 million verdict against defendants in a healthcare cost recovery case in New York was reversed, and all claims were dismissed with prejudice in February 2005 in the *Blue Cross/Blue Shield*

case. In October 2004, after exhausting all appeals, Philip Morris paid $3.3 million in an individual smoking and health case in Florida (the *Eastman* case, discussed below). In March 2005, after exhausting all appeals, Philip Morris paid $17 million in an individual smoking and health case in California (the *Henley* case, discussed below). Altria has reported that in December 2005, after exhausting all appeals, Philip Morris paid $328,759 as its share of the judgment amount and interest in a flight attendant ETS case in Florida (the *French* case, discussed below) and will pay attorneys' fees yet to be determined. In addition, in February 2005, after exhausting all appeals, Reynolds Tobacco, due to its obligation to indemnify B&W, paid approximately $9.1 million in the *Boerner* case (see below) and on June 17, 2005, after exhausting all appeals, Reynolds Tobacco paid a $196,416 plus interest and costs judgment in an individual case in Kansas (the *Burton* case, discussed below). In March 2006, after exhausting all appeals, Philip Morris paid approximately $82.5 million (including interest of approximately $27 million) in an individual smoking and health case in California (the *Boeken* case, described below). In October 2006, after exhausting all appeals, Philip Morris paid approximately $1.1 million in judgment, interest and attorneys' fees in an individual smoking and health case in Florida (the *Arnitz* case described below) and in January 2007, after exhausting all appeals, Philip Morris paid approximately $1.1 million in judgment and interest in an individual smoking and health case in Missouri (the *Thompson* case described below).

Class Action Lawsuits. The MSA does not release the PMs from liability in class action lawsuits. Plaintiffs have brought claims as class actions on behalf of large numbers of individuals for damages allegedly caused by smoking, price fixing and consumer fraud. One OPM (Altria) has reported that, as of May 1, 2008, there were 32 such class actions pending against it in the U.S., as well as one in Israel and two in Canada. Plaintiffs in class action smoking and health lawsuits allege essentially the same theories of liability against the tobacco industry as those in the individual lawsuits. Other class action plaintiffs allege consumer fraud or violations of consumer protection or unfair trade statutes. Plaintiffs historically have had limited success in obtaining class certification, a prerequisite to proceeding as a class action lawsuit, because of the individual circumstances related to each smoker's election to smoke and the individual nature of the alleged harm. One OPM (Altria) reports that class certification has been denied or reversed in 57 smoking and health class actions involving that OPM.

To date, plaintiffs have successfully maintained class certification in federal and state court class action cases in at least the following states: California, Florida, Illinois, Louisiana, Massachusetts, Minnesota, Missouri, New York, North Carolina, Ohio, Oregon, Washington, and West Virginia. One OPM (Reynolds) reports that 17 federal courts that have considered the issue, including two courts of appeals, have rejected class certification in smoking and health cases. Only two federal district courts have certified a smoker class action. (See *In re Simon (II) Litigation*, and *Schwab v. Philip Morris USA Inc.*, each discussed below). The class in the *Simon* case was subsequently dismissed by the plaintiffs after being decertified by the U.S. Court of Appeals for the Second Circuit. On April 3, 2008, the Second Circuit decertified the class in *Schwab*.

On September 6, 2000, in *In re Simon (II) Litigation*, lawyers for plaintiffs in ten tobacco-related cases pending in U.S. District Court for the Eastern District of New York filed suit in the same court (before Judge Weinstein) to consolidate the pending cases and seek certification of a class and subclasses to obtain compensatory and punitive damages from the tobacco industry defendants. The pending cases included individual and purported nationwide class action lawsuits alleging tobacco-related personal injuries, as well as healthcare cost recovery cases brought by union trust funds, an insurance plan and an asbestos fund. The suit sought to certify a nationwide class action to consolidate all punitive damage aspects of the pending cases for a single trial and to try the compensatory damage aspects of the pending claims separately. On September 19, 2002, Judge Weinstein certified a class to hear the punitive damages claims. The class consisted of all smokers diagnosed with a variety of illnesses, including lung cancer, emphysema and some forms of heart disease, after April 9, 1993. In May 2005, the U.S. Court of Appeals for the Second Circuit, in a unanimous opinion, decertified the class. Plaintiffs' motion for

rehearing en banc was denied on August 8, 2005, and the time for plaintiffs to petition the U.S. Supreme Court for further review has expired. On February 6, 2006, Judge Weinstein dismissed the case upon the plaintiffs' motion. He stayed the order for 30 days to allow potential plaintiffs who expressed interest in the case to receive notices and to protect their interest. On March 22, 2006, a final judgment was entered dismissing the case. Two of the 10 original cases, *Falise v. American Tobacco Co.*, and *H.K. Porter Company, Inc. v. The American Tobacco Company* were dismissed in June 2001 and July 2001, respectively. Other plaintiffs who would have been part of the *Simon II* class remain free to pursue their own individual lawsuits.

On December 14, 2006, in *Donovan v. Philip Morris*, a federal class action complaint was filed by a group of Massachusetts residents who are fifty years of age or older, have smoked a pack of cigarettes a day for at least twenty years, continue to smoke or have quit smoking within one year of filing, have not been diagnosed with lung cancer, and have smoked Marlboro cigarettes within Massachusetts. The class seeks to compel Philip Morris to fund each member's CT scans to support the early detection of lung cancer. The case is pending in the U.S. District Court for the District of Massachusetts.

A number of state courts have rejected class certification. In May 2000, Maryland's highest court ordered the trial court to vacate its certification of a class in *Richardson v. Philip Morris*. The parties agreed to dismiss the case in March 2001. In September 2000, in *Walls v. American Tobacco Co.*, an Oklahoma state court answered a series of state law questions, certified to the state court by the federal court where the purported class was filed, in such a way that led the parties to stipulate that the case should not be certified as a class action in federal court and that the individual plaintiffs would dismiss their federal court cases without prejudice. In October 2000, the federal court issued its order refusing to certify the case as a class action, and dismissed the individual plaintiffs' cases.

In December 2000, in *Geiger v. American Tobacco Co.*, the Appellate Division of the Supreme Court of New York affirmed the trial court's denial of class action status to a purported class defined as all New York residents, including their heirs, representatives, and estates, who contracted lung or throat cancer as a result of smoking cigarettes. Plaintiffs filed a motion for leave to appeal the order denying certification to the New York Court of Appeals, the highest court in the state. The New York Court of Appeals dismissed the plaintiff's appeal in February 2001.

In *Engle v. R.J. Reynolds Tobacco Co.*, a Florida state court certified a class of Florida smokers alleging injury due to their tobacco use. The estimated size of the class ranges from 300,000 to 700,000 members. The court determined that the lawsuit could be tried as a class action because, even though certain factual issues are unique to individual plaintiffs and must be tried separately, certain other factual issues were common to all class members and could be tried in one proceeding for the whole class. In July 1999, in the first phase of a three-phase trial, the jury found against the defendants regarding the issues common to the class, such as whether smoking caused certain diseases, whether tobacco was addictive, and whether the tobacco companies withheld information from the public. In July 2000, in the second phase of the *Engle* trial, the jury returned a verdict assessing punitive damages totaling approximately $145 billion against the tobacco industry defendants. Following entry of judgment, the defendants appealed. The defendants posted bonds to stay collection of the final judgment with respect to the punitive damages against them and statutory interest thereon pending the exhaustion of all appeals. In May 2003, the Florida Third District Court of Appeal reversed the judgment entered by the trial court and instructed the trial court to order the decertification of the class. The plaintiffs petitioned the Florida Supreme Court for further review and, in May 2004, the Florida Supreme Court agreed to review the case.

On July 6, 2006, the Florida Supreme Court remanded the *Engle* case to the District Court with directions to decertify the class, and it approved the District Court's reversal of the $145 billion class action award. The court also reinstated the compensatory damages awards to two purported class

members of $2.8 million and $4 million, and approved the District Court's findings (the "**Findings**") as to the adverse health effects of smoking, that nicotine is addictive, that the defendants placed defective and unreasonably dangerous products in the market, that defendants concealed or omitted information about the health effects and addictive nature of cigarettes, and otherwise that defendants were negligent. The Florida Supreme Court stated that certain individual members of the purported class could bring actions within one year of the court's decision, in which the courts would be bound by the conclusions reached in the Findings, and in which the plaintiffs would be expected to address causation, reliance, and apportionment of fault among the defendants. One result of the court's decision may be an increase in the number of individual plaintiffs' suits in Florida from members of the decertified Engle class. One such individual suit was filed in Florida state court on July 10, 2006 against Philip Morris and Reynolds Tobacco (*Pummer v. Philip Morris*). On November 16, 2006, that case was removed to the U.S. District Court for the Southern District of Florida. On December 15, 2006, the court dismissed the case without prejudice, pursuant to stipulation, due to the wrongful joinder of defendant Publix Supermarkets, Inc., a Florida corporation not named in the *Engle* case, and thus not privy to the allowance of one year for plaintiffs to sue (it had been nearly ten years since the initial cause of action, which exceeds Florida's statute of limitations).

On August 7, 2006, the *Engle* defendants filed a motion for rehearing with the Florida Supreme Court, asking the court to reverse its decision to uphold the Findings. On December 21, 2006, the Florida Supreme Court declined to reconsider and clarify its ruling, with the exception of invalidating the conspiracy to misrepresent charge against the tobacco companies. The court withdrew the July 6th opinion, issuing the December 21st opinion in lieu thereof. In January 2007, the Florida Supreme Court issued the mandate from its revised opinion (which begins the one-year period for individual class members to file lawsuits) and defendants filed a motion with the Florida Third District Court of Appeals requesting the court's review of legal errors previously raised but not ruled on. On February 21, 2007, the court denied the defendants' motion. In March 2007, the U.S. Supreme Court granted defendants' motion for an extension of time in which to file a petition for a writ of certiorari, and the *Engle* defendants filed their petition on May 21, 2007. On October 1, 2007, the U.S. Supreme Court denied the petition for a writ of certiorari and in November 2007, the U.S. Supreme Court denied defendants' petition for rehearing from the denial of the petition for writ of certiorari. Reynolds American has stated that it is likely that individual case filings in Florida will increase as a result of the *Engle* case. As of April 11, 2008, approximately 1,931 individual smoking and health cases have been brought by or on behalf of the 8,178 plaintiffs in Florida. In addition, on February 14, 2008, the trial court decertified the class and formally vacated the punitive damages award pursuant to the Florida Supreme Court's mandate.

Florida has enacted legislation capping the amount of the appeal bond necessary to stay execution of the punitive judgment pending appeal to the lesser of: (1) the amount of punitive damages, plus twice the statutory rate of interest; or (2) 10% of a defendant's net worth, but in no case more than $100 million. Forty-one other states have passed and several additional states are considering statutes limiting the amount of bonds required to file an appeal of an adverse judgment in state court. The limitation on the amount of such bonds generally ranges from $1 million to $150 million. Such bonding statutes allow defendants that are subject to large adverse judgments, such as cigarette manufacturers, to reasonably bond such judgments and pursue the appellate process. In six jurisdictions — Connecticut, Maine, Massachusetts, New Hampshire, Vermont and Puerto Rico — the filing of a notice of appeal automatically stays the judgment of the trial court.

One *Engle* purported class member has previously received a judgment at trial. In *Lukacs v. Reynolds Tobacco*, a Florida appellate court granted the plaintiff the right to proceed before he died, but stated that any award in favor of the plaintiff would not be enforced until after the *Engle* appeal is decided. On June 11, 2002, a Florida jury awarded $37.5 million in compensatory damages to the plaintiff. On April 1, 2003, the Miami-Dade County Circuit Court granted in part the defendants' motion

for remittitur, reducing the total award to $25.125 million. Because the *Engle* appeal is now resolved, subject to motions for rehearing, the defendants' time to appeal the case is expected to begin to run. On August 2, 2006, plaintiff filed a motion for partial judgment on the compensatory damages award, and trial was scheduled to begin on November 27, 2006. However, on September 27, 2006, the trial court granted the defendants' motion to strike as premature the plaintiff's motions and removed the case from the trial calendar. On January 2, 2007, the defendants moved to set aside the June 11, 2002 verdict and to dismiss the plaintiff's punitive damage claim. On January 3, 2007, the plaintiffs filed a motion for entry of judgment. A hearing on the motion was held in March 2007 and on August 1, 2007, the trial court deferred ruling on plaintiffs' motion for entry of judgment until after the U.S. Supreme Court's review of *Engle* is completed and until after further submissions by the parties. One OPM (Vector) reports that it is a defendant in 11 separate cases pending in Florida courts in which the plaintiffs claim that they are members of the *Engle* class, that all liability issues associated with their claims were resolved in the earlier phases of the *Engle* proceedings, and that trials on their claims should proceed immediately. Vector also reported that settlement of the appellate activity in *Engle* would be a prerequisite for those cases proceeding.

On June 6, 2007, a plaintiff representing the estates of her deceased mother and grandmother filed suit against several PMs in Miami-Dade County Circuit Court, Florida, in which she alleges that her mother and grandmother died of health problems related to smoking PMs' tobacco products. In that case, *Gloria Tucker v. Philip Morris U.S.A. et al*, the plaintiff alleges that the PMs engaged in cynical and exploitative marketing that targeted African-American communities and asserts theories of strict liability, negligent design, fraud by concealment and civil conspiracy. The plaintiff in *Tucker* also reportedly is requesting more than $1 billion in compensatory and punitive damages. This action was removed to federal court and is currently pending in the District Court for the Southern District of Florida.

In October 1997, the tobacco industry defendants settled another class action case, *Broin I*. *Broin I* was brought in Florida state court by flight attendants alleging injuries related to ETS. See "*Individual Plaintiffs' Lawsuits*" below. The *Broin I* settlement established a protocol for the resolution of individual claims by class members against the tobacco companies. In addition to shifting the burden of proof to defendants as to whether ETS causes certain illnesses such as lung cancer and emphysema, the *Broin I* settlement required defendants to pay $300 million to be used to establish a foundation to sponsor research with respect to the early detection and cure of tobacco-related diseases. Individual members of the *Broin I* class retained the right to bring individual claims, although they are limited to non-fraud type claims and may not seek punitive damages. Altria has reported that as of May 1, 2008, approximately 2,621 of these individual cases (known as *Broin II* cases) are pending against it in Florida. In October 2000, Judge Robert P. Kaye, the presiding judge of the original *Broin I* class action, held that the flight attendants will not be required to prove the substantive liability elements of their claims for negligence, strict liability and breach of implied warranty in order to recover damages, if any. The court also ruled that the trials of these suits will address whether the plaintiffs' alleged injuries were caused by their exposure to ETS and, if so, the amount of damages. The defendants' appeal of these rulings was dismissed by the intermediate appellate court on the basis that the appeal was premature and that the court lacked jurisdiction. On January 23, 2002, the defendants asked the Florida Supreme Court to review the district court's order. That request was denied.

Seven *Broin II* cases have gone to trial since Judge Kaye's ruling in October 2000. Six of these cases have resulted in verdicts for the defendants: *Fontana* in June 2001, *Tucker* in June 2002, *Janoff* in October 2002, *Seal* in February 2003, *Routh* in October 2003 and *Swaty* in May 2005. Appeals are pending in some of these cases. On September 12, 2002, the plaintiff in the *Janoff* case filed a motion for a new trial, which the judge granted on January 8, 2003. The defendants appealed to the Florida Third District Court of Appeal, which, on October 27, 2004, affirmed the trial court's order granting a new trial. The defendants' motion for rehearing was denied. The defendants filed a notice of intent to invoke the

discretionary jurisdiction of the Florida Supreme Court on June 17, 2005. On November 1, 2005, the Florida Supreme Court refused to hear the case. In *Swaty*, the plaintiff filed a motion for a new trial on May 12, 2005, which was denied on June 23, 2005. On May 17, 2005, the court entered a final judgment in favor of the defendants. The plaintiff's motion for a new trial was denied on June 23, 2005. The plaintiff's appeal to the Third District Court of Appeal was denied and the Court of Appeal affirmed the trial court's verdict in November 2006. The one plaintiff's verdict was returned in *French v. Philip Morris*. On June 18, 2002, the *French* jury awarded the plaintiff $5.5 million in damages, finding that the flight attendant's sinus disease was cause by ETS. On September 13, 2002, the judge reduced the award to $500,000. The defendants appealed the trial court's final judgment to the Florida Third District Court of Appeal on various grounds, the primary one being that under Judge Kaye's October 2000 ruling, the burden of proof was erroneously shifted and the plaintiff was not required to show that the tobacco companies' cigarettes were defective, that the tobacco company defendants acted negligently or that a warranty was made and breached. In December 2004, the Florida Third District Court of Appeal affirmed the judgment awarding plaintiff $500,000 and directed the trial court to hold the defendants jointly and severally liable. In April 2005, the appellate court denied defendants' motion for a rehearing. On May 11, 2005, the defendants filed a notice of intent to invoke the discretionary jurisdiction of the Florida Supreme Court. On November 28, 2005, the Florida Supreme Court declined to hear the appeal. The defendants satisfied the judgment on December 6, 2005.

In *Scott v. American Tobacco Company, Inc.*, a Louisiana medical monitoring and smoking cessation case, the court certified a class consisting of smokers desiring to participate in a program designed to assist them in the cessation of smoking and monitor the medical condition of class members to ascertain whether they might be suffering from diseases caused by cigarette smoking. The class members may also choose to bring individual smoking and health lawsuits. On July 28, 2003, following the first phase of a trial, the jury returned a verdict in favor of the tobacco industry defendants on the medical monitoring claim and found that cigarettes were not defective products. The jury found against the defendants, however, on claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On March 31, 2004, phase two of the trial began to address the scope and cost of smoking cessation programs. On May 21, 2004, the jury returned a verdict in the amount of $591 million ($590 million plus prejudgment interest accruing from the date the suit commenced) on the class's claim for a smoking cessation program. On July 1, 2004, the judge upheld the jury's verdict and awarded the plaintiffs prejudgment interest, which, as of February 15, 2007, totals approximately $444 million, as reported by Altria. On August 31, 2004, the defendants' motion for judgment notwithstanding the verdict or, in the alternative, for a new trial was denied. On September 29, 2004, pursuant to a stipulation of the parties, the defendants posted a $50 million bond (pursuant to legislation that limits the amount of the bond to $50 million collectively for MSA signatories) and noticed their appeal. Oral argument occurred on April 27, 2006. The defendants filed post-argument briefs on April 28, 2006. Under the terms of the stipulation, the plaintiffs reserved the right to contest the constitutionality of the bond cap law. On February 7, 2007, the state appeals court upheld part of the jury's verdict but reduced the $591 million by approximately $312 million, eliminated the award of prejudgment interest, and remanded the case back to the trial court. On March 6, 2007, the state appeals court refused to reconsider its verdict. Plaintiffs' and defendants' petitions for writ of certiorari with the Louisiana Supreme Court were denied in January 2008. Defendants filed a writ of certiorari with the U.S. Supreme Court on April 7, 2008.

In August 2000, a West Virginia state court conditionally certified, only to the extent of medical monitoring, in *In re Tobacco Litigation* (formerly known as *Blankenship*), a class of West Virginia residents. The plaintiffs proposed that the class include all West Virginia residents who: (1) on or after January 1, 1995, smoked cigarettes supplied by defendants; (2) smoked at least a pack a day for five years without having developed any of a specified list of tobacco-related illness; and (3) do not receive healthcare paid or reimbursed by the state of West Virginia. Trial began in January 2001. On January 25, 2001, the trial court granted a motion for a mistrial, ruling that the plaintiffs had improperly introduced

testimony about addiction to smoking as a basis for claiming damages. In March 2001, the court denied the defendants' motion to decertify the class. The retrial began in September 2001, and on November 14, 2001 the jury returned a verdict that defendants were not liable for funding the medical monitoring program. On July 18, 2002, the plaintiffs petitioned the Supreme Court of West Virginia for leave to appeal, which was granted on February 25, 2003. The Supreme Court of West Virginia affirmed the judgment for the defendants on May 6, 2004. On July 1, 2004, the class's petition for rehearing was denied. The plaintiffs did not seek review by the U.S. Supreme Court.

Altria has reported that approximately 728 cases against Philip Morris and other tobacco industry defendants are pending in a single West Virginia court in a consolidated proceeding. The West Virginia court has scheduled a single trial for these consolidated cases, but it has certified a question to the Supreme Court of Appeals of West Virginia requesting a determination of the extent to which the claims in these individual cases can be consolidated in a single trial. On December 2, 2005, the Supreme Court of Appeals of West Virginia held that the Due Process Clause of the 14th Amendment, as interpreted by *State Farm v. Campbell*, does not preclude a bifurcated trial plan in which a punitive damages multiplier is established prior to compensatory damages. In November 2007, the Supreme Court of Appeals of West Virginia denied defendants' renewal motion for review of the trial plan. In December 2007, defendants filed a petition for writ of certiorari with the U.S. Supreme Court, which was denied on February 25, 2008. In February 2008, the court granted defendants' motion to stay the case pending the decision in *Good*, described below.

In *Daniels v. Philip Morris* (also known as *In re Tobacco Case II*), a California state court certified a class comprised of individuals who were minors residing in California, who were exposed to defendants' marketing and advertising activities, and who smoked one or more cigarettes within the applicable time period. Certification was granted as to plaintiffs' claims that defendants violated the state's unfair business practice laws. On September 12, 2002, the trial court judge granted the defendants' motion for summary judgment on First Amendment and preemption (Federal Cigarette Labeling and Advertising Act) claims. In November 2002, the court confirmed its earlier rulings granting defendant's motion for summary judgment. The plaintiffs filed a petition for review with the California Supreme Court. On August 2, 2007, the California Supreme Court affirmed the grant of summary judgment. In December 2007, plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court. On March 17, 2008, plaintiff's petition was denied.

During April 2001, a California state court issued an oral ruling in the case of *Brown v. The American Tobacco Company, Inc.*, in which it granted in part plaintiffs' motion for class certification and certified a class comprised of residents of California who smoked at least one of defendants' cigarettes during the period from June 10, 1993 through April 23, 2001 and who were exposed to defendants' marketing and advertising activities in California. Certification was granted as to plaintiffs' claims that defendants violated California Business and Professions Code Sections 17200 and 17500. The court denied the motion for class certification as to plaintiffs' claims under the California Legal Remedies Act. Defendants' writ with the court of appeals challenging the trial court's class certification was denied on January 16, 2002. The defendants filed a motion for summary judgment on January 31, 2003. On August 4, 2004, the defendants' motion for summary judgment was granted in part and denied in part. Following the November 2004 election, and the passage of a proposition in California that brought about a change in the law regarding the requirements for filing cases of this nature, the defendants filed a motion to decertify the class based on the changes in the law. On March 7, 2005, the court granted the defendants' motion to decertify the class. On March 17, 2005, plaintiffs filed a motion for reconsideration of the court's ruling decertifying the class. The trial judge denied the plaintiffs' motion on April 20, 2005, and the plaintiffs appealed on May 19, 2005. On September 5, 2006, the California Court of Appeals affirmed the judge's order decertifying the class. On October 13, 2006, the plaintiffs filed a petition for review with the California Supreme Court, which review was granted on November 1, 2006.

Altria has reported that, as of May 1, 2008, there are 17 putative class actions pending against Philip Morris in the U.S. on behalf of individuals who purchased and consumed various brands of cigarettes, including Marlboro Lights, Marlboro Ultra Lights, Virginia Slims Lights and Superslims, Merit Lights, and Cambridge Lights. These actions allege, among other things, that the use of the term "Lights" or "Ultra Lights" constitutes deceptive and unfair trade practices and seek injunctive and equitable relief, including restitution. As reported by Altria, trial courts have certified classes in cases pending against Philip Morris in Massachusetts (*Aspinall*), Minnesota (*Curtis*), Missouri (*Craft*), and New York (*Schwab*). Philip Morris has appealed or otherwise challenged these class certification orders. Additionally, an appellate court in Florida has overturned a class certification by the trial court in the "lights" case styled *Hines v. Philip Morris, Inc.*, and the plaintiffs have petitioned the Florida Supreme Court for further review. On December 10, 2004, the Florida Supreme Court stayed further proceedings pending its decision in the *Engle* case, which was entered thereafter on December 21, 2006. On January 8, 2007, the court ordered the plaintiff in *Hines* to respond by January 23, 2007 as to why the decision in *Engle* should not control the outcome in *Hines*. The plaintiffs petitioned the Florida Supreme Court for further review, and on January 14, 2008, the Florida Supreme Court denied the petition.

In August 2004, the Massachusetts Supreme Judicial Court affirmed class certification in the "lights" case *Aspinall v. Philip Morris Cos*. In April 2006, plaintiffs filed a motion to redefine the class to include all persons who after November 25, 1994 purchased packs or cartons of *Marlboro Lights* in Massachusetts that displayed the legend "Lower Tar & Nicotine" (the original class definition did not include a reference to lower tar and nicotine). In August 2006, the trial court denied Philip Morris's motion for summary judgment based on the state consumer protection statutory exemption and federal preemption. On motion of the parties, the trial court subsequently reported its decision to deny summary judgment to the appeals court for review and the trial court proceedings are stayed pending completion of the appellate review. Motions for direct appellate review with the Massachusetts Supreme Judicial Court were granted in April 2007. Arguments were heard in January 2008. In February 2008, the parties jointly agreed to stay the case pending the U.S. Supreme Court decision in *Good*, described below.

In *Watson v. Philip Morris*, the U.S. District Court for the Eastern District of Arkansas upheld the federal officer removal statute as a basis for removal of "lights" cases from state to federal court, and the U.S. Court of Appeals for the Eighth Circuit affirmed. The U.S. Supreme Court granted plaintiffs a writ of certiorari and requested comment from the U.S. Solicitor General as to whether federal jurisdiction of the matter, based on the involvement of the Federal Trade Commission ("**FTC**"), was appropriate. The U.S. Solicitor General filed its brief amicus curiae on December 19, 2006, recommending that the petition for writ of certiorari be denied, despite its belief that the Eighth Circuit erred, because the error below (that Philip Morris marketed its cigarettes as "light" pursuant to the FTC's comprehensive direction and control) was fact-specific and insufficient to warrant review. On January 12, 2007, the U.S. Supreme Court granted the petition for a writ of certiorari. On June 11, 2007, the Supreme Court issued a ruling in which it reversed the trial court's order and directed that the Watson case be remanded and transferred back for further proceedings to the Arkansas state court where it had originally been filed. The Court held that the *Watson* case did not qualify under applicable federal law for removal and transfer from the Arkansas state court to the Arkansas federal court. In December 2007, the court rejected the parties' proposed stipulation to stay the case pending the U.S. Supreme Court's decision on defendants' petition for writ of certiorari in *Good*, which was granted on January 18, 2008. A motion is pending to reconsider this denial.

In April 2005, the Minnesota Supreme Court declined to review the trial court's class certification order in the "lights" case *Curtis v. Altria*. In September 2005, the case was removed to the U.S. District Court for the District of Minnesota, based on the Eighth Circuit's decision in *Watson*. In February 2006, the U.S. District Court denied plaintiffs' motion to remand the case to state court, and the case is pending in federal court. On July 31, 2006, the court stayed all proceedings pending resolution of the appeal in

Dahl (described below). In February 2007, the U.S. Court of Appeals for the Eighth Circuit issued its ruling in *Dahl*, and reversed the federal district court's denial of plaintiff's motion to remand that case to the state trial court. On October 17, 2007, the district court remanded the case to state court. In December 2007, the Minnesota Court of Appeals reversed the trial court's determination in *Dahl* that the Lights class action was subject to preemption, and defendants have appealed. The *Dahl* case has been stayed pending the U.S. Supreme Court decision in *Good*.

In August 2005, the Missouri Court of Appeals, Eastern District, affirmed the class certification order in *Craft v. Philip Morris Cos*. In September 2005, Philip Morris removed the case to federal court based on *Watson*. In March 2006, the federal trial court granted plaintiffs' motion and remanded the case to the Missouri state trial court. Philip Morris filed a motion for appellate review of the trial court's class certification. In May 2006, the Missouri Supreme Court declined to review the class certification decision. Trial is currently scheduled to begin in January 2009.

On May 11, 2004, smokers of "Lights" cigarettes filed a purported class action suit, presently styled *Schwab v. Philip Morris USA, Inc.* (but originally filed as *McLaughlin et al. v. Philip Morris USA, Inc.*), in the U.S. District Court for the Eastern District of New York against the OPMs and their parent companies, Liggett and certain other entities. Plaintiffs allege that the defendants formed an "association-in-fact" enterprise, in violation of the federal RICO statute, to defraud the public into believing that "light" cigarettes were healthier alternatives to regular cigarettes. Plaintiffs seek to certify a nationwide class of smokers comprising all purchasers of "light" cigarettes manufactured by the defendants since the 1970s. Oral argument on the plaintiffs' motion for class certification occurred on September 12, 2005. The defendants filed a motion to deny class certification and to dismiss the complaint, asserting that the plaintiffs' request – that any determination as to damages payable to a certified class be allocated among class members on a "fluid recovery" basis – is illegal. On November 14, 2005, the court denied the defendants' motion, ruling that the plaintiffs' request for "fluid recovery" is not illegal and does not require denial of class certification or dismissal of the action. The trial judge ordered several months of additional discovery before deciding the class certification issue. On September 25, 2006, the court granted class certification and set a trial date of January 22, 2007. On October 6, 2006, the defendants filed a petition seeking review by the U.S. Court of Appeals for the Second Circuit of the class certification decision along with a motion to stay that decision pending review. On October 24, 2006, the Second Circuit ordered a temporary stay of all pre-trial and trial proceedings pending the disposition of the petition for review and motion to stay. In November 2006, the Second Circuit granted the defendants' petition for review of the class certification order. On April 3, 2008, the Second Circuit decertified the class.

In *Marrone v. Philip Morris, USA, Inc.*, smokers of "Lights" cigarettes manufactured and sold by Philip Morris, Inc. filed class-action complaints in an Ohio state court against Philip Morris, alleging violations of Ohio's Consumer Sales Practices Act ("**OCSPA**") in that, among other allegations, Philip Morris falsely represented the cigarettes as "light" to mislead smokers into believing that the cigarettes delivered lower tar and nicotine and therefore were safer than their "regular" cigarette counterparts. The trial court certified a limited class of consumers from an area of Ohio on the OCSPA claims and Philip Morris appealed. The Ohio appellate court affirmed the trial court's judgment certifying the class. In contrast to the above "lights" cases, on June 14, 2006, the Supreme Court of Ohio reversed the judgment of the appellate court and ruled that the plaintiffs did not meet the standard to qualify for class-action certification under the OCSPA, concluding that the plaintiffs had not shown prior rules or court decisions determining that conduct sufficiently similar to the alleged acts of Philip Morris constituted a deceptive act or practice.

Moreover, the Supreme Court of Illinois has overturned a judgment in favor of a plaintiff class in *Price v. Philip Morris Cos., Inc.* (formerly known as *Miles v. Philip Morris, Inc.*). A Madison County Illinois state court certified a class comprised of all residents of Illinois who purchased and consumed

Cambridge Lights and Marlboro Lights within a specified time period but who did not have a claim for personal injury resulting from the purchase or consumption of cigarettes. The plaintiffs alleged consumer fraud claims and sought economic damages in the form of a refund of purchase costs of the cigarettes. On March 21, 2003, after a non-jury trial, the trial court judge ruled in favor of the plaintiffs, ordering Philip Morris to pay $10.1 billion ($7.1 billion in compensatory damages, $3.0 billion in punitive damages) to the State of Illinois, and $1.78 billion in plaintiff lawyer fees to be paid from the $10.1 billion. The court also stayed execution of the judgment for 30 days. After entry of the judgment on March 21, 2003, Philip Morris had 30 days within which to file a notice of appeal. Under Illinois court rules then-applicable, the enforcement of a trial court's money judgment may be stayed only if, among other things, an appeal bond in an amount sufficient to cover the amount of the judgment, interest, and costs is posted by a defendant within the 30-day period during which an appeal may be taken. With the approval of the trial court, such 30-day period may be extended for up to an additional 15 days. The trial court judge initially set the bond at $12 billion. Because of the difficulty of posting a bond of that magnitude, Philip Morris pursued various avenues of relief from the $12 billion bond requirement. In April 2003, the judge reduced the amount of the appeal bond. He ordered the bond to be secured by $800 million, payable in four equal quarterly installments beginning in September 2003, and a pre-existing 7.0%, $6 billion long-term note from Altria Group, Inc. to Philip Morris to be placed in an escrow account pending resolution of the case. The plaintiffs appealed the judge's order reducing the amount of the bond. On July 14, 2003, the Illinois Fifth District Court of Appeals ruled that the trial court had exceeded its authority in reducing the bond and ordered the trial judge to reinstate the original bond. On September 16, 2003, the Illinois Supreme Court upheld the reduced bond set by the trial court and agreed to hear Philip Morris's appeal without the need for intermediate appellate court review. On December 15, 2005, the Illinois Supreme Court reversed the trial court's judgment and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission, and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the U.S. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. The plaintiffs filed a motion asking the court to reconsider its decision, which was denied on May 5, 2006 by the Supreme Court of Illinois. In June 2006, the Illinois Supreme Court ordered the return to Philip Morris of approximately $2.15 billion held in escrow to secure the appeal bond and terminated Philip Morris's obligations to pay administrative fees. The pre-existing 7.0%, $6 billion long-term note from Altria Group, Inc. to Philip Morris was being held in escrow pending the outcome of plaintiffs' petition for writ of certiorari to the U.S. Supreme Court, filed on October 2, 2006. On November 27, 2006, the U.S. Supreme Court denied plaintiff's petition for certiorari. In December 2006, the trial court then entered an order of dismissal. In January 2007, the plaintiff filed a motion to vacate the dismissal. In May 2007, the state trial court judge in the *Price* case asked the Illinois Fifth District Appellate Court whether he has the authority to reopen the *Price* case, citing possible new evidence presented in a case pending before the U.S. Supreme Court. On May 30, 2007, Philip Morris filed a motion to stay the Fifth District proceeding, which motion was granted by the Illinois Fifth District Appellate Court on June 1, 2007. It has also been reported that on May 17, 2007, Philip Morris petitioned the Illinois Supreme Court for an order that would prevent the trial court judge from reopening the *Price* case. In August 2007, the Illinois Supreme Court granted the petition and the trial court dismissed plaintiffs' motion to vacate or withhold final judgment.

According to Reynolds American, "lights" class-action cases are pending against Reynolds or Brown & Williamson in Illinois (*Turner and Howard*), Missouri (*Collora and Black*), Minnesota (*Dahl and Thompson*), Florida (*Rios*) and New York (*Schwab*). Illinois state courts have certified classes in *Turner v. R.J. Reynolds Tobacco Co.* and *Howard v. Brown & Williamson*. In Turner, the state court certified a class defined as "[a]ll persons who purchased defendants' Doral Lights, Winston Lights, Salem Lights and Camel Lights, in Illinois, for personal consumption, between the first date that defendants sold

Doral Lights, Winston Lights, Salem Lights and Camel Lights through the date the court certifies this suit as a class action…." On June 6, 2003, Reynolds Tobacco filed a motion to stay the case pending Philip Morris's appeal of the *Price* case. On July 11, 2003, the court denied the motion, and Reynolds Tobacco appealed to the Illinois Fifth District Court of Appeals. The Court of Appeals denied this motion on October 17, 2003. On October 20, 2003, the trial judge ordered that the case be stayed for 90 days, or pending the result of the *Price* appeal. The order stated that a hearing would be held at the end of the 90-day period to determine if the stay should be continued. However, on October 24, 2003, the Illinois Supreme Court ordered an emergency stay of all proceedings pending review by the entire Illinois Supreme Court of Reynolds Tobacco's emergency stay order request filed on October 15, 2003. On November 5, 2003, the Illinois Supreme Court granted Reynolds Tobacco's motion for a stay pending the court's final appeal decision in *Price*. On October 11, 2007, the Illinois Fifth District Court of Appeals dismissed Reynolds Tobacco's appeal and remanded the case to the circuit court. The *Howard* case remains stayed by order of the trial judge, although the plaintiffs appealed this stay order to the Illinois Fifth District Court of Appeals, which appeal was denied on August 19, 2005.

On December 31, 2003, a Missouri state court judge certified a similar class in the "lights" case *Collora v. R.J. Reynolds Tobacco Co.* On January 14, 2004, Reynolds Tobacco removed the case to the U.S. District Court for the Eastern District of Missouri. On September 30, 2004, the case was remanded to the Circuit Court for the City of St. Louis. Reynolds Tobacco removed the case once again, and on April 18, 2006, the case was remanded for the second time to the Circuit Court for the City of St. Louis. *Black v. Brown & Williamson Tobacco Corp.* is another "lights" case pending in Missouri. Brown & Williamson removed the case to the U.S. District Court for the Eastern District of Missouri on September 23, 2005. On October 25, 2005, the plaintiffs filed a motion to remand, which was granted on March 17, 2006. The plaintiffs' motion for class certification is scheduled to be heard on April 16, 2008. A consolidated hearing in both *Black* and *Collora* has been set for December 25, 2007. On December 22, 2006, the plaintiffs filed a motion to reassign both *Black* and *Collora* to a single general division, which motion was granted on April 19, 2007.

In May 2005, a Minnesota state court dismissed in its entirety the "lights" case *Dahl v. R.J. Reynolds Tobacco Company*, ruling that the plaintiffs' claims conflicted with the federal Cigarette Labeling and Advertising Act. On July 11, 2005, the plaintiffs appealed. Pending appeal, Reynolds Tobacco removed the case to the U.S. District Court for the District of Minnesota. The plaintiffs filed a motion to remand, which was denied on February 14, 2006. On March 9, 2006, the case was transferred to the U.S. Court of Appeals for the Eighth Circuit. On February 28, 2007, the Eighth Circuit reversed and remanded the case to the Minnesota Court of Appeals and oral argument occurred on September 18, 2007. In December 2007, the Minnesota Court of Appeals reversed the trials court's determination in *Dahl* that the Lights class action was subject to preemption, and defendants' have appealed. The *Dahl* case has been stayed pending the U.S. Supreme Court decision in *Good*. In *Thompson v. R.J. Reynolds Tobacco Co.*, also pending in Minnesota, Reynolds removed the case on September 23, 2005 to the United States District Court for the District of Minnesota. On October 21, 2005, the plaintiffs filed a motion to remand, which was denied on February 14, 2006. On August 7, 2006, the parties filed a stipulation to stay the case, pending resolution of the appeal in *Dahl*. On October 29, 2007, the United States District Court remanded the case to the District Court for Hennepin County. On February 1, 2008, the court stayed the case until the completion of *Dahl*.

On August 31, 2005, a Louisiana federal district court ruled in a proposed class action, *Sullivan v. Philip Morris*, that the Federal Cigarette Labeling and Advertising Act (FCLAA) does not preempt plaintiffs' claims of a breach of express warranty and certain state law remedies with respect to manufacturing defects. On September 14, 2005, the same district court ruled in the proposed class action *Brown v. Brown & Williamson* that the FCLAA does not preempt plaintiffs' fraudulent misrepresentation/concealment and defective product claims. Brown & Williamson filed a petition to the

U.S. Court of Appeals for the Fifth Circuit for permission to appeal, which was granted on February 10, 2006. In February 2007, the Fifth Circuit reversed the judgment and remanded the case with directions to dismiss all claims with prejudice. Philip Morris also filed a petition to the U.S. Court of Appeals for the Fifth Circuit for permission to appeal the Sullivan ruling, which was granted on March 31, 2006. On January 27, 2005, also in Louisiana, a federal judge denied the plaintiffs' motion to remand in *Harper v. R.J. Reynolds Tobacco Co*. The plaintiffs appealed, and on July 17, 2006, the Fifth Circuit Court of Appeals affirmed the district court's order.

Pending in the state of Washington is the "lights" case *Huntsberry v. R.J. Reynolds Tobacco Co.*, in which the plaintiffs' motion for class certification was denied on April 21, 2006. On September 18, 2006, the court denied the plaintiffs' motion for discretionary review. The plaintiffs filed a motion to modify the ruling with the Washington Court of Appeals on October 17, 2006, which motion was denied in December 2006. In January 2007, plaintiffs filed a motion with the Washington Supreme Court, asking the court to review the rulings that denied their motions for class certification, which motion was denied on March 1, 2007. The plaintiffs filed a motion to modify the ruling of that court on April 2, 2007, which motion is set for reconsideration on June 5, 2007. Pending in Florida is the "lights" case *Rios v. R.J. Reynolds Tobacco Co.*, which is currently dormant pending plaintiffs' counsel's attempt to appeal decertification in the Florida case *Hines v. Philip Morris, Inc.* Also pending in Florida is *Rivera v. Brown & Williamson Tobacco Corp.* which was filed in October 2006 and removed by the defendant in November 2006 to the federal District Court for the Southern District of Florida. On September 10, 2007, the court stayed the case until disposition of *Hines*.

On June 9, 2005, a proposed "lights" class action was filed in U.S. District Court for the District of New Mexico (*Mulford v. Altria Group, Inc.*). Philip Morris's motions for summary judgment on preemption and consumer protection statutory exemption grounds are pending resolution of the plaintiffs' amended motion for class certification. In March 2007, the federal district court denied plaintiffs' amended motion for class certification and in June 2007, plaintiffs renewed their motion for class certification. On June 27, 2005, a similar class action was filed in Kansas state court against Philip Morris and its parent, Altria (*Benedict v. Altria Group, Inc*.). The case has been transferred to U.S. District Court for the District of Kansas, where plaintiffs' motion for class certification and Philip Morris's motion for summary judgment are pending. It is also reported that on August 15, 2005, three individuals filed a "lights" class action in the U.S. District Court for the District of Maine against the same defendants (*Good v. Altria Group, Inc.*). In May 2006, the court granted Philip Morris's motion for summary judgment on the grounds that plaintiffs' claims are preempted by the Federal Cigarette Labeling and Advertising Act (the "**FCLAA**") and dismissed the case. In June 2006, plaintiffs appealed to the U.S. Court of Appeals for the First Circuit. On August 31, 2007, the First Circuit issued an opinion holding that the plaintiffs' claims are not preempted. The court reasoned that plaintiffs' claims of fraudulent misrepresentation are neither expressly nor implicitly preempted by the FCLAA. The court also disagreed with those courts, including the *Price* court, which have held that "lights" advertising is authorized by the FTC and therefore beyond the reach of state consumer protection statutes. The First Circuit remanded the case to the district court. The district court has stayed proceedings pending the ruling of the United States Supreme Court on defendant's petition for writ of certiorari, which the court granted on January 18, 2008. Oral argument has been scheduled for October 6, 2008.

On April 3, 2002, in *Deloach v. Philip Morris*, a federal district court in North Carolina granted class certification to a group of tobacco growers and quota-holders from Alabama, Florida, Georgia, North Carolina, South Carolina, and Tennessee. The class accused cigarette manufacturers of conspiring to set prices offered for tobacco in violation of antitrust laws. In June 2002, the defendants' petition to the Fourth Circuit Court of Appeals seeking permission to appeal the class certification was denied. In May 2003, the plaintiffs reached a settlement with all of the tobacco industry defendants other than Reynolds Tobacco. The settling defendants agreed to pay $210 million to the plaintiffs, to pay plaintiffs'

attorney fees of $75.3 million as set by the court and to purchase a minimum amount of U.S. leaf for ten years. The case continued against Reynolds Tobacco. On April 22, 2004, after the trial began, the parties settled the case. Under the settlement, Reynolds Tobacco has paid $33 million into a settlement fund, which, after deductions for attorneys' fees and administrative costs, will be distributed to the class pending final settlement approval. Reynolds Tobacco has also agreed to purchase a minimum amount of U.S. leaf for the next ten years. On March 21, 2005, the court approved the settlement and dismissed the suit.

On May 23, 2001, a lawsuit was filed in the U.S. District Court for the District of Columbia styled *Simms v. Philip Morris Incorporated*, which sought class action status for millions of youths who began smoking cigarettes before they were legally allowed to buy cigarettes. Plaintiffs sought to recover moneys that underage smokers spent on cigarettes before they were legally allowed to buy cigarettes, whether or not they have suffered health problems, and/or profits the tobacco manufacturers have earned from sales to children. The lawsuit alleged that tobacco manufacturers concealed the addictive nature of cigarettes and concealed the health risks of smoking in their advertising. In February 2003, the court denied plaintiffs' motion for class certification. The plaintiffs have filed several motions for reconsideration of the order denying class certification, which motions were denied in December 2006. The case has been stayed pending resolution of the *U.S. Department of Justice* case described below under "*–Healthcare Cost Recovery Lawsuits*".

On January 19, 2006, a lawsuit styled *Caronia v. Philip Morris USA, Inc.* was filed in the U.S. District Court for the Eastern District of New York to require Philip Morris to pay for low dose CAT scans (on an annual basis) for a class of smokers over the age of 50 who have been smoking at least a pack of Marlboro a day for 20 years and have not been diagnosed with lung cancer. Motions for summary judgment and class certification are pending in district court. On November 3, 2006, plaintiffs filed a Third Amended Complaint, which Philip Morris answered on November 13, 2006. Class certification discovery ended in February 2007, and briefing was due in April. A similar lawsuit, styled *Donovan, et al. v. Philip Morris USA, Inc. et al.*, was filed on March 2, 2007 in the United States District Court in Massachusetts.

On December 2006, a lawsuit styled *Espinosa, et al. v. Philip Morris USA, Inc. et al.* was filed in the Cook County, Illinois circuit court on behalf of individuals from throughout Illinois and/or the United States who purchased cigarettes manufactured by certain defendants from 1996 through the date of any judgment in plaintiffs' favor. Excluded from the class are any individuals who allege personal injury or healthcare costs. The complaint alleges, among other things, that defendants were negligent and violated the Illinois consumer fraud statute by certain defendants' steadily and purposefully increasing the nicotine level and absorption of their cigarettes into the human body, including the brands most popular with young people and minorities. On January 12, 2007, Philip Morris removed the case to the United States District Court for the Northern District of Illinois. In March 2007, the District Court rejected plaintiffs' motion to remand the case to the Circuit Court of Cook County. On June 18, 2007, the District Court granted Philip Morris' motion to dismiss the action.

Individual Plaintiffs' Lawsuits. The MSA does not release PMs from liability in individual plaintiffs' cases. Numerous cases have been brought by individual plaintiffs who allege that their cancer or other health effects have resulted from their use of cigarettes, addiction to smoking, or exposure to environmental tobacco smoke. Individual plaintiffs' allegations of liability are based on various theories of recovery, including but not limited to, negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, restitution, indemnification, violations of deceptive trade practice laws and consumer protection statutes, and claims under federal and state RICO statutes. The tobacco industry has traditionally defended individual health and smoking lawsuits by asserting, among

other defenses, assumption of risk and/or comparative fault on the part of the plaintiff, as well as lack of proximate cause.

Altria has reported that as of May 1, 2008, there were approximately 103 individual plaintiff smoking and health cases and 10 smoking and health class actions and aggregated claims pending in the U.S. against it (many of which cases include other tobacco industry defendants), including 728 cases pending before a single West Virginia state court in a consolidated proceeding. In addition, approximately 2,621 additional individual cases (referred to herein as the *Broin II* cases) are pending in Florida by individual current and former flight attendants claiming personal injury allegedly related to ETS in airline cabins. The individuals in the *Broin II* cases are limited by the settlement of a previous class action lawsuit, *Broin v. Philip Morris* (known as *Broin I*), to the recovery of compensatory damages only, and are precluded from seeking or recovering punitive damages. As a result of the settlement, however, the burden of proof as to whether ETS causes certain illnesses such as lung cancer and emphysema was shifted to the tobacco industry defendants. To date, seven individual *Broin II* flight attendant cases have gone to trial, one of which has resulted in a jury verdict against the tobacco industry defendants. The defendants' appeal in that case is pending. See also "Class Action Lawsuits," above.

In the last ten years, juries have returned verdicts in individual smoking and health cases against the tobacco industry, including one or more of the PMs. Thus far, a number of those cases have resulted in significant verdicts against the defendants — some have been appealed, some have been overturned, and others have been affirmed.

By way of example only, and not as an exclusive or complete list, the following individual matters are illustrative of individual cases.

- In February 1999, a California jury in *Henley v. Philip Morris* awarded $1.5 million in compensatory damages and $50 million in punitive damages. The award was subsequently reduced by the trial judge to $25 million in punitive damages, and both Philip Morris and the plaintiff appealed. In September 2003, a California Court of Appeal further reduced the punitive damage award to $9 million, but otherwise affirmed the judgment for compensatory damages, and Philip Morris appealed to the California Supreme Court. In September 2004, the California Supreme Court dismissed Philip Morris's appeal. In October 2004, the California Court of Appeal issued an order allowing the execution of the judgment. In December 2004, Philip Morris filed with the U.S. Supreme Court a petition for a writ of certiorari. On March 21, 2005, the U.S. Supreme Court denied Philip Morris's petition. Philip Morris subsequently satisfied the judgment, paying $1.5 million in compensatory damages, $9 million in punitive damages and $6.4 million in accumulated interest.

- In March 1999, an Oregon jury in *Williams-Branch v. Philip Morris* awarded $821,500 in actual damages and $79.5 million in punitive damages. The trial judge subsequently reduced the punitive damages award to $32 million, but the reduction was overturned and the full amount of the punitive damages award was reinstated by the Oregon Court of Appeals. The Oregon Supreme Court declined to review the reinstated punitive damage award and Philip Morris petitioned the U.S. Supreme Court for further review. In October 2003, the U.S. Supreme Court set aside the Oregon appellate court's ruling and directed the Oregon court to reconsider the case in light of *State Farm v. Campbell*. In June 2004, the Oregon Court of Appeals reinstated the punitive damages award. In December 2004, the Oregon Supreme Court granted Philip Morris's petition for review of the case. On February 2, 2006, the Oregon Supreme Court affirmed the Court of Appeals decision, holding that the punitive damage award does not violate the due process guarantees of the U.S. Constitution. On March 30, 2006, Philip Morris filed a

petition for certiorari review with the U.S. Supreme Court challenging the ruling of the Oregon Supreme Court as a violation of the principles set forth in *State Farm v. Campbell* regarding the permissible size of punitive damage awards relative to compensatory damage awards. The U.S. Supreme Court granted Philip Morris's petition for review in May 2006, and oral argument was heard on October 31, 2006. On February 20, 2007, the U.S. Supreme Court ruled that a punitive damage award may not be based on a jury's desire to punish a defendant for harming persons who were not parties to the case in question and held that such an award would amount to an unconstitutional taking of property from a defendant without due process. The Court vacated the judgment of the Oregon Supreme Court and remanded the case for further proceedings not inconsistent with its opinion. On January 31, 2008, the Oregon Supreme Court affirmed the Oregon Court of Appeals' June 2004 decision, which in turn, upheld the jury's compensatory damage award and reinstated the jury's award of $79.5 million in punitive damages. On June 9, 2008, the U.S. Supreme Court granted Philip Morris' petition for certiorari.

- In April 1999, a Maryland jury in *Connor v. Lorillard* awarded $2.225 million in damages. An appellate court has remanded the case for a determination of the date of injury to determine whether a statutory cap on non-economic damages applies.

- In March 2000, a California jury in *Whiteley v. Raybestos-Manhattan, Inc.* returned a verdict in favor of the plaintiff and found the defendants, including Philip Morris and Reynolds Tobacco, liable for negligent product design and fraud, and awarded $1.72 million in compensatory damages and $20 million in punitive damages. Both damage awards were upheld by the trial judge, who denied the defendants' post-verdict challenge. The defendants appealed the verdict. In April 2004, the California Court of Appeal reversed the judgment and remanded the case for a new trial. The plaintiff's motion for rehearing was denied on April 29, 2004. In May 2006, the plaintiff filed an amended consolidated complaint. In September 2006, the trial court granted the plaintiff's motion for a preferential trial date and trial began on January 22, 2007. On May 2, 2007, the jury awarded plaintiffs $2.46 million in compensatory damages against Philip Morris and the other defendant in the case. The jury also found that plaintiffs are entitled to punitive damages against the other defendant, but not Philip Morris, in an amount to be determined in a later phase of the trial. Philip Morris has stated it intends to seek review of the compensatory damage verdict. On September 5, 2007, the court denied Reynolds Tobacco's motion for judgment notwithstanding the verdict or, in the alternative, a new trial. On October 3, 2007, Reynolds Tobacco filed for appeal.

- In October 2000, a Tampa, Florida jury in *Jones v. R.J. Reynolds Tobacco Co.* found Reynolds Tobacco liable for negligence and strict liability and returned a verdict in favor of the widower of a deceased smoker, awarding approximately $200,000 in compensatory damages; the jury rejected the plaintiff's conspiracy claim and did not award punitive damages. Reynolds Tobacco filed a motion for judgment notwithstanding the verdict, or, in the alternative, for a new trial. On December 28, 2000, the court granted the motion for a new trial and on August 30, 2002 the Second District Court of Appeal of Florida affirmed the decision to grant a new trial. The plaintiff has filed for permission to appeal to the Florida Supreme Court. On December 9, 2002, the Supreme Court of Florida issued an order to show cause as to why Jones's notice of appeal should not be treated as a notice to invoke discretionary jurisdiction. On April 27, 2005 the Florida Supreme Court denied the plaintiff's notice of appeal without prejudice. On May 25, 2005 the plaintiff served an amended notice of intent to invoke discretionary jurisdiction. On August 31, 2005, the Florida Supreme Court denied review for lack of

jurisdiction. On April 20, 2006, the plaintiff voluntarily dismissed all claims against Reynolds Tobacco.

- In November 2000, the Supreme Court of Florida reinstated the verdict by a Florida jury in *Carter v. Brown & Williamson Tobacco Corporation* to award $750,000 in damages to the plaintiff. In 1996, the jury had found that cigarettes were a defective product and that B&W was negligent for not warning people of the danger, but an appeals court reversed this decision. In March 2001, the plaintiff received slightly over $1 million from a trust account that contained the $750,000 jury award plus interest and became the first smoker to be paid by a tobacco company in an individual lawsuit. On June 29, 2001, the U.S. Supreme Court denied B&W's petition for a writ of certiorari, thus leaving the jury verdict intact.

- In March 2001, a Massachusetts lower court in *Haglund v. Philip Morris* dismissed, without factual inquiries, a claim brought on behalf of a deceased smoker for breach of implied warranty of merchantability, based upon the applicability of a defense as to "unreasonable" use of the product by the smoker and the stipulation by the plaintiff that the defendant would prevail if the defense was made applicable. In May 2006, the Massachusetts Supreme Judicial Court, in reversing and remanding the case for further factual proceedings as to reasonableness of use, noted that such defense will not be available in most cases involving the manufacture and sale of cigarettes, but will only be available in situations where the plaintiff has acted so overwhelmingly unreasonable that imposing liability would be unfair.

- In June 2001, in *Boeken v. Philip Morris Incorporated*, a California state court jury found against Philip Morris on all six claims of fraud, negligence and making a defective product alleged by the plaintiff. The jury awarded the plaintiff $5.5 million in compensatory damages and $3 billion in punitive damages. The $3 billion punitive damages award was reduced to $100 million post-trial. Philip Morris appealed. In September 2004, the California Second District Court of Appeal further reduced the punitive damage award to $50 million, but otherwise affirmed the judgment entered in the case. In October 2004 the Court of Appeal granted the parties' motions for rehearing and, in April 2005, reaffirmed the amount of the September 2004 ruling. On August 10, 2005, the California Supreme Court denied Philip Morris's request for review. Philip Morris and the plaintiff have petitioned the U.S. Supreme Court for review. Plaintiff has agreed not to execute on the judgment pending the disposition of Philip Morris's petition. On March 20, 2006, the U.S. Supreme Court denied all parties' petitions for review. After exhausting all appeals, Philip Morris paid approximately $82.5 million (including interest of approximately $27 million) to the plaintiffs.

- In December 2001, a Florida state court jury awarded the plaintiff $165,000 in compensatory damages but no punitive damages in *Kenyon v. R.J. Reynolds Tobacco Co*. Reynolds Tobacco appealed to the Second District Court of Appeal of Florida, which, on May 30, 2003, affirmed per curium (that is, without writing an opinion) the trial court's judgment in favor of the plaintiff. Reynolds Tobacco paid $196,000, which represents the amount of the judgment plus accrued interest, in order to pursue further appeals. On September 5, 2003, Reynolds Tobacco petitioned the Florida Supreme Court to require the Second District Court of Appeal to write an opinion. On April 22, 2004, the Florida Supreme Court denied the petition. On January 26, 2004, the U.S. Supreme Court denied Reynolds Tobacco's petition for a writ of certiorari, thus leaving the jury verdict intact. Reynolds Tobacco subsequently paid approximately $1.3 million in attorneys' fees to the plaintiff's counsel.

- In February 2002, a federal jury in Kansas City awarded $198,000 in compensatory damages to a former smoker in *Burton v. R.J. Reynolds Tobacco Co*. The jury also determined that punitive damages were appropriate and, after a separate hearing was held to address that issue, the court awarded the plaintiff $15 million in punitive damages. On February 9, 2005, the U.S. Court of Appeals for the Tenth Circuit upheld the compensatory damages award, but unanimously reversed the award of punitive damages in its entirety. On May 17, 2005, the District Court entered a second amended judgment for $196,416 plus interest and costs. On June 17, 2005, Reynolds Tobacco paid the judgment.

- In March 2002, a Portland, Oregon jury awarded approximately $168,500 in compensatory damages and $150 million in punitive damages to the family of a light cigarette smoker in *Schwarz v. Philip Morris Incorporated*. The trial judge subsequently reduced the punitive damages awarded to $100 million. Philip Morris and the plaintiffs appealed this judgment. In May 2006, the Oregon Court of Appeals affirmed the compensatory damages verdict and reversed the award of punitive damages and remanded the case to the trial court for a second trial to determine the amount of punitive damages, if any. In June 2006, plaintiffs filed a petition to the Oregon Supreme Court to review the portion of the Oregon Court of Appeals decision reversing the punitive damages and remanding the case for a new trial on punitive damages. In October 2006, the Oregon Supreme Court announced that it would hold this petition in abeyance until the U.S. Supreme Court decides the *Williams* case described above. In February 2007, the U.S. Supreme Court vacated the punitive damages judgment in the *Williams* case and remanded the case to the Oregon Supreme Court for proceedings consistent with its decision. The parties have submitted their briefs to the Oregon Supreme Court setting forth their respective views on how the *Williams* decision impacts the plaintiffs pending petition for review.

- In June 2002, in *Lukacs v. Philip Morris, Inc.*, a Florida jury awarded a smoker $37.5 million in compensatory damages against Philip Morris and other defendants. In March 2003, the trial court reduced the damages award to $24.9 million. The court has not yet entered the judgment in the jury verdict. In January 2007, defendants petitioned the trial court to set aside the jury's verdict and plaintiff filed a motion for entry of judgment. On August 1, 2007, the trial court deferred ruling on plaintiff's motion until the U.S. Supreme Court reviews *Engle*. Philip Morris has stated it intends to appeal if a judgment is entered in this case.

- In September 2002, in *Figueroa-Cruz v. R.J. Reynolds Tobacco Co.*, a Puerto Rico jury awarded two sons of a deceased smoker $500,000 each. The trial judge vacated one of the awards on statute of limitations grounds, and granted Reynolds Tobacco's motion for judgment as a matter of law on the other award on October 9, 2002. On October 28, 2003, the U.S. Court of Appeals for the First Circuit affirmed the trial court's ruling. The plaintiffs' petition for a writ of certiorari was denied by the U.S. Supreme Court in November 2004.

- In October 2002, in *Bullock v. Philip Morris, Inc.*, a Los Angeles, California jury awarded a smoker $850,000 in compensatory damages. In October 2002, the same jury awarded the plaintiff $28 billion in punitive damages. In December 2002, the trial judge reduced the punitive damage award to $28 million. Philip Morris and the plaintiff have each appealed and the appeal was argued on January 18, 2006. On April 21, 2006, the California Court of Appeal, Second Appellate District, Division Three, upheld the $28 million punitive damages award. In August 2006, the California Supreme Court denied

the plaintiff's petition to overturn the trial court's reduction in the punitive damage award and granted Philip Morris's petition for review challenging the punitive damage award, with further action deferred pending the U.S. Supreme Court's decision on punitive damages in the *Williams* case described above. In February 2007, the U.S. Supreme Court vacated the punitive damages judgment in *Williams* and remanded the case to the Oregon Supreme Court for proceedings consistent with its decision. On January 30, 2008, the California Court of Appeals reversed the judgment with respect to the $28 million punitive damages award, affirmed the judgment in all other respects, and remanded the case to trial court on the amount of punitive damages.

- In April 2003, in *Eastman v. Philip Morris*, a Florida jury awarded a smoker $3.26 million in damages, after reducing the award to reflect the plaintiff's partial responsibility. Defendants Philip Morris and B&W appealed to the Second District of Florida Court of Appeal. In May 2004, the Second District Court of Appeal rejected the appeal in a per curium decision (that is, without a written opinion). The defendants' petition for a written opinion and rehearing was denied on October 14, 2004, and that ruling is not subject to review by the Florida Supreme Court. On October 29, 2004, Philip Morris and Reynolds Tobacco, due to their obligation to indemnify B&W, satisfied their respective portions of the judgment.

- In May 2003, in *Boerner v. Brown & Williamson*, an Arkansas jury awarded the plaintiff $15 million in punitive damages and $4 million in compensatory damages. Following a series of appeals, on January 7, 2005, the U.S. Court of Appeals for the Eighth Circuit affirmed the trial court's May 2003 judgment, but reduced the punitive damages award to $5 million. Reynolds Tobacco, due to its obligation to indemnify B&W, satisfied the approximately $9.1 million judgment on February 16, 2005.

- In November 2003, in *Thompson v. Philip Morris, Inc.*, a Missouri jury returned a split verdict, awarding approximately $1.6 million in compensatory damages to the plaintiff and an additional $500,000 in damages to his wife. The jury apportioned 40% of fault to Philip Morris, 10% of fault to B&W and the remaining 50% to the plaintiff. Accordingly, under Missouri law, the court must reduce the damages award by half. On March 8, 2004, the defendants appealed to the Missouri Court of Appeals for the Western District, which affirmed the judgment entered in favor of the plaintiffs on August 22, 2006. On September 26, 2006, the Court of Appeals denied the defendants' motion to transfer the case to the Missouri Supreme Court. The defendants filed an application to transfer in the Missouri Supreme Court on October 10, 2006, and on December 19, 2006, the application was denied. In January 2007, Philip Morris and Reynolds Tobacco paid approximately $1.1 million and $268,100, respectively, in judgment and interest to the plaintiff.

- In December 2003, in *Frankson v. Brown & Williamson*, a New York jury awarded the plaintiff $350,000 in compensatory damages and $20 million in punitive damages. On June 22, 2004, the trial judge granted a new trial unless the parties agree to an increase in compensatory damages to $500,000 and a decrease in punitive damages to $5 million. On January 21, 2005, the plaintiff stipulated to the court's reduction in the amount of punitive damages. The defendants' appeal was denied by the appellate division in July 2006. On August 4, 2006, the defendants filed a motion for rehearing, or, in the alternative, for leave to appeal to the New York Court of Appeals. That motion was denied on October 5, 2006. The defendants' motion to stay entry and enforcement of the final judgment pending further appeal was granted in January 2007 and the defendants also appealed the judgment that same month. Judgment was entered against the

defendants on March 7, 2007 and they have filed a notice of appeal. The appeals will be consolidated.

- In April 2004, a Florida jury returned a verdict in favor of the plaintiff in *Davis v. Liggett Group, Inc.*, awarding a total of $540,000 in actual damages. In addition, the jury awarded legal fees of $752,000. The jury did not award punitive damages. Liggett has appealed.

- In October 2004, in *Arnitz v. Philip Morris, Inc.*, a Florida jury returned a verdict in favor of the plaintiff, who claims that as a result of his smoking he developed lung cancer and emphysema. The jury awarded a total of $240,000 in compensatory damages. Philip Morris, the sole defendant in the case, appealed to the Florida Second District Court of Appeals. In July 2006, the appellate court affirmed the judgment of the trial court. In September 2006, the appellate court denied Philip Morris's motion for rehearing. Philip Morris subsequently filed a motion to stay the issuance of the mandate with the appellate court. On October 6, 2006, the appellate court denied this motion, and the mandate was issued. On October 16, 2006, Philip Morris paid $1,094,352 in judgment, interest, and attorneys' fees. On October 19, 2006, Philip Morris filed a petition for discretionary review with the Florida Supreme Court. The petition was denied on December 20, 2006.

- In February 2005, in *Smith v. Brown & Williamson*, a Missouri state court jury returned a split verdict, finding in favor of the defendant on counts of fraudulent concealment and conspiracy and in favor of the plaintiffs on a negligence count. The jury awarded the plaintiffs $500,000 in compensatory damages and $20 million in punitive damages. On March 10, 2005, the defendant filed a motion for judgment notwithstanding the verdict or, in the alternative, for a new trial. On May 23, 2005, the trial court denied defendant's motion, and on June 1, 2005, the defendant appealed. Oral argument occurred on October 5, 2006. On July 31, 2007 a majority of the judges of the Missouri Appeals Court for the Western District issued a decision affirming the jury's finding of negligence and its award of compensatory damages, but reversing the $20 million punitive damages award based on its determination that plaintiffs had not shown by clear and convincing evidence that B&W had engaged in intentional wrongdoing with respect to that portion of its negligence claim based on theories of negligent failure to warn and negligent product design. However, the majority of the Court also found that plaintiffs had submitted sufficient evidence of B&W's intentional wrongdoing with respect to their strict liability product defect theory, and the majority indicated its intent to remand the case for a new trial on punitive damages on the strict liability product defect claim only. Because one of the justices of the Appeals Court dissented from several of the rulings of the majority opinion, the case has been transferred in accordance with the Missouri Constitution to the Missouri Supreme Court where it remains pending. Oral argument was heard on February 13, 2008.

- In March 2005, in *Rose v. Philip Morris*, a New York jury awarded $3.42 million in compensatory damages against B&W and Philip Morris. On August 18, 2005, B&W filed a notice of appeal. Pursuant to its agreement to indemnify B&W, on February 7, 2006, Reynolds Tobacco posted a supersede as bond in the approximate amount of $2.058 million. The jury also returned a punitive damages award totaling $17.1 million against Philip Morris. In December 2005, Philip Morris's post-trial motions challenging the verdict were denied by the trial court. Philip Morris appealed and on April 10, 2008, the New York Appellate Division, First Department, vacated both the compensation damages and punitive damages award and dismissed plaintiff's claims.

- Also in March 2005, the Ninth Circuit Court of Appeals referred the case *Grisham v. Philip Morris* to the California Supreme Court to determine the statute of limitations in tobacco cases, noting an inconsistency in federal and California state law. The plaintiff, who was diagnosed with severe periodontal disease caused by toxins in cigarette smoke, alleged that Philip Morris and Brown & Williamson deceived her for four decades about the safety of their products. The case had reached the Ninth Circuit after a Los Angeles federal court dismissed the case as being time-barred. On December 6, 2006, the California Supreme Court heard arguments regarding whether long-term smokers who relied on manufacturers' false safety claims are required to file suit when health problems emerge or much earlier, when smokers realize they are addicted. On February 15, 2007, the California Supreme Court ruled that such smokers need not have filed suit when they realized they were addicted, thus permitting the Grisham lawsuit to proceed in federal court in California.

In August 2002, the California Supreme Court issued a decision limiting evidence of wrongdoing between 1988 and 1998 by tobacco companies. One OPM has reported that this decision worked to the advantage of the tobacco industry defendants in the Whiteley case, and it believes that it will have a favorable impact for tobacco industry defendants in other California cases, both at the trial court level and on appeal.

Healthcare Cost Recovery Lawsuits. In certain pending proceedings, domestic and foreign governmental entities and non-governmental plaintiffs, including Native American tribes, insurers and self-insurers such as Blue Cross and Blue Shield plans, hospitals and others, are seeking reimbursement of healthcare cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages as well. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees. The PMs are exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims belonging to the Settling States. Altria has reported that as of May 1, 2008, there were three healthcare cost recovery actions pending against Philip Morris in the U.S. For example, on August 4, 2005, a national senior citizens' organization filed a lawsuit (*United Senior Association, Inc. v. Philip Morris Inc., et al.*) in Boston against cigarette manufacturers under the federal "Medicare as Secondary Payer" statute, which permits Medicare beneficiaries or others to bring actions on behalf of Medicare to recover healthcare costs paid by Medicare for which another party may be liable. The plaintiffs are reportedly seeking to recover more than $60 billion in alleged Medicare spending on treatment of smoking related illnesses since August 4, 1999. On October 24, 2005, the defendants filed a motion to dismiss, or, in the alternative, to transfer the case to the U.S. District Court for the Middle District of Florida, where a similar lawsuit involving Medicare payments in Florida was dismissed on July 26, 2005. The Boston lawsuit reportedly does not seek to recover Medicare payments in Florida. On August 28, 2006, the defendants' motion to dismiss was granted. On September 7, 2006, the plaintiffs filed a notice of appeal with the U.S. Court of Appeals for the First Circuit. On August 20, 2007, the First Circuit issued an opinion affirming the District Court's dismissal of the action. In November, 2007, plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court, which was denied on January 22, 2008.

The claims asserted in the healthcare cost recovery actions include the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of healthcare costs allegedly attributable to smoking, the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under federal and state statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under federal Racketeer Influenced and Corrupt Organizations Act ("**RICO**") and parallel state statutes.

Defenses raised include lack of proximate cause, remoteness of injury, failure to state a valid claim, lack of benefit, adequate remedy at law, "unclean hands" (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), lack of antitrust standing and injury, federal preemption, lack of statutory authority to bring suit, and statutes of limitations. In addition, defendants argue that they should be entitled to "set off" any alleged damages to the extent the plaintiff benefits economically from the sale of cigarettes through the receipt of excise taxes or otherwise. Defendants also argue that these cases are improper because plaintiffs must proceed under principles of subrogation and assignment. Under traditional theories of recovery, a payor of medical costs (such as an insurer) can seek recovery of healthcare costs from a third party solely by "standing in the shoes" of the injured party. Defendants argue that plaintiffs should be required to bring any actions as subrogees of individual healthcare recipients and should be subject to all defenses available against the injured party.

Although there have been some decisions to the contrary, most courts that have decided motions in these cases have dismissed all or most of the claims against the industry. In addition, eight federal Courts of Appeals (the Second, Third, Fifth, Seventh, Eighth, Ninth, Eleventh, and District of Columbia Circuits), as well as California, Florida, New York, and Tennessee intermediate appellate courts, relying primarily on grounds that plaintiffs' claims were too remote, have affirmed dismissals of, or reversed trial courts that had refused to dismiss, healthcare cost recovery actions. The U.S. Supreme Court has refused to consider plaintiffs' appeals from the cases decided by the U.S. Courts of Appeals for the Second, Third, Fifth, Ninth, and District of Columbia Circuits.

A number of foreign governmental entities have filed suit in state and federal courts in the U.S. against tobacco industry defendants to recover funds for healthcare and medical and other assistance paid by those foreign governments to their citizens. Such suits have been brought in the U.S. by 13 countries, a Canadian province, 11 Brazilian states and 11 Brazilian cities. All of these suits have been dismissed. In addition to these cases brought in the U.S., healthcare cost recovery actions have also been brought in Israel, the Marshall Islands (where the suit was dismissed), Canada, France (where the suit was dismissed), Spain and Nigeria. In September 2003, the case pending in France was dismissed and the plaintiff has appealed. Other governmental entities have stated that they are considering filing such actions. On September 29, 2005, the Supreme Court of Canada upheld legislation passed in 1998 by the province of British Columbia allowing the provincial government to seek damages from tobacco companies for healthcare costs incurred during the past 50 years, as well as for future illness-related expenses in connection with tobacco use. The legislation also lightens the required burden of proof and curtails certain traditional defenses in civil suits. Other provinces are reported to have already adopted or are expected to adopt similar legislation. See discussion of HCCR Act, below.

In September 1999, the U.S. government filed a lawsuit (*USA v. Philip Morris USA*) in the U.S. District Court for the District of Columbia against the OPMs, certain related parent companies and two tobacco industry research and lobbying organizations, seeking medical cost recovery for federal funds spent to treat alleged tobacco-related illnesses and asserting violation of RICO. In September 2000, the trial court dismissed the government's medical cost recovery claims, but permitted discovery to proceed on the government's claims for relief under RICO. The government alleged that disgorgement by defendants of approximately $280 billion is an appropriate remedy. In May 2004, the court issued an order denying defendants' motion for partial summary judgment limiting the disgorgement remedy. In June 2004, the trial court certified that order for immediate appeal, and in July 2004, the U.S. Court of Appeals for the District of Columbia agreed to hear the appeal on an expedited basis. On February 4, 2005, the appeals court, in a 2-1 decision, ruled that disgorgement is not an available remedy in this case. This ruling eliminated the government's claim for $280 billion and limits the government's potential remedies principally to forward-looking relief, including funding for anti-smoking programs. The government appealed this ruling to seek a rehearing en banc. On April 20, 2005, the appeals court denied

the government's appeal. On July 18, 2005, the government appealed the ruling with regard to the $280 billion disgorgement decision to the U.S. Supreme Court. On October 17, 2005 the U.S. Supreme Court, without comment, denied the appeal.

In addition to the claim for disgorgement, the government sought relief consisting of, among other things: (1) prohibitory injunctions (including prohibitions on committing acts of racketeering, making false or misleading statements about cigarettes, and on youth marketing); (2) disclosure of documents concerning the health risks and addictive nature of smoking, the ability to develop less hazardous cigarettes and youth marketing campaigns; (3) mandatory corrective statements about the health risks of smoking and the addictive properties of nicotine in future marketing campaigns; and (4) funding of remedial programs (including research, public education campaigns, medical monitoring programs, and smoking cessation programs). The trial phase of the case concluded on June 9, 2005. In its closing argument and submissions, the government requested that the tobacco industry be required to fund an up to ten-year, $14 billion smoking cessation program. The government has reportedly also asked the court to appoint a lawyer as monitor with power to order the defendants to sell off their research and development facilities related to developing so-called safer cigarettes. The monitor would also have power to review the business policies of the defendants. The government has also reportedly requested that restrictions be placed on the defendants' ability to sell their cigarette businesses and that the defendants be compelled to run public advertisements regarding the dangers of smoking. The defendants filed a motion to dismiss the government's request for the $14 billion award, arguing that the award was barred by the February 4, 2005 appellate decision. On July 22, 2005, the District Court judge granted the motion made under Federal Rule of Civil Procedure 24 by six public interest groups to intervene in this action for the very limited purpose of being heard on the issue of permissible and appropriate remedies in this case, should the government prevail on its claims with respect to smoking cessation programs. On August 15, 2005, the parties filed their proposed findings of fact. Post-trial briefing was completed on October 9, 2005. In August 2006, the District Court entered judgment in favor of the government, finding the defendants liable for the RICO claims, but imposing no direct financial penalties on the defendants, instead ordering the defendants to make certain "corrective communications" in a variety of media and enjoining the defendants from using certain brand descriptors. Both parties appealed — the defendants filed on September 11, 2006, and the government filed on October 16, 2006. In March 2007, the trial court denied defendants' post-trial motion for clarification of those portions of the court's remedial order prohibiting defendants from making certain statements to consumers about their products both within and outside the United States, but granted defendants' post-trial motion for clarification that the court's remedial order requiring corrective statements on display at retail points of sale do not apply outside the United States. The defendants have filed amended notices of appeal. The District Court's stay of the proceedings remains in effect pending appeal to the Court of Appeals. Briefing of the parties' consolidated appeal was scheduled to conclude in May 2008. The Court of Appeals has scheduled oral argument on the appeal for October 14, 2008.

In January of 2001, the Canadian Province of British Columbia enacted the Damages and Healthcare Costs Recovery Act (the "**HCCR Act**"). The HCCR Act authorizes an action by the government of British Columbia against a manufacturer of tobacco products for the recovery by the government of the present value of past and reasonably expected future healthcare expenditures incurred by the government in treating British Columbians with diseases caused by exposure to tobacco products, where such exposure was caused by a manufacturer's tort in British Columbia or a breach of a duty owed to persons in British Columbia. The HCCR Act allows the government to bring such action for expenditures related to a particular individual or on an aggregate basis for a population of persons. In an action brought on an aggregate basis, the Act does not require the government identify a particular person or to prove particular injury, healthcare costs or causation of harm with respect to any particular person. Where the government proves in an aggregate claim with respect of a type of tobacco product that a manufacturer breached a legal duty owed to persons who have been or might become exposed to the

tobacco product and that exposure to the tobacco product can cause or contribute to a disease, the court is required to presume that: (1) the population of persons who were exposed to the tobacco product would not have been exposed to the product but for the breach of duty; and (2) such exposure caused or contributed to disease or risk of disease in such population of persons. In such cases, the court is required to determine on an aggregate basis the cost of healthcare benefits provided after the date of the breach of duty and to assess liability among defendants based on the proportion of the aggregate cost equal to each defendant's market share in the type of tobacco product. Statistical information and information derived from epidemiological and other relevant studies is admissible as evidence under the HCCR Act to establish causation and for quantifying damages in an action brought by the government under the HCCR Act or in an action brought by a class of persons under Canada's class action statute.

Subsequently to the enactment of the HCCR Act, the government of British Columbia brought an action under the HCCR Act against certain foreign and domestic tobacco manufacturers, including Philip Morris International, a subsidiary of Altria. The defendants challenged the constitutionality of the HCCR Act, and in a decision dated June 5, 2003, British Columbia's trial level court held that the HCCR Act was unconstitutional as exceeding the territorial jurisdiction of the Province. On appeal, British Columbia's highest court reversed the lower court in a decision dated May 20, 2004, holding that the HCCR Act was constitutional. The matter was appealed to the Canadian Supreme Court, Canada's highest court. By a unanimous decision dated September 29, 2005 the Canadian Supreme Court affirmed the lower court, holding that the HCCR Act was constitutional. In the decision, the court also vacated the stay of proceedings and the action was allowed to continue. On September 15, 2006, the British Columbia Court of Appeal unanimously ruled that the foreign defendants served ex juris are subject to British Columbia law, allowing the government to proceed with its lawsuit against them. On November 10, 2006, the ex juris defendants applied for leave to appeal the judgment to the Supreme Court of Canada. On April 5, 2007, the Supreme Court of Canada dismissed the defendants' application. While the judgment only applies to British Columbia, it is expected that other provincial governments may follow suit. It has been reported that Newfoundland has enacted, and Saskatchewan and Nova Scotia are considering enacting, legislation similar to the HCCR Act.

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

- *Asbestos Contribution Cases*. These cases, which have been brought against cigarette manufacturers on behalf of former asbestos manufacturers, their personal injury settlement trusts and insurers, seek, among other things, contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking. Two of the cases were dismissed.

- *Cigarette Price-Fixing Cases*. According to one OPM, as of May 1, 2008, there were two cases pending against domestic cigarette manufacturers in Kansas (*Smith v. Philip Morris*) and New Mexico (*Romero v. Philip Morris*), alleging that defendants conspired to fix cigarette prices in violation of antitrust laws. The plaintiffs' motions for class certification have been granted in both cases. In February 2005, the New Mexico Court of Appeals affirmed the class certification decision in the *Romero* case. On April 19, 2005, the defendants filed motions for summary judgment. In June 2006, the court granted defendant's motion, and the plaintiffs appealed on August 14, 2006. In the *Smith* case, on July 14, 2006, the court issued an order confirming that fact discovery is closed, except for such privilege issues that the court determines, based on a Special Master's report, justify further limited fact discovery. Expert discovery, as necessary, will begin in early 2007.

- *Cigarette Contraband Cases*. In May 2001 and August 2001, various governmental entities of Colombia, the European Community and ten member states filed suits in the U.S. against certain PMs, alleging that defendants sold to distributors cigarettes that would be illegally imported into various jurisdictions. The claims asserted in these cases include negligence, negligent misrepresentation, fraud, unjust enrichment, violations of RICO and its state-law equivalents and conspiracy. Plaintiffs in these cases seek actual damages, treble damages and undisclosed injunctive relief. In February 2002, the trial court granted defendants' motions to dismiss all of the actions. Plaintiffs in each case have appealed. In January 2004, the U.S. Court of Appeals for the Second Circuit affirmed the dismissals of the cases. In April 2004, plaintiffs petitioned the U.S. Supreme Court for further review. The European Community and the 10 member states moved to dismiss their petition in July 2004 following an agreement entered into among Philip Morris, the European Commission and 10 member states of the European Community. The terms of this cooperation agreement provide for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts and resolve all disputes between the parties on these issues. In May 2005, the U.S. Supreme Court granted the petitions for review, vacated the judgment of the Second Circuit Court of Appeals and remanded the case to that court for further review in light of the Supreme Court's recent decision in *U.S. v. Pasquantino*. On September 13, 2005, the Second Circuit Court of Appeals found that Pasquantino was inapplicable to the case and affirmed its earlier decision that the revenue rule bars foreign sovereigns' civil claims for recovery of lost tax revenue and law enforcement costs related to cigarette smuggling. In January 2006, the U.S. Supreme Court rejected the European Union's petition for review.

- *Patent Litigation*. In 2001 and 2002, Star Scientific, Inc. ("**Star**") filed two patent infringement actions against Reynolds Tobacco in the U.S. District Court for the District of Maryland. Such actions have been consolidated. Reynolds Tobacco filed various motions for summary judgment, which were all denied. Reynolds Tobacco has also filed counterclaims seeking a declaration that the claims of the two Star patents in dispute are invalid, unenforceable and not infringed by Reynolds Tobacco. Between January 31, 2005 and February 8, 2005, the District Court held a first bench trial on Reynolds Tobacco's affirmative defense and counterclaim based upon inequitable conduct. The District Court has not yet issued a ruling on this issue. Additionally, in response to the court's invitation, Reynolds Tobacco filed two summary judgment motions on January 20, 2005. The District Court has indicated that it will rule on Reynolds Tobacco's two pending summary judgment motions and the issue of inequitable conduct at the same time. On June 26, 2007, the court ruled that Star's patents are unenforceable. The court also entered final judgment in favor of Reynolds Tobacco, dismissing all of Star's claims with prejudice. On June 27, 2007, Star filed a notice of appeal with the U.S. Court of Appeals for the Federal Circuit. Oral argument is scheduled for March 7, 2008.

- *Vermont Litigation*. On July 22, 2005, Vermont announced that it had sued Reynolds Tobacco in the Vermont Superior Court for using false and misleading advertising to promote its "Eclipse" brand of cigarettes. The lawsuit charges that Reynolds Tobacco's advertising, which claims that smoking Eclipse cigarettes is less harmful than smoking other brands of cigarettes, violated Vermont's consumer protection statutes. The State of Vermont is seeking declaratory, injunctive, and monetary relief. Reynolds Tobacco has answered the complaint. Discovery is underway. No trial date has been set. According to the Vermont Attorney General, the offices of Attorneys General across the country, including California, Connecticut, the District of Columbia, Idaho, Illinois, Iowa, Maine, New York, and Tennessee, have actively participated in the investigation leading up to this lawsuit and will continue to assist Vermont in it.

- *Foreign Lawsuits*. Lawsuits have been filed in foreign jurisdictions against certain OPMs and/or their subsidiaries and affiliates, including individual smoking and health actions, class actions and healthcare cost recovery suits.

The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon the Issuer's examination or analysis of the court records of the cases mentioned or of any other court records. It is based on SEC filings by OPMs and on other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2008 Bonds are referred to the reports filed with the SEC by certain of the OPMs and applicable court records for additional descriptions thereof.

Litigation is subject to many uncertainties. In its SEC filing, one OPM states that it is not possible to predict the outcome of litigation pending against it, and that it is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of pending litigation, and that it is possible that its business, volume, results of operations, cash flows, or financial position could be materially affected by an unfavorable outcome or settlement of certain pending litigation or by the enactment of federal or state tobacco legislation. It can be expected that at any time and from time to time there will be developments in the litigation presently pending and filing of new litigation that could adversely affect the business of the PMs and the market for or prices of securities such as the Series 2008 Bonds payable from tobacco settlement payments made under the MSA.

THE GLOBAL INSIGHT CONSUMPTION REPORT

The following information has been extracted from the Global Insight Consumption Report, a copy of which is attached hereto as Appendix A. This summary does not purport to be complete and the Global Insight Consumption Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The Global Insight Consumption 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

Global Insight (USA), Inc. ("**Global Insight**"), formerly known as DRI•WEFA, Inc., has prepared a report dated June 26, 2008 on the consumption of cigarettes in the United States from 2007 through 2058 entitled, "*A Forecast of U.S. Cigarette Consumption (2008-2058) for Michigan Tobacco Settlement Finance Authority*." Global Insight is an internationally recognized econometric and consulting firm of over 325 economists in 25 offices worldwide. Global Insight is a privately held company, which is a provider of financial, economic and market research information.

Global Insight has developed a cigarette consumption model based on historical United States data between 1965 and 2003. Global Insight 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, real per capita disposable personal income, the impact of restrictions on smoking in public places, and the trend over time in individual behavior and preferences), Global Insight 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;

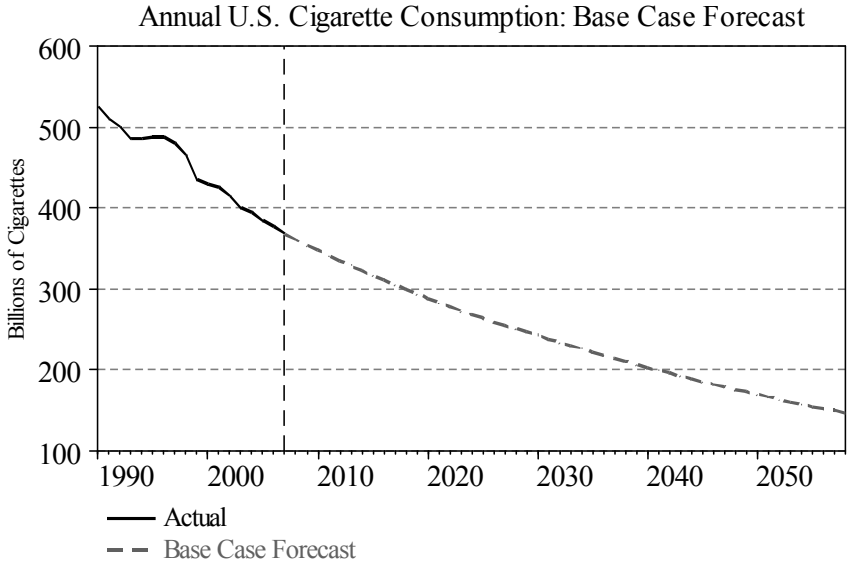
(ii) income elasticity of demand of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.40% per year holding other recognized significant factors constant.

Global Insight's model, coupled with its long term forecast of the United States economy, was then used to project total United States cigarette consumption from 2004 through 2058 (the "**Base Case Forecast**"). The Base Case Forecast indicates that the total United States cigarette consumption in 2058 will be 144 billion cigarettes (approximately 7 billion packs), a 61% decline from the 2007 level. After 2009, the rate of decline in total cigarette consumption is projected to moderate and average less than 2% per year. From 2007 through 2058 the average annual rate of decline is projected to be 1.82%. On a per capita basis, consumption is forecast to fall at an average annual rate of 2.47%. Total consumption of cigarettes in the United States is forecast to fall from an estimated 368 billion in 2007, to 357 billion in 2008, to under 300 billion by 2017, and to under 200 billion by 2040, as set forth in the following table. The Global Insight Consumption Report states that Global Insight believes that the assumptions on which the Base Case Forecast is based are reasonable.

Global Insight Base Case Forecast of Cigarette Consumption

Year	Cigarettes (billions)	Year	Cigarettes (billions)
2006	376.70	2033	226.32
2007	368.10	2034	222.43
2008	356.56	2035	218.19
2009	348.08	2036	214.36
2010	341.85	2037	210.63
2011	335.60	2038	207.03
2012	329.36	2039	203.29
2013	323.08	2040	199.65
2014	316.78	2041	196.13
2015	311.19	2042	192.54
2016	305.65	2043	189.04
2017	299.99	2044	185.62
2018	294.43	2045	182.26
2019	288.83	2046	178.99
2020	283.64	2047	175.80
2021	278.46	2048	172.69
2022	273.49	2049	169.65
2023	268.55	2050	166.65
2024	263.97	2051	163.68
2025	259.46	2052	160.75
2026	255.04	2053	157.85
2027	250.74	2054	154.99
2028	246.52	2055	152.17
2029	242.38	2056	149.39
2030	238.31	2057	146.64
2031	234.20	2058	143.92
2032	230.23		

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



The Global Insight Consumption Report also presents alternative forecasts that project higher and lower paths of cigarette consumption, predicting that by 2058, total United States consumption could be as low as 131 billion or as high as 157 billion cigarettes. In addition, the Global Insight Consumption Report presents scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption. In one such scenario, Global Insight projects that assuming a 4% decline per year total United States consumption could be as low as 46 billion cigarettes by 2058.

Comparison with Prior Forecasts

In August 2007 Global Insight presented a similar study, "A Forecast of U.S. Cigarette Consumption (2000-2052)." Its long run conclusions were quite similar to this study. The current forecast of consumption for the year 2052 is 1.7% less than that of the previous study, 160.75 billion versus 163.47 billion.

This forecast also differs from earlier forecasts in 2008. Subsequent to the release of industry shipment data for the first quarter of 2008, which indicated a sharp decline in cigarette shipments, Global Insight adjusted its forecast downward to account for the industry and economic conditions. Cigarette consumption in 2008 and 2009 is projected to be lower by 4.0 and 5.8, billion cigarettes, respectively. The difference by 2052 is 2.7 billion cigarettes, or 1.7%.

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 and Firearms) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2003.

The following table sets forth United States domestic cigarette consumption for the ten years ended December 31, 2007.* The data in this table vary from statistics on cigarette shipments in the United States. While the Global Insight Consumption Report is based on consumption, payments 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
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) trends over time, (vi) smoking bans in public places, (vii) nicotine dependence, and (viii) health warnings. While some of these factors were not found to have a measurable impact on changes in demand for cigarettes, all of these factors are thought to affect smoking in some manner and to affect 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 Global Insight, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. Global Insight'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.

* Source: USDA-ERS; 2004, 2005, 2006, 2007 estimates by Global Insight. USDA estimates for 2004, 2005 and 2006 diverge significantly from estimates based on independent data from the industry and from the U.S. Tobacco and Tax Bureau ("**TTB**"). 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.

SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION

Introduction

The following discussion describes the methodology and assumptions used to calculate projections of Collections to be received by the Indenture Trustee (the "**Cash Flow Assumptions**"), as well as the methodology and assumptions used to structure the Sinking Fund Installments and Turbo Term Bond Maturities for the Series 2008 Bonds and calculate the Projected Turbo Schedule (the "**Bond Structuring Methodology**").

Cash Flow Assumptions

In calculating projections of Collections to be received by the Indenture Trustee, different assumptions of cigarette consumption in the United States, including the forecast developed by Global Insight described as the Base Case Forecast, were applied to calculate Annual Payments and Strategic Contribution Payments to be made by the PMs pursuant to the MSA. The calculations of Annual Payments and Strategic Contribution Payments required to be made were performed in accordance with the terms of the MSA; however, as described below, certain assumptions were made with respect to consumption of cigarettes in the United States and the applicability of certain adjustments and offsets to such payments set forth in the MSA. In addition, it was assumed that the PMs make all payments required to be made by them pursuant to the MSA, and that the relative market share for each of the PMs remains constant throughout the forecast period at 84.87% for the OPMs, 9.99% for the SPMs and 5.14% for the NPMs.[*] It was further assumed that each company that is currently a PM remains such throughout the term of the Series 2008 Bonds.

In applying consumption forecasts from the Global Insight Consumption Report, it was assumed that United States consumption, which was forecasted by Global Insight, 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 Global Insight Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

Annual Payments

For each projection, the amount of Annual Payments to be made by the PMs was calculated by applying the adjustments applicable to the Annual Payments 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 set forth in the MSA. The inflation rate is compounded annually at the greater of 3.0% or the percentage increase in the actual Consumer Price Index for All Urban Consumers (the "**CPI**") in the prior year as published by the Bureau of Labor Statistics (released each January). The calculations of Annual Payments assume the minimum Inflation Adjustment provided in the MSA of 3.0% in every year except for calendar years 2000, 2004, 2005 and 2007, where actual CPI results of 3.40%, 3.256%, 3.416% and 4.08% respectively, were used.

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

Volume Adjustment. Next, the Annual Payments calculated for each year after application of the Inflation Adjustment were adjusted for the Volume Adjustment by applying the projected cigarette consumption for each scenario to the market share of the OPMs for the prior year. No add back or benefit was assumed from any Income Adjustment. See "SUMMARY OF THE MSA — Adjustments to Payments — Volume Adjustment" herein for a description of the formula used to calculate the Volume Adjustment.

Previously Settled States Reduction. Next, the annual amounts calculated for each year after application of the Inflation Adjustment and the Volume Adjustment were reduced by the Previously Settled States Reduction which applies only to the Annual Payments owed by the OPMs. The Previously Settled States Reduction is as follows for each year of the following period:

2000 through 2007	12.4500000%
2008 through 2017	12.2373756%
2018 and after	11.0666667%

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

NPM Adjustment. The NPM Adjustment will not apply to the Annual Payments payable to any state that enacts and diligently enforces a Qualifying Statute, where such statute is not held to be unenforceable. The Cash Flow Assumptions include an assumption that the State has and will diligently enforce a Qualifying Statute that is not held to be unenforceable. For a discussion of the State's Qualifying Statute, see "SUMMARY OF THE MSA — MSA Provisions Relating to Model/Qualifying Statutes — State's Qualifying Statute" herein. For a description of the opinion of Nixon Peabody LLP to be delivered to the Authority with respect to the Model Statute, see "LEGAL CONSIDERATIONS — Model Statute Constitutionality" herein.

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

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

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

Subsequent Participating Manufacturers. The Cash Flow Assumptions assume that the relative market share of the SPMs remains constant at 9.99%. Because the 9.99% market share is greater than 3.125% (125% of 2.5%, the SPMs' estimated 1997 market share), the SPMs are assumed to make Annual Payments in each year.

State Allocation Percentage for the State. The amounts of Annual Payments after application of the Inflation Adjustment, the Volume Adjustment and the Previously Settled States Reduction for each year were multiplied by the State Allocation Percentage for Michigan (4.3519476%) in order to determine the amount of Annual Payments to be made by the PMs in each year to be allocated to the State.

Percentage of 2006 Sold Tobacco Receipts. The amount of Annual Payments in each year to be allocated to the Authority, calculated as described in the preceding paragraphs, was then multiplied by

13.34%, which is the percentage of the Annual Payments to be sold to the Authority and pledged under the Indenture as 2006 Pledged TSRs upon the Closing Date.

Strategic Contribution Payments

In accordance with the Cash Flow Assumptions, the amount of Strategic Contribution Payments to be made by the PMs was calculated by applying the adjustments applicable to the Strategic Contribution Payments 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 Strategic Contribution Payments set forth in the MSA. The calculations of Strategic Contribution Payments assume the minimum Inflation Adjustment provided in the MSA of 3.0% in every year except for calendar years 2000, 2004, 2005 and 2007, where actual CPI results of 3.40%, 3.256%, 3.416% and 4.08% respectively, were used.

Volume Adjustment. Next, the Strategic Contribution Payments calculated for each year after application of the Inflation Adjustment were adjusted for the Volume Adjustment by applying the projected cigarette consumption for each scenario to the market share of the OPMs for the prior year. No add back or benefit was assumed from any Income Adjustment. See "SUMMARY OF THE MSA — Adjustments to Payments — Volume Adjustment" herein for a description of the formula used to calculate the Volume Adjustment.

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

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

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

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

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

Subsequent Participating Manufacturers. The Cash Flow Assumptions assume that the relative market share of the SPMs remains constant at 9.99%. Because the 9.99% market share is greater than 3.125% (125% of 2.5%, the SPMs' estimated 1997 market share), the SPMs are assumed to make Annual Payments in each year.

State Allocation Percentage for the State. The amounts of Strategic Contribution Payments after application of the Inflation Adjustment and the Volume Adjustment for each year were multiplied by the State Allocation Percentage for Michigan (2.5771774%) in order to determine the amount of Strategic Contribution Payments to be made by the PMs in each year to be allocated to the State.

Percentage of 2006 Sold Tobacco Receipts. The amount of Strategic Contribution Payments in each year to be allocated to the Authority, calculated as described in the preceding paragraphs, was then multiplied by 13.34%, which is the percentage of the Strategic Contribution Payments to be sold to the Authority and pledged under the Indenture as 2006 Pledged TSRs upon the Closing Date.

Interest Earnings

The Cash Flow Assumptions assume that the Indenture Trustee will receive ten days after April 15th the Authority's share of the Annual Payments owed by the PMs in 2006 and each year thereafter. Earnings are assumed at 4.00% per annum on the Annual Payments and the Strategic Contribution Payments received by the Indenture Trustee until the applicable Distribution Date. Interest earnings have been assumed to begin accruing upon receipt by the Indenture Trustee of the Annual Payments and the Strategic Contribution Payments.

$37,801,532.39 of the amount on deposit in the Liquidity Reserve Account is assumed to be invested at the rate of 5.27% per annum through June 1, 2022, based upon the Authority's actual investment, and 3.00% thereafter. The remaining $1,000,000 on deposit in the Liquidity Reserve Account is assumed to be invested at a rate of 3.00% per annum.

Amounts on deposit in the Capitalized Interest Subaccount of the Debt Service Account are assumed to be invested at a rate of 1.90% per annum.

Other Assumptions

Sinking Fund Installments. The schedules of Sinking Fund Installments for the Series 2008 Bonds are as indicated under "THE SERIES 2008 BONDS — Sinking Fund Installments" herein.

Maturity Dates of Series 2008 Bonds. The Series 2008 Bonds mature as set forth on the inside front cover hereof.

Liquidity Reserve Account. The Liquidity Reserve Account Requirement was established for the Bonds at $38,801,532.39. It has been assumed that no surety, guaranty or similar agreement will be deposited in lieu of cash in the Liquidity Reserve Account.

Operating Expense Assumptions. Annual operating expenses of the Authority have been assumed at the Operating Cap of $218,545 in 2009. In each year thereafter, the Operating Cap was assumed to be inflated at 3% per year. No operating expenses are assumed in excess of the annual Operating Cap and no Tax Obligations, Priority Payments or Termination Payments were assumed.

Issuance Date. The Series 2008 Bonds were assumed to be issued on July 7, 2008.

Series 2008A Interest Rates and Computation of Interest. The Series 2008A Bonds were assumed to bear interest at the rate set forth on the inside front cover hereof. Computations of interest were assumed to be made on the basis of a 360-day year consisting of twelve 30-day months for the Series 2008A Bonds.

Capitalized Interest. Interest on the Series 2008A Bonds is capitalized through December 1, 2008 from bond proceeds. During the capitalized interest period, earnings on the Liquidity Reserve Account are assumed to be available at 5.27% per annum for $37,801,532.39 of the amount on deposit in the Liquidity Reserve Account, and at 3.00% per annum for $1,000,000 of the amount on deposit in the Liquidity Reserve Account. On June 1, 2009, any projected balances remaining in the Capitalized Interest Subaccount are assumed to be used to make Turbo Redemptions.

Series 2008B and 2008C Yield and Computations of Accreted Value. The Series 2008B Bonds and the Series 2008C Bonds were assumed to accrete at the yields set forth on the inside front cover hereof until their respective Maturity Dates or earlier redemption. Computations of Accreted Value were assumed to be made on the basis of a 360-day year consisting of twelve 30-day months for the Series 2008B Bonds and the Series 2008C Bonds.

Miscellaneous. The Cash Flow Assumptions assume that no Swap Payments are required to be made, that there is no optional redemption of the Bonds, that no Payment Default occurs, that no Lump Sum Payment, Partial Lump Sum Payment or Total Lump Sum Payment is received, that no Turbo Redemptions occur on any Distribution Date other than June 1, that Turbo Redemptions of the Series 2008A, the Series 2008B Bonds and the Series 2008C Bonds occur on a *pro rata* basis in chronological order of their respective schedules of Sinking Fund Installments, that no Additional Bonds or Refunding Bonds are issued and that there is a Mandatory Clean-up Call from balances in the Liquidity Reserve Account. It is further assumed that all Distribution Dates occur on the first day of each June and December, whether or not such date is a Business Day.

Bond Structuring Methodology

Cigarette Consumption. The Series 2008 Bonds have been structured utilizing the Global Insight Base Case Forecast. The following tables present the projections of 2006 Pledged TSRs to be received by the Indenture Trustee in each year through 2058, calculated in accordance with the Cash Flow Assumptions and using Global Insight's Base Case Forecast. Global Insight's Base Case Forecast for United States cigarette consumption is set forth under "THE GLOBAL INSIGHT CONSUMPTION REPORT" herein. See Appendix A hereto for a discussion of the assumptions underlying the projections of cigarette consumption contained in the Global Insight Consumption Report.

Projection of Annual Payments to be Received by the Indenture Trustee*

Year	Global Insight Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Annual Payments by OPMs	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Total Adjusted Annual Payments to Michigan	Pledged Portion of OPM Annual Payments*	Pledged Portion of SPM Annual Payments*	Total Annual Payments of 2006 Pledged TSRs*
2008	356,560,000,000	302,612,472,000								
2009	348,080,000,000	295,415,496,000	$8,139,000,000	$3,029,253,211	$ (3,981,747,436)	$ (879,439,704)	$274,480,210	$36,615,660	$3,374,766	$39,990,426
2010	341,850,000,000	290,128,095,000	8,139,000,000	3,364,300,807	(4,271,771,029)	(884,949,461)	276,199,850	36,845,060	3,395,909	40,240,969
2011	335,600,000,000	284,823,720,000	8,139,000,000	3,709,399,831	(4,528,997,053)	(895,702,810)	279,556,057	37,292,778	3,437,174	40,729,952
2012	329,360,000,000	279,527,832,000	8,139,000,000	4,064,851,826	(4,798,238,835)	(906,252,677)	282,848,755	37,732,024	3,477,658	41,209,682
2013	323,080,000,000	274,197,996,000	8,139,000,000	4,430,967,381	(5,079,339,230)	(916,656,302)	286,095,810	38,165,181	3,517,581	41,682,762
2014	316,780,000,000	268,851,186,000	8,139,000,000	4,808,066,402	(5,373,892,796)	(926,757,699)	289,248,538	38,585,755	3,556,344	42,142,099
2015	311,190,000,000	264,106,953,000	8,139,000,000	5,196,478,394	(5,682,014,536)	(936,583,119)	292,315,130	38,994,838	3,594,048	42,588,886
2016	305,650,000,000	259,405,155,000	8,139,000,000	5,596,542,746	(5,986,734,443)	(948,250,777)	295,956,700	39,480,624	3,638,821	43,119,445
2017	299,990,000,000	254,601,513,000	8,139,000,000	6,008,609,029	(6,303,386,815)	(959,926,935)	299,600,923	39,966,763	3,683,628	43,650,391
2018	294,430,000,000	249,882,741,000	9,000,000,000	7,113,568,706	(7,338,785,027)	(971,076,063)	339,613,266	45,304,410	4,120,617	49,425,027
2019	288,830,000,000	245,130,021,000	9,000,000,000	7,596,975,767	(7,720,306,781)	(982,351,371)	343,556,566	45,830,446	4,168,462	49,998,908
2020	283,640,000,000	240,725,268,000	9,000,000,000	8,094,885,040	(8,119,310,610)	(993,296,907)	347,384,535	46,341,097	4,214,908	50,556,005
2021	278,460,000,000	236,329,002,000	9,000,000,000	8,607,731,591	(8,522,683,044)	(1,005,412,042)	351,621,547	46,906,314	4,266,317	51,172,631
2022	273,490,000,000	232,110,963,000	9,000,000,000	9,135,963,539	(8,942,633,322)	(1,017,395,214)	355,812,407	47,465,375	4,317,165	51,782,541
2023	268,550,000,000	227,918,385,000	9,000,000,000	9,680,042,445	(9,373,250,828)	(1,029,951,609)	360,203,740	48,051,179	4,370,447	52,421,626
2024	263,970,000,000	224,031,339,000	9,000,000,000	10,240,443,718	(9,820,647,707)	(1,042,457,428)	364,577,385	48,634,623	4,423,513	53,058,136
2025	259,460,000,000	220,203,702,000	9,000,000,000	10,817,657,030	(10,273,977,428)	(1,056,167,212)	369,372,092	49,274,237	4,481,689	53,755,926
2026	255,040,000,000	216,452,448,000	9,000,000,000	11,412,186,741	(10,743,169,875)	(1,070,037,870)	374,223,060	49,921,356	4,540,547	54,461,903
2027	250,740,000,000	212,803,038,000	9,000,000,000	12,024,552,343	(11,227,958,595)	(1,084,156,378)	379,160,709	50,580,039	4,600,456	55,180,495
2028	246,520,000,000	209,221,524,000	9,000,000,000	12,655,288,913	(11,727,621,847)	(1,098,661,825)	384,233,682	51,256,773	4,662,008	55,918,781
2029	242,380,000,000	205,707,906,000	9,000,000,000	13,304,947,581	(12,244,039,559)	(1,113,407,158)	389,390,549	51,944,699	4,724,578	56,669,277
2030	238,310,000,000	202,253,697,000	9,000,000,000	13,974,096,008	(12,777,673,697)	(1,128,404,072)	394,635,402	52,644,363	4,788,215	57,432,578
2031	234,200,000,000	198,765,540,000	9,000,000,000	14,663,318,888	(13,329,409,832)	(1,143,619,272)	399,956,596	53,354,210	4,852,778	58,206,988
2032	230,230,000,000	195,396,201,000	9,000,000,000	15,373,218,455	(13,904,454,976)	(1,158,543,162)	405,175,910	54,050,466	4,916,106	58,966,572
2033	226,320,000,000	192,077,784,000	9,000,000,000	16,104,415,009	(14,495,860,744)	(1,174,013,342)	410,586,277	54,772,209	4,981,751	59,753,961
2034	222,430,000,000	188,776,341,000	9,000,000,000	16,857,547,459	(15,107,523,998)	(1,189,669,267)	416,061,605	55,502,618	5,048,185	60,550,803
2035	218,190,000,000	185,177,853,000	9,000,000,000	17,633,273,883	(15,741,909,361)	(1,205,311,011)	421,531,973	56,232,365	5,114,558	61,346,923
2036	214,360,000,000	181,927,332,000	9,000,000,000	18,432,272,099	(16,417,549,775)	(1,218,962,607)	426,306,330	56,869,264	5,172,487	62,041,751
2037	210,630,000,000	178,761,681,000	9,000,000,000	19,255,240,262	(17,099,304,128)	(1,234,590,269)	431,771,773	57,598,355	5,238,800	62,837,155
2038	207,030,000,000	175,706,361,000	9,000,000,000	20,102,897,470	(17,802,099,052)	(1,250,621,695)	437,378,425	58,346,282	5,306,827	63,653,109
2039	203,290,000,000	172,532,223,000	9,000,000,000	20,975,984,394	(18,524,858,267)	(1,267,257,962)	443,196,606	59,122,427	5,377,421	64,499,848
2040	199,650,000,000	169,442,955,000	9,000,000,000	21,875,263,926	(19,282,519,478)	(1,282,930,389)	448,677,705	59,853,606	5,443,924	65,297,530
2041	196,130,000,000	166,455,531,000	9,000,000,000	22,801,521,844	(20,063,407,216)	(1,299,018,023)	454,304,014	60,604,155	5,512,190	66,116,345
2042	192,540,000,000	163,408,698,000	9,000,000,000	23,755,567,499	(20,866,920,834)	(1,315,676,902)	460,130,104	61,381,356	5,582,879	66,964,235
2043	189,040,000,000	160,438,248,000	9,000,000,000	24,738,234,524	(21,704,717,801)	(1,331,709,188)	465,737,056	62,129,323	5,650,910	67,780,233
2044	185,620,000,000	157,535,694,000	9,000,000,000	25,750,381,560	(22,568,533,590)	(1,348,124,513)	471,477,968	62,895,161	5,720,566	68,615,727
2045	182,260,000,000	154,684,062,000	9,000,000,000	26,792,893,006	(23,459,637,121)	(1,364,880,322)	477,337,957	63,676,883	5,791,667	69,468,550
2046	178,990,000,000	151,908,813,000	9,000,000,000	27,866,679,796	(24,380,027,307)	(1,381,856,213)	483,274,915	64,468,874	5,863,701	70,332,575
2047	175,800,000,000	149,201,460,000	9,000,000,000	28,972,680,190	(25,328,551,362)	(1,399,283,595)	489,369,772	65,281,928	5,937,652	71,219,580
2048	172,690,000,000	146,562,003,000	9,000,000,000	30,111,860,596	(26,306,573,596)	(1,417,118,432)	495,607,129	66,113,991	6,013,331	72,127,322
2049	169,650,000,000	143,981,955,000	9,000,000,000	31,285,216,414	(27,314,846,090)	(1,435,387,653)	501,996,401	66,966,320	6,090,854	73,057,174
2050	166,650,000,000	141,435,855,000	9,000,000,000	32,493,772,906	(28,354,860,134)	(1,454,039,684)	508,519,554	67,836,508	6,170,001	74,006,510
2051	163,680,000,000	138,915,216,000	9,000,000,000	33,738,586,094	(29,429,702,374)	(1,472,849,803)	515,097,994	68,714,072	6,249,819	74,963,892
2052	160,750,000,000	136,428,525,000	9,000,000,000	35,020,743,676	(30,541,206,551)	(1,491,735,446)	521,702,847	69,595,160	6,329,958	75,925,118
2053	157,850,000,000	133,967,295,000	9,000,000,000	36,341,365,987	(31,689,742,912)	(1,510,779,625)	528,363,145	70,483,644	6,410,769	76,894,412
2054	154,990,000,000	131,540,013,000	9,000,000,000	37,701,606,966	(32,877,254,515)	(1,529,895,009)	535,048,346	71,375,449	6,491,882	77,867,331
2055	152,170,000,000	129,146,679,000	9,000,000,000	39,102,655,175	(34,104,131,578)	(1,549,169,949)	541,789,347	72,274,699	6,573,672	78,848,371
2056	149,390,000,000	126,787,293,000	9,000,000,000	40,545,734,831	(35,371,566,333)	(1,568,607,985)	548,587,388	73,181,558	6,656,155	79,837,712
2057	146,640,000,000	124,453,368,000	9,000,000,000	42,032,106,875	(36,680,784,092)	(1,588,213,059)	555,443,847	74,096,209	6,739,346	80,835,555
2058			9,000,000,000	43,563,070,082	(38,033,963,174)	(1,607,887,836)	562,324,683	75,014,113	6,822,833	81,836,946

* Amounts shown are approximately 0.5805% of the total Annual Payments due under the MSA, computed as the State Allocation Percentage for Michigan's Annual Payments (4.3519476%) multiplied by the percentage (13.34%) of Michigan's share of MSA payments that represent 2006 Sold Tobacco Receipts that have been pledged as 2006 Pledged TSRs.

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

			Strategic Contribution Payments						Total Payments		
Year	Global Insight Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Strategic Contribution Payments by OPMs	Inflation Adjustment	Volume Adjustment	Total Adjusted Strategic Contribution Payments by OPMs	Pledged Portion of OPM Strategic Contribution Payments**	Pledged Portion of SPM Strategic Contribution Payments**	Total Annual Payments to Indenture Trustee	Total Strategic Contribution Payments to Indenture Trustee	Total Payments to Indenture Trustee
2008	356,560,000,000	302,612,472,000									
2009	348,080,000,000	295,415,496,000	$861,000,000	$320,455,463	$(421,216,924)	$19,592,696	$2,613,666	$211,415	$39,990,426	$2,825,081	$42,815,507
2010	341,850,000,000	290,128,095,000	861,000,000	355,899,127	(451,897,636)	19,715,446	2,630,040	212,740	40,240,969	2,842,780	43,083,749
2011	335,600,000,000	284,823,720,000	861,000,000	392,406,101	(479,108,793)	19,955,015	2,661,999	215,325	40,729,952	2,877,324	43,607,276
2012	329,360,000,000	279,527,832,000	861,000,000	430,008,284	(507,591,060)	20,190,052	2,693,353	217,861	41,209,682	2,911,214	44,120,896
2013	323,080,000,000	274,197,996,000	861,000,000	468,738,532	(537,327,814)	20,421,830	2,724,272	220,362	41,682,762	2,944,634	44,627,396
2014	316,780,000,000	268,851,186,000	861,000,000	508,630,688	(568,487,738)	20,646,875	2,754,293	222,790	42,142,099	2,977,084	45,119,182
2015	311,190,000,000	264,106,953,000	861,000,000	549,719,609	(601,082,997)	20,865,772	2,783,494	225,152	42,588,886	3,008,646	45,597,533
2016	305,650,000,000	259,405,155,000	861,000,000	592,041,197	(633,318,387)	21,125,711	2,818,170	227,957	43,119,445	3,046,127	46,165,572
2017	299,990,000,000	254,601,513,000	861,000,000	635,632,433	(666,816,077)	21,385,840	2,852,871	230,764	43,650,391	3,083,635	46,734,026
2018	294,430,000,000	249,882,741,000	0	0	0	0	0	0	49,425,027	0	49,425,027
2019	288,830,000,000	245,130,021,000	0	0	0	0	0	0	49,998,908	0	49,998,908
2020	283,640,000,000	240,725,268,000	0	0	0	0	0	0	50,556,005	0	50,556,005
2021	278,460,000,000	236,329,002,000	0	0	0	0	0	0	51,172,631	0	51,172,631
2022	273,490,000,000	232,110,963,000	0	0	0	0	0	0	51,782,541	0	51,782,541
2023	268,550,000,000	227,918,385,000	0	0	0	0	0	0	52,421,626	0	52,421,626
2024	263,970,000,000	224,031,339,000	0	0	0	0	0	0	53,058,136	0	53,058,136
2025	259,460,000,000	220,203,702,000	0	0	0	0	0	0	53,755,926	0	53,755,926
2026	255,040,000,000	216,452,448,000	0	0	0	0	0	0	54,461,903	0	54,461,903
2027	250,740,000,000	212,803,038,000	0	0	0	0	0	0	55,180,495	0	55,180,495
2028	246,520,000,000	209,221,524,000	0	0	0	0	0	0	55,918,781	0	55,918,781
2029	242,380,000,000	205,707,906,000	0	0	0	0	0	0	56,669,277	0	56,669,277
2030	238,310,000,000	202,253,697,000	0	0	0	0	0	0	57,432,578	0	57,432,578
2031	234,200,000,000	198,765,540,000	0	0	0	0	0	0	58,206,988	0	58,206,988
2032	230,230,000,000	195,396,201,000	0	0	0	0	0	0	58,966,572	0	58,966,572
2033	226,320,000,000	192,077,784,000	0	0	0	0	0	0	59,753,961	0	59,753,961
2034	222,430,000,000	188,776,341,000	0	0	0	0	0	0	60,550,803	0	60,550,803
2035	218,190,000,000	185,177,853,000	0	0	0	0	0	0	61,346,923	0	61,346,923
2036	214,360,000,000	181,927,332,000	0	0	0	0	0	0	62,041,751	0	62,041,751
2037	210,630,000,000	178,761,681,000	0	0	0	0	0	0	62,837,155	0	62,837,155
2038	207,030,000,000	175,706,361,000	0	0	0	0	0	0	63,653,109	0	63,653,109
2039	203,290,000,000	172,532,223,000	0	0	0	0	0	0	64,499,848	0	64,499,848
2040	199,650,000,000	169,442,955,000	0	0	0	0	0	0	65,297,530	0	65,297,530
2041	196,130,000,000	166,455,531,000	0	0	0	0	0	0	66,116,345	0	66,116,345
2042	192,540,000,000	163,408,698,000	0	0	0	0	0	0	66,964,235	0	66,964,235
2043	189,040,000,000	160,438,248,000	0	0	0	0	0	0	67,780,233	0	67,780,233
2044	185,620,000,000	157,535,694,000	0	0	0	0	0	0	68,615,727	0	68,615,727
2045	182,260,000,000	154,684,062,000	0	0	0	0	0	0	69,468,550	0	69,468,550
2046	178,990,000,000	151,908,813,000	0	0	0	0	0	0	70,332,575	0	70,332,575
2047	175,800,000,000	149,201,460,000	0	0	0	0	0	0	71,219,580	0	71,219,580
2048	172,690,000,000	146,562,003,000	0	0	0	0	0	0	72,127,322	0	72,127,322
2049	169,650,000,000	143,981,955,000	0	0	0	0	0	0	73,057,174	0	73,057,174
2050	166,650,000,000	141,435,855,000	0	0	0	0	0	0	74,006,510	0	74,006,510
2051	163,680,000,000	138,915,216,000	0	0	0	0	0	0	74,963,892	0	74,963,892
2052	160,750,000,000	136,428,525,000	0	0	0	0	0	0	75,925,118	0	75,925,118
2053	157,850,000,000	133,967,295,000	0	0	0	0	0	0	76,894,412	0	76,894,412
2054	154,990,000,000	131,540,013,000	0	0	0	0	0	0	77,867,331	0	77,867,331
2055	152,170,000,000	129,146,679,000	0	0	0	0	0	0	78,848,371	0	78,848,371
2056	149,390,000,000	126,787,293,000	0	0	0	0	0	0	79,837,712	0	79,837,712
2057	146,640,000,000	124,453,368,000	0	0	0	0	0	0	80,835,555	0	80,835,555
2058			0	0	0	0	0	0	81,836,946	0	81,836,946

* Amounts shown are approximately 0.3438% of the total Strategic Contribution Payments due under the MSA, computed as the State Allocation Percentage for Michigan's Strategic Contribution Payments (2.5771774%) multiplied by the percentage (13.34%) of Michigan's share of MSA payments that represent 2006 Sold Tobacco Receipts that have been pledged as 2006 Pledged TSRs.

Debt Service Coverage of Series 2006A and Series 2008A Bonds

Set forth below is a schedule showing estimated debt service for the Series 2006A Bonds and the Series 2008A Bonds and the resulting estimated debt service coverage ratios, assuming the Series 2006A Bonds bear interest at the rates shown on the inside front cover of the Offering Circular related to the Series 2006 Bonds dated May 12, 2006, the Series 2008A Bonds bear interest at the rates described above, cigarette consumption is consistent with the Global Insight Base Case Forecast, Collections are received in accordance with the Cash Flow Assumptions and no Turbo Redemptions are made in advance of the schedule of Sinking Fund Installments and Turbo Term Bond Maturities. As used herein, "**debt service coverage ratio**" means, for any period, a fraction, expressed as a multiple, the numerator of which is the amount of Collections received in such period (including earnings on the Liquidity Reserve Account and other Pledged Accounts and earnings on 2006 Pledged TSRs until the applicable Distribution Date) and the denominator of which is the sum, for the Series 2006A Bonds and Series 2008A Bonds, of interest, Sinking Fund Installments and Turbo Term Bond Maturities required to be paid in such period plus Operating Expenses at the Operating Cap. The denominator does not include Turbo Redemptions from Surplus Collections. Sinking Fund Installments are based on the assumption that no such Turbo Redemptions will occur. Under the Global Insight Base Case Forecast, the average debt service coverage ratio is 1.87x with a minimum debt service coverage ratio of 1.21x.

Estimated Debt Service Coverage of Series 2006A Bonds and Series 2008A Bonds

Year	Total Available Funds[1]	Sinking Fund Installments and Turbo Term Bond Maturities	Interest	Operating Expenses[2]	Total Debt Service and Operating Expenses[3]	Debt Service Coverage for Series 2006A and Series 2008A Bonds
2009	$45,347,137	$0	$33,822,744	$218,545	$34,041,290	1.33x
2010	45,616,452	0	33,822,744	225,102	34,047,846	1.34x
2011	46,139,113	4,050,000	33,674,737	231,855	37,956,592	1.22x
2012	46,651,239	4,855,000	33,349,304	238,810	38,443,114	1.21x
2013	47,155,712	5,545,000	32,969,236	245,975	38,760,211	1.22x
2014	47,644,879	6,275,000	32,537,274	253,354	39,065,628	1.22x
2015	48,119,983	7,060,000	32,049,946	260,955	39,370,901	1.22x
2016	48,684,495	7,935,000	31,501,954	268,783	39,705,737	1.23x
2017	49,248,699	8,925,000	30,885,805	276,847	40,087,652	1.23x
2018	51,943,509	9,515,000	30,211,916	285,152	40,012,068	1.30x
2019	52,512,195	10,250,000	29,489,604	293,707	40,033,310	1.31x
2020	53,063,462	11,025,000	28,712,109	302,518	40,039,627	1.33x
2021	53,673,867	11,885,000	27,874,863	311,593	40,071,456	1.34x
2022	53,847,810	12,805,000	26,972,567	320,941	40,098,508	1.34x
2023	54,050,457	13,610,000	26,007,231	330,570	39,947,800	1.35x
2024	54,678,802	14,655,000	24,974,286	340,487	39,969,773	1.37x
2025	55,367,831	15,805,000	23,861,126	350,701	40,016,827	1.38x
2026	56,064,177	17,040,000	22,660,805	361,222	40,062,027	1.40x
2027	56,772,217	18,370,000	21,366,747	372,059	40,108,805	1.42x
2028	57,498,992	19,790,000	19,972,189	383,221	40,145,410	1.43x
2029	58,236,903	21,325,000	18,469,642	394,717	40,189,359	1.45x
2030	58,986,465	22,975,000	16,850,698	406,559	40,232,257	1.47x
2031	59,745,883	24,750,000	15,106,588	418,756	40,275,344	1.48x
2032	60,489,027	26,650,000	13,228,175	431,318	40,309,493	1.50x
2033	61,258,584	28,705,000	11,205,227	444,258	40,354,484	1.52x
2034	62,036,018	30,915,000	9,026,414	457,586	40,398,999	1.54x
2035	62,825,465	14,340,000	7,403,688	471,313	22,215,001	2.83x
2036	63,513,199	14,360,000	6,417,125	485,452	21,262,577	2.99x
2037	64,301,912	14,360,000	5,429,875	500,016	20,289,891	3.17x
2038	65,111,258	14,360,000	4,442,625	515,017	19,317,642	3.37x
2039	65,951,511	14,360,000	3,455,375	530,467	18,345,842	3.59x
2040	66,742,511	14,360,000	2,468,125	546,381	17,374,506	3.84x
2041	67,554,729	14,360,000	1,480,875	562,772	16,403,647	4.12x
2042	67,814,115	14,360,000	493,625	579,656	15,433,281	4.39x

(1) Includes 2006 Pledged TSRs plus earnings on the Liquidity Reserve Account and other Pledged Accounts until distributed.

(2) Includes Operating Expenses at the Operating Cap.

(3) Includes interest, Sinking Fund Installments and Turbo Term Bond Maturities on the Series 2006A Bonds and the Series 2008A Bonds and Operating Expenses at the Operating Cap.

The estimated debt service coverage ratios shown in the preceding table assume that Collections are received in accordance with the Cash Flow Assumptions and applied, subject to the payment priorities set forth in the Indenture, to pay expenses, interest as due, Sinking Fund Installments and Turbo Term Bond Maturities for the Series 2006A Bonds and the Series 2008A Bonds. The above table does not reflect the actual amortization of the Series 2006A Bonds and the Series 2008A Bonds which will occur if the Global Insight Base Case Forecast is realized. If actual Collections are received in the amounts assumed under the Global Insight Base Case Forecast and the Cash Flow Assumptions, Surplus Collections would be applied to make Turbo Redemptions, as required pursuant to the Indenture. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION — Effect of Changes in Cigarette Consumption Levels on Turbo Redemptions" herein.

Allocation of Principal Payments

Due to a number of factors, including the actual consumption of cigarettes in the United States, the amount of Collections will fluctuate from year to year. Unless a Payment Default has occurred, Collections available to make principal payments on the Series 2008 Bonds on any Distribution Date will be allocated to Sinking Fund Installments and Turbo Term Bond Maturities due prior to allocations to Turbo Redemptions. Surplus Collections available to make Turbo Redemptions will be credited against Sinking Fund Installments and Turbo Term Bond Maturities in chronological order.

Projected Outstanding Amounts, Weighted Average Lives and Final Principal Payments. The tables below have been prepared to show the effect of changes in cigarette consumption on the weighted average lives and final principal payments of the Series 2008 Bonds. The tables are based on the Cash Flow Assumptions and the Bond Structuring Methodology, except that the annual cigarette consumption varies in each case. In addition to the Global Insight Base Case Forecast, several alternative cigarette consumption scenarios are presented below, including four alternative forecasts of Global Insight (the Global Insight High Forecast, the Global Insight Low Case 1, the Global Insight FET Increase Forecast, the Global Insight Low Case 2 and the Global Insight Low Case 3, each as hereinafter defined) and two other consumption scenarios prepared by Global Insight (assuming 3.5% and 4.0% annual consumption declines). In each scenario, if actual cigarette consumption in the United States is as forecast and assumed, and events occur as assumed by the Cash Flow Assumptions, the final principal payments and weighted average lives (in years) of each of the Series 2008 Bonds will be as set forth in such tables. The tables presented below are for illustrative purposes only. Actual cigarette consumption in the United States cannot be definitively forecast. To the degree actual consumption varies from the alternative scenarios presented below, the projected outstanding balances, weighted average lives and final projected principal payment dates for the Series 2008 Bonds will be either shorter (sooner) or longer (later) than projected below.

Projected Outstanding Principal Balances for Series 2008A Current Interest Turbo Term Bonds Maturing June 1, 2042*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight FET Increase Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Settlement	$114,860,000	$114,860,000	$114,860,000	$114,860,000	$114,860,000	$114,860,000	$114,860,000	$114,860,000
June 1, 2009	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2010	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2011	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2012	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2013	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2014	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2015	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2016	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2017	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2018	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2019	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2020	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2021	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2022	114,860,000	108,525,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000	114,860,000
June 1, 2023	76,195,000	59,385,000	114,860,000	102,290,000	113,930,000	114,860,000	114,860,000	114,860,000
June 1, 2024	0	0	79,170,000	55,555,000	69,560,000	114,860,000	114,860,000	114,860,000
June 1, 2025	0	0	0	0	0	114,860,000	114,860,000	114,860,000
June 1, 2026	0	0	0	0	0	114,860,000	90,620,000	114,860,000
June 1, 2027	0	0	0	0	0	114,860,000	53,425,000	114,860,000
June 1, 2028	0	0	0	0	0	98,205,000	0	87,345,000
June 1, 2029	0	0	0	0	0	55,365,000	0	54,390,000
June 1, 2030	0	0	0	0	0	0	0	0
June 1, 2031	0	0	0	0	0	0	0	0
June 1, 2032	0	0	0	0	0	0	0	0
June 1, 2033	0	0	0	0	0	0	0	0
June 1, 2034	0	0	0	0	0	0	0	0
June 1, 2035	0	0	0	0	0	0	0	0
June 1, 2036	0	0	0	0	0	0	0	0
June 1, 2037	0	0	0	0	0	0	0	0
June 1, 2038	0	0	0	0	0	0	0	0
June 1, 2039	0	0	0	0	0	0	0	0
June 1, 2040	0	0	0	0	0	0	0	0
June 1, 2041	0	0	0	0	0	0	0	0
June 1, 2042	0	0	0	0	0	0	0	0
June 1, 2043	0	0	0	0	0	0	0	0
June 1, 2044	0	0	0	0	0	0	0	0
June 1, 2045	0	0	0	0	0	0	0	0
June 1, 2046	0	0	0	0	0	0	0	0
June 1, 2047	0	0	0	0	0	0	0	0
June 1, 2048	0	0	0	0	0	0	0	0
June 1, 2049	0	0	0	0	0	0	0	0
June 1, 2050	0	0	0	0	0	0	0	0
June 1, 2051	0	0	0	0	0	0	0	0
June 1, 2052	0	0	0	0	0	0	0	0
June 1, 2053	0	0	0	0	0	0	0	0
June 1, 2054	0	0	0	0	0	0	0	0
June 1, 2055	0	0	0	0	0	0	0	0
June 1, 2056	0	0	0	0	0	0	0	0
June 1, 2057	0	0	0	0	0	0	0	0
June 1, 2058	0	0	0	0	0	0	0	0

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

Projected Outstanding Bond Obligation for Series 2008B Taxable Turbo Capital Appreciation Bonds Maturing June 1, 2046* **

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight FET Increase Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Settlement	$29,874,650	$29,874,650	$29,874,650	$29,874,650	$29,874,650	$29,874,650	$29,874,650	$29,874,650
June 1, 2009	32,193,719	32,193,719	32,193,719	32,193,719	32,193,719	32,193,719	32,193,719	32,193,719
June 1, 2010	34,989,213	34,989,213	34,989,213	34,989,213	34,989,213	34,989,213	34,989,213	34,989,213
June 1, 2011	38,029,925	38,029,925	38,029,925	38,029,925	38,029,925	38,029,925	38,029,925	38,029,925
June 1, 2012	41,329,869	41,329,869	41,329,869	41,329,869	41,329,869	41,329,869	41,329,869	41,329,869
June 1, 2013	44,917,069	44,917,069	44,917,069	44,917,069	44,917,069	44,917,069	44,917,069	44,917,069
June 1, 2014	48,819,550	48,819,550	48,819,550	48,819,550	48,819,550	48,819,550	48,819,550	48,819,550
June 1, 2015	53,058,331	53,058,331	53,058,331	53,058,331	53,058,331	53,058,331	53,058,331	53,058,331
June 1, 2016	57,661,438	57,661,438	57,661,438	57,661,438	57,661,438	57,661,438	57,661,438	57,661,438
June 1, 2017	62,670,906	62,670,906	62,670,906	62,670,906	62,670,906	62,670,906	62,670,906	62,670,906
June 1, 2018	68,107,756	68,107,756	68,107,756	68,107,756	68,107,756	68,107,756	68,107,756	68,107,756
June 1, 2019	74,021,031	74,021,031	74,021,031	74,021,031	74,021,031	74,021,031	74,021,031	74,021,031
June 1, 2020	80,445,763	80,445,763	80,445,763	80,445,763	80,445,763	80,445,763	80,445,763	80,445,763
June 1, 2021	87,430,994	87,430,994	87,430,994	87,430,994	87,430,994	87,430,994	87,430,994	87,430,994
June 1, 2022	95,018,763	95,018,763	95,018,763	95,018,763	95,018,763	95,018,763	95,018,763	95,018,763
June 1, 2023	103,272,125	103,272,125	103,272,125	103,272,125	103,272,125	103,272,125	103,272,125	103,272,125
June 1, 2024	98,073,925	79,245,993	112,233,119	112,233,119	112,233,119	112,233,119	112,233,119	112,233,119
June 1, 2025	52,969,925	30,948,887	112,551,298	87,932,687	103,998,635	121,978,813	121,978,813	121,978,813
June 1, 2026	3,248,736	0	70,376,660	43,488,026	62,648,377	132,565,256	132,565,256	132,565,256
June 1, 2027	0	0	23,861,437	0	17,219,265	144,076,525	144,076,525	144,076,525
June 1, 2028	0	0	0	0	0	156,582,681	131,099,234	156,582,681
June 1, 2029	0	0	0	0	0	170,174,806	101,930,003	170,174,806
June 1, 2030	0	0	0	0	0	154,686,420	70,395,520	164,923,177
June 1, 2031	0	0	0	0	0	119,980,267	36,293,019	143,301,555
June 1, 2032	0	0	0	0	0	81,625,063	0	120,107,744
June 1, 2033	0	0	0	0	0	39,294,206	0	95,207,800
June 1, 2034	0	0	0	0	0	0	0	68,441,138
June 1, 2035	0	0	0	0	0	0	0	39,641,771
June 1, 2036	0	0	0	0	0	0	0	8,627,828
June 1, 2037	0	0	0	0	0	0	0	0
June 1, 2038	0	0	0	0	0	0	0	0
June 1, 2039	0	0	0	0	0	0	0	0
June 1, 2040	0	0	0	0	0	0	0	0
June 1, 2041	0	0	0	0	0	0	0	0
June 1, 2042	0	0	0	0	0	0	0	0
June 1, 2043	0	0	0	0	0	0	0	0
June 1, 2044	0	0	0	0	0	0	0	0
June 1, 2045	0	0	0	0	0	0	0	0
June 1, 2046	0	0	0	0	0	0	0	0
June 1, 2047	0	0	0	0	0	0	0	0
June 1, 2048	0	0	0	0	0	0	0	0
June 1, 2049	0	0	0	0	0	0	0	0
June 1, 2050	0	0	0	0	0	0	0	0
June 1, 2051	0	0	0	0	0	0	0	0
June 1, 2052	0	0	0	0	0	0	0	0
June 1, 2053	0	0	0	0	0	0	0	0
June 1, 2054	0	0	0	0	0	0	0	0
June 1, 2055	0	0	0	0	0	0	0	0
June 1, 2056	0	0	0	0	0	0	0	0
June 1, 2057	0	0	0	0	0	0	0	0
June 1, 2058	0	0	0	0	0	0	0	0

* Outstanding amounts represent Accreted Value after application of available Collections to Turbo Redemptions on the referenced date.

** In the event of an annual consumption decline of 4.5% and taking into account the Cash Flow Assumptions outlined herein, the Series 2008B Bonds would be repaid by their Turbo Term Bond Maturity Date.

Projected Outstanding Bond Obligation for Series 2008C Turbo Capital Appreciation Bonds Maturing June 1, 2058* **

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight FET Increase Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Settlement	$57,673,814	$57,673,814	$57,673,814	$57,673,814	$57,673,814	$57,673,814	$57,673,814	$57,673,814
June 1, 2009	62,377,395	62,377,395	62,377,395	62,377,395	62,377,395	62,377,395	62,377,395	62,377,395
June 1, 2010	68,048,068	68,048,068	68,048,068	68,048,068	68,048,068	68,048,068	68,048,068	68,048,068
June 1, 2011	74,202,286	74,202,286	74,202,286	74,202,286	74,202,286	74,202,286	74,202,286	74,202,286
June 1, 2012	80,927,967	80,927,967	80,927,967	80,927,967	80,927,967	80,927,967	80,927,967	80,927,967
June 1, 2013	88,269,070	88,269,070	88,269,070	88,269,070	88,269,070	88,269,070	88,269,070	88,269,070
June 1, 2014	96,269,553	96,269,553	96,269,553	96,269,553	96,269,553	96,269,553	96,269,553	96,269,553
June 1, 2015	105,017,334	105,017,334	105,017,334	105,017,334	105,017,334	105,017,334	105,017,334	105,017,334
June 1, 2016	114,556,372	114,556,372	114,556,372	114,556,372	114,556,372	114,556,372	114,556,372	114,556,372
June 1, 2017	124,930,625	124,930,625	124,930,625	124,930,625	124,930,625	124,930,625	124,930,625	124,930,625
June 1, 2018	136,271,970	136,271,970	136,271,970	136,271,970	136,271,970	136,271,970	136,271,970	136,271,970
June 1, 2019	148,668,323	148,668,323	148,668,323	148,668,323	148,668,323	148,668,323	148,668,323	148,668,323
June 1, 2020	162,119,686	162,119,686	162,119,686	162,119,686	162,119,686	162,119,686	162,119,686	162,119,686
June 1, 2021	176,845,850	176,845,850	176,845,850	176,845,850	176,845,850	176,845,850	176,845,850	176,845,850
June 1, 2022	192,890,776	192,890,776	192,890,776	192,890,776	192,890,776	192,890,776	192,890,776	192,890,776
June 1, 2023	210,386,338	210,386,338	210,386,338	210,386,338	210,386,338	210,386,338	210,386,338	210,386,338
June 1, 2024	229,508,373	229,508,373	229,508,373	229,508,373	229,508,373	229,508,373	229,508,373	229,508,373
June 1, 2025	250,300,838	250,300,838	250,300,838	250,300,838	250,300,838	250,300,838	250,300,838	250,300,838
June 1, 2026	273,027,486	250,678,755	273,027,486	273,027,486	273,027,486	273,027,486	273,027,486	273,027,486
June 1, 2027	246,277,576	216,596,957	297,776,234	292,362,453	297,776,234	297,776,234	297,776,234	297,776,234
June 1, 2028	212,877,459	178,622,055	297,419,072	265,613,122	292,150,715	324,810,834	324,810,834	324,810,834
June 1, 2029	175,678,947	136,323,626	270,350,035	235,777,328	266,748,065	354,263,163	354,263,163	354,263,163
June 1, 2030	134,358,227	89,322,662	240,113,354	202,599,831	238,522,364	386,396,973	386,396,973	386,396,973
June 1, 2031	88,535,113	37,185,620	206,420,531	165,803,366	207,254,208	421,476,016	421,476,016	421,476,016
June 1, 2032	37,797,304	0	168,939,055	125,022,253	172,615,565	459,720,085	459,108,292	459,720,085
June 1, 2033	0	0	127,312,386	79,886,643	134,294,041	501,436,891	460,874,740	501,436,891
June 1, 2034	0	0	81,140,824	29,981,566	91,935,880	539,513,918	462,910,949	546,890,187
June 1, 2035	0	0	30,037,874	0	45,196,921	537,734,998	465,330,906	596,519,559
June 1, 2036	0	0	0	0	0	535,200,460	468,103,086	650,632,719
June 1, 2037	0	0	0	0	0	531,789,010	471,280,491	684,866,418
June 1, 2038	0	0	0	0	0	527,397,474	474,891,838	713,109,912
June 1, 2039	0	0	0	0	0	521,875,995	478,941,943	744,142,232
June 1, 2040	0	0	0	0	0	515,225,991	483,520,727	778,294,106
June 1, 2041	0	0	0	0	0	507,266,079	488,617,868	815,752,713
June 1, 2042	0	0	0	0	0	497,895,454	494,316,655	856,880,665
June 1, 2043	0	0	0	0	0	486,994,318	500,651,057	901,975,433
June 1, 2044	0	0	0	0	0	474,410,684	507,675,380	951,390,454
June 1, 2045	0	0	0	0	0	459,985,085	515,456,172	1,005,524,612
June 1, 2046	0	0	0	0	0	443,531,520	524,049,197	1,064,787,815
June 1, 2047	0	0	0	0	0	424,847,721	533,522,404	1,129,634,608
June 1, 2048	0	0	0	0	0	403,713,434	543,951,682	1,200,561,430
June 1, 2049	0	0	0	0	0	379,897,866	555,425,816	1,278,136,404
June 1, 2050	0	0	0	0	0	353,125,763	568,027,493	1,362,928,010
June 1, 2051	0	0	0	0	0	323,139,460	581,863,386	1,455,608,635
June 1, 2052	0	0	0	0	0	289,632,090	597,036,936	1,556,878,644
June 1, 2053	0	0	0	0	0	252,281,816	613,661,184	1,667,502,151
June 1, 2054	0	0	0	0	0	210,732,070	631,857,067	1,788,309,845
June 1, 2055	0	0	0	0	0	164,603,134	651,777,238	1,920,255,578
June 1, 2056	0	0	0	0	0	113,472,747	673,569,755	2,064,330,646
June 1, 2057	0	0	0	0	0	56,870,345	697,383,717	2,221,592,383
June 1, 2058	0	0	0	0	0	0	723,420,000	2,393,285,000

* Outstanding amounts represent Accreted Value after application of available Collections to Turbo Redemptions on the referenced date.

** In the event of an annual consumption decline of 3.3% and taking into account the Cash Flow Assumptions outlined herein, the Series 2008C Bonds would be repaid by their Turbo Term Bond Maturity Date. However, in the event of a 3.5% or 4% annual consumption decline and taking into account the Cash Flow Assumptions outlined herein, the Series 2008C Bonds may never be repaid.

Consumption Forecast	Series 2008A Current Interest Turbo Term Bonds Maturing June 1, 2042	
	Projected Average Life (Years)*	Final Expected Maturity (Years)
Global Insight Base Case Forecast	15.6	15.9
Global Insight High Forecast	15.4	15.9
Low Case 1	16.3	16.9
Low Case 2	16.5	16.9
Low Case 3	21.2	21.9
Global Insight FET Increase Case	16.6	16.9
3.5% Annual Decline	19.1	19.9
4.0% Annual Decline	21.1	21.9

Consumption Forecast	Series 2008B Taxable Capital Appreciation Turbo Term Bonds Maturing June 1, 2046	
	Projected Average Life (Years)**	Final Expected Maturity (Years)
Global Insight Base Case Forecast	17.3	18.9
Global Insight High Forecast	16.9	17.9
Low Case 1	18.0	18.9
Low Case 2	18.4	19.9
Low Case 3	24.0	25.9
Global Insight FET Increase Case	18.6	19.9
3.5% Annual Decline	22.0	23.9
4.0% Annual Decline	25.2	28.9
4.5% Annual Decline	31.4	37.9

Consumption Forecast	Series 2008C Capital Appreciation Turbo Term Bonds Maturing June 1, 2058	
	Projected Average Life (Years) **	Final Expected Maturity (Years)
Global Insight Base Case Forecast	21.8	24.9
Global Insight High Forecast	21.1	23.9
Low Case 1	23.2	26.9
Low Case 2	24.1	27.9
Low Case 3	38.9	49.9
Global Insight FET Increase Case	24.0	27.9
3.3% Annual Decline	36.6	49.9
3.5% Annual Decline	N/A†	N/A†
4.0% Annual Decline	N/A†	N/A†

* Series 2008A Bonds Weighted Average Life and final principal payment is calculated from the date of issuance.

** Series 2008B Bonds and Series 2008C Bonds Weighted Average Life is calculated based on Accreted Value at the time of Turbo Redemption.

† In the event of an annual consumption decline higher than 3.3%, and assuming the values of all other Structuring variables as set forth under the caption "- Collection Methodology and Assumptions" above, the Series 2008C Bonds may never be repaid.

Explanation of Alternative Global Insight Forecasts

The alternative Global Insight forecast of cigarette consumption decline are based upon the methodology described below. See also "GLOBAL INSIGHT CONSUMPTION REPORT" herein and Appendix A - "**GLOBAL INSIGHT CONSUMPTION REPORT**" attached hereto.

Global Insight's high forecast of consumption (the "**Global Insight High Forecast**") deviates from the Base Case Forecast by assuming a lower price forecast, under which prices are increasing at an annual rate 0.5% more slowly than the Base Case Forecast. Under the Global Insight High Forecast, the average annual rate of decline in cigarette consumption is moderated slightly, from an average annual rate in the Base Case Forecast of 1.82%, to 1.66%, resulting in consumption of 157 billion in 2058.

Global Insight's low forecast of consumption (the "**Global Insight Low Case 1**") deviates from the Base Case Forecast by assuming a sharper price elasticity of demand. The Global Insight Base Case Forecast applied a price elasticity of demand of -0.33. However, in order to develop the lowest consumption forecast that Global Insight believed may be reasonably anticipated, a price elasticity of -0.4 was applied. Under the Global Insight Low Case 1, the average rate of decline in cigarette consumption increased to 2.00%, resulting in consumption of 131 billion in 2058. Under the Base Case Forecast, the rate of decline was 1.82%.

Although beyond the range of Global Insight's reasonably anticipated decline in consumption, Global Insight also prepared an alternative low case (the "**Global Insight Low Case 2**") that deviated from the Base Case Forecast by assuming a price elasticity of demand of -0.5. This produces a decline in consumption of an average annual rate of 2.18% to 120 billion in 2058. Global Insight prepared another alternative low case (the "**Global Insight Low Case 3**") that deviated from the Base Case Forecast by assuming either an adverse federal government settlement or tort claims of three times the size of the MSA, resulting in an immediate real price increase of 57% and a decline in consumption of 18% over two years. Under the Global Insight Low Case 3, the average annual rate of decline in cigarette consumption would be 2.20%, compared to the Base Case Forecast of 1.82%, resulting in consumption of 118 billion in 2058.

Should the federal excise tax increase to $1.00 per pack, the resulting price increase, would, according to Global Insight, lead to a sharper, one-time, consumption decline of 4.3%, or 15.5 billion cigarettes, by 2010. This is illustrated in an alternative low case (the "**Global Insight FET Increase Case**"). The difference with the Global Insight Base Case forecast would be somewhat lower over the longer term, because the Global Insight Base Case forecast assumptions incorporate the likelihood of significant excise tax increases over time. By 2058 consumption would equal 137 billion, resulting in an average rate of decline of 1.91%.

Finally, for comparative purposes Global Insight calculated the volume of total cigarette consumption under four alternative annual rates of decline, 2.5%, 3.0%, 3.5% and 4.0%. Global Insight states that at 2.5% per year consumption falls to 101 billion by 2058, at 3.0% per year consumption falls to 78 billion by 2058, at 3.5% per year it falls to 60 billion by 2058, and at 4.0% per year it falls to 46 billion by 2058. These calculations are simple arithmetic examples, and are neither forecasts nor projections.

Cigarette Consumption Decline (2008-2058)

Global Insight Base Case Forecast	Global Insight FET Increase Case	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3
1.82%	1.91%	1.66%	2.00%	2.18%	2.20%

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2008 Bonds will be as assumed, or that the other assumptions underlying the Cash Flow Assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Cash Flow Assumptions, the amount of Surplus Collections available to make Turbo Redemptions will be affected and the resulting weighted average lives and final principal payment dates of the Series 2008 Bonds will vary. See "RISK FACTORS" herein.

THE AUTHORITY

The Authority is a public body corporate and politic of the State, separate and distinct from the State and exercising public and essential governmental functions. The Authority is governed by a seven member board of directors. The names of the Authority's current directors, and their principal occupations and offices, are set forth below:

Name	Occupation
Robert J. Kleine, Chairperson	State Treasurer
Jerry Campbell	Retired, Chairman, Citizens Republic Bancorp
Stephen N. Cassin	Executive Director, Macomb County Planning & Economic Development
Charlotte P. Edwards	Assistant Vice-President & Community Development Officer, Citizens Republic Bancorp
Donald H. Gilmer	Retired, Administrator, Kalamazoo County
John G. Russell	President and Chief Operating Officer, CMS Energy
Keith W. Cooley	Director, Department of Labor & Economic Growth

THE RESIDUAL CERTIFICATE

The Residual Certificate will be transferred by the Authority to the State as part of the purchase price of the 2006 Sold Tobacco Receipts.

The Residual Certificate represents the entitlement to receive all amounts required to be distributed pursuant to the Indenture in respect of the Residual Certificate. While the Series 2008 Bonds are outstanding, payments on the Residual Certificate will be made only from Unencumbered TSRs and may not be made from Collections.

CONTINUING DISCLOSURE UNDERTAKING

To the extent that Rule 15c2-12 (the "**Rule**") of the Securities and Exchange Commission (the "**SEC**") promulgated under the Securities Exchange Act of 1934, as amended (the "**1934 Act**"), requires

the Underwriters to determine, as a condition to purchasing the Series 2008 Bonds, that the Authority had made such covenants, the Authority will covenant for the sole benefit of the Bondholders (the **"Undertaking"**) to the effect that:

(a) The Authority, not later than seven calendar months after the first day of the Authority's Fiscal Year, will deliver to each nationally recognized municipal securities information repository (each a **"National Repository"**) and to any state information depository for the State (the **"State Repository"** and each National Repository and State Repository, a **"Repository"**):

(1) an Annual Report for the preceding Fiscal Year consisting of (A) it's audited financial statements for such preceding Fiscal Year, or, if the audited financial statements for such preceding Fiscal Year are not then available, unaudited financial statements for such preceding Fiscal Year in a format similar to the audited financial statements then most recently prepared for the Authority, and (B) an update of the (x) operating data for such preceding Fiscal Year set forth under the column titled "Total Annual Payments of 2006 Pledged TSRs" in the table captioned "Projection of Annual Payments to be Received by the Indenture Trustee" under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION — Bond Structuring Methodology," contained in the Offering Circular relating to the Series 2008 Bonds and (y) the actual debt service coverage ratio for such preceding Fiscal Year, determined in substantially the manner described in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION — Debt Service Coverage of Series 2006A and Series 2008A Bonds" set forth in the Offering Circular; and

(2) if the Authority is unable, within seven calendar months after the first day of its Fiscal Year, to provide the Repositories an Annual Report for the preceding Fiscal Year, a written notice, in the form prescribed by the Securities Exchange Commission, to each National Repository or to the Municipal Securities Rulemaking Board (the **"MSRB"**) and to the State Repository of its failure to file such information;

(b) If the audited financial statements for the preceding Fiscal Year have not been so filed within seven calendar months after the first day of the Authority's subsequent Fiscal Year, the Authority will file such audited financial statements when available; and

(c) The Authority will file, in a timely manner, to each Repository and to the MSRB, notice of any of the following events with respect to the Series 2008 Bonds, if material:

(1) principal and interest payment delinquencies;

(2) non-payment related defaults;

(3) unscheduled draws on debt service reserves reflecting financial difficulties;

(4) unscheduled draws on credit enhancements reflecting financial difficulties;

(5) substitution of credit or liquidity providers, or their failure to perform;

(6) adverse tax opinions or events affecting the tax-exempt status of the Series 2008 Bonds which have become Tax-Exempt Bonds (as defined in the Indenture);

(7) modifications to rights of Bondholders;

(8) bond calls;

(9) defeasances;

(10) release, substitution, or sale of property securing repayment of the Series 2008 Bonds; and

(11) rating changes.

Any filing in accordance with (a) or (b) above may be made solely by transmitting such filing to the Texas Municipal Advisory Council (the "**MAC**") as provided at www.DisclosureUSA.org unless the Securities and Exchange Commission has withdrawn the interpretive advise in its letter to the MAC dated September 7, 2004.

The Authority will not undertake to provide any notice with respect to (i) credit enhancement if the credit enhancement is added after the primary offering of the Series 2008 Bonds, the Authority does not apply for or participate in obtaining the enhancement and the enhancement is not described in this Offering Circular or (ii) tax exemption other than pursuant to Section 103 of the Code.

The Authority will not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if (i) the terms, dates and amounts of redemption are set forth in detail herein, (ii) the only open issue is which Series 2008 Bonds will be redeemed in the case of a partial redemption, (iii) notice of redemption is given to the Bondholders as required under the terms of the Series 2008 Bonds and (iv) public notice of the redemption is given pursuant to 1934 Act Release No. 23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or Series 2008 Bond purchases.

The Authority will not undertake to provide updates or revisions to any forward-looking statements contained in this Offering Circular, including but not limited to, those that include the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," "assumes," or analogous expressions.

In the event of a failure of the Authority to comply with any provision of the Undertaking, any Bondholder or Beneficial Owner may bring an action to obtain specific performance of the obligations of the Authority under the Undertaking, but no person or entity shall be entitled to recover monetary damages under the Undertaking under any circumstances, and any failure to comply with the obligations under the Undertaking shall not constitute a default with respect to the Series 2008 Bonds or under the Indenture.

An amendment to the Undertaking may only take effect if the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Authority, or type of business conducted; the Undertaking, as amended, would have complied with the requirements of the Rule at the time of sale of the Series 2008 Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and the amendment does not materially impair the interests of Bondholders.

In the event of any amendment to, or waiver of a provision of, the Undertaking, the Authority shall describe such amendment waiver in the next Annual Report and shall include an explanation of the reason for such amendment or waiver. If the amendment results in a change to the accounting principles

to be followed in preparing financial statements as set forth in the Undertaking, the Annual Report for the year in which the change is made shall include a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

If all or any part of the Rule, as interpreted by the staff of the SEC at the date of the Series 2008 Bonds, ceases to be in effect for any reason, and the Authority receives an opinion of counsel to the affect those portions of the rule do not or no longer apply to the Series 2008 Bonds, the Authority may terminate the Undertaking.

For purposes of the Undertaking, a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares investment power which includes the power to dispose, or to direct the disposition of, such security, subject to certain exceptions as set forth in the Undertaking. Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above.

TAX MATTERS

Series 2008A Bonds and Series 2008C Bonds

In the opinion of the Attorney General of the State of Michigan and in the opinion of Dickinson Wright PLLC and Dykema Gossett PLLC, Co-Bond Counsel, based on their examination of the documents described in their opinions, under existing law, the interest on the Series 2008A Bonds and the Series 2008C Bonds (a) is excluded from gross income for federal income tax purposes, and (b) is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, it should be noted that certain corporations must take into account interest on the Series 2008A Bonds and the Series 2008C Bonds in determining adjusted current earnings for the purpose of computing such alternative minimum tax. The opinion set forth in clause (a) above is subject to the condition that the Authority and the State comply with all requirements of the Internal Revenue Code of 1986, as amended (the "**Code**"), that must be satisfied subsequent to the issuance of the Series 2008A Bonds and the Series 2008C Bonds in order that interest thereon be (or continue to be) excluded from gross income for federal income tax purposes. Failure to comply with such requirements could cause the interest on the Series 2008A Bonds and the Series 2008C Bonds to be included in gross income retroactive to the date of issuance of the Series 2008A Bonds and the Series 2008C Bonds. The Authority and the State have covenanted to comply with all such requirements to the extent permitted by law. Co-Bond Counsel and the Attorney General of the State of Michigan will express no opinion regarding other federal tax consequences arising with respect to the Series 2008A Bonds and the Series 2008C Bonds and the interest thereon.

Prospective purchasers of the Series 2008A Bonds and the Series 2008C Bonds should be aware that (i) interest on the Series 2008A Bonds and the Series 2008C Bonds is included in the effectively connected earnings and profits of certain foreign corporations for purposes of calculating the branch profits tax imposed by Section 884 of the Code, (ii) interest on the Series 2008A Bonds and the Series 2008C Bonds may be subject to a tax on excess net passive income of certain S corporations imposed by Section 1375 of the Code, (iii) interest on the Series 2008A Bonds and the Series 2008C Bonds is included in the calculation of modified adjusted gross income for purposes of determining taxability of social security or railroad retirement benefits, (iv) the receipt of interest on the Series 2008A Bonds and the Series 2008C Bonds by life insurance companies may affect the federal tax liability of such companies, (v) in the case of property and casualty insurance companies, the amount of certain loss deductions otherwise allowed is reduced by a specific percentage of, among other things, interest on the Series 2008A Bonds and the Series 2008C Bonds, (vi) registered owners acquiring the Series 2008A

Bonds and the Series 2008C Bonds subsequent to initial issuance will generally be required to treat market discount recognized under Section 1276 of the Code as ordinary taxable income, (vii) the receipt or accrual of interest on the Series 2008A Bonds and the Series 2008C Bonds may cause disallowance of the earned income credit under Section 32 of the Code, and (viii) registered owners of the Series 2008A Bonds and the Series 2008C Bonds may not deduct interest on indebtedness incurred or continued to purchase or carry the Series 2008A Bonds and the Series 2008C Bonds, and financial institutions may not deduct that portion of their interest expense allocated to interest on the Series 2008A Bonds and the Series 2008C Bonds.

In the opinion of the Attorney General of the State of Michigan and in the opinion of Dickinson Wright PLLC and Dykema Gossett PLLC, Co-Bond Counsel, based on their examination of the documents described in their opinions, under existing law, the interest on the Series 2008A Bonds and the Series 2008C Bonds is excluded from taxable income for purposes of the State of Michigan personal income tax.

Tax Treatment of Accruals on Original Issue Discount Series 2008A Bonds and Series 2008C Bonds

For federal income tax purposes, the difference between the initial offering prices to the public (excluding bond houses and brokers) at which a substantial amount of the Series 2008A Bonds and the Series 2008C Bonds initially sold at a discount as shown on the inside cover page hereof (the "**OID Bonds**") is sold and the amount payable at the stated redemption price at maturity thereof constitutes "original issue discount." Such discount is treated as interest excluded from federal gross income to the extent properly allocable to each registered owner thereof. The original issue discount accrues over the term to maturity of each such OID Bond on the basis of a constant interest rate compounded at the end of each six-month period (or shorter period from the date of original issue) with straight line interpolations between compounding dates. The amount of original issue discount accruing during each period is added to the adjusted basis of such OID Bonds to determine taxable gain upon disposition (including sale, redemption or payment on maturity) of such OID Bonds.

The Code contains certain provisions relating to the accrual of original issue discount in the case of registered owners of the OID Bonds who purchase such bonds after the initial offering of a substantial amount thereof. Registered owners who do not purchase such OID Bonds in the initial offering at the initial offering and purchase prices should consult their own tax advisors with respect to the tax consequences of ownership of such OID Bonds.

NO ASSURANCE CAN BE GIVEN THAT ANY FUTURE LEGISLATION OR CLARIFICATIONS OR AMENDMENTS TO THE CODE, IF ENACTED INTO LAW, WILL NOT CONTAIN PROPOSALS THAT COULD CAUSE THE INTEREST ON THE SERIES 2008A BONDS OR THE SERIES 2008C BONDS TO BE SUBJECT DIRECTLY OR INDIRECTLY TO FEDERAL OR STATE OF MICHIGAN INCOME OR OTHER TAXATION, ADVERSELY AFFECT THE MARKET PRICE OR MARKETABILITY OF THE SERIES 2008A BONDS OR THE SERIES 2008C BONDS, OR OTHERWISE PREVENT THE REGISTERED OWNERS FROM REALIZING THE FULL CURRENT BENEFIT OF THE STATUS OF THE INTEREST THEREON. FURTHER, NO ASSURANCE CAN BE GIVEN THAT ANY SUCH FUTURE LEGISLATION, OR ANY ACTIONS OF THE INTERNAL REVENUE SERVICE, INCLUDING, BUT NOT LIMITED TO, SELECTION OF THE SERIES 2008A BONDS OR THE SERIES 2008C BONDS FOR AUDIT EXAMINATION, OR THE AUDIT PROCESS OR RESULT OF ANY EXAMINATION OF THE SERIES 2008A BONDS OR THE SERIES 2008C BONDS OR OTHER BONDS THAT PRESENT SIMILAR TAX ISSUES, WILL NOT ADVERSELY AFFECT THE MARKET PRICE OF THE SERIES 2008A BONDS OR THE SERIES 2008C BONDS.

INVESTORS SHOULD CONSULT WITH THEIR TAX ADVISORS AS TO THE TAX CONSEQUENCES OF THEIR ACQUISITION, HOLDING OR DISPOSITION OF THE SERIES 2008A BONDS AND THE SERIES 2008C BONDS AND THE TAX CONSEQUENCES OF THE ORIGINAL ISSUE DISCOUNT OR PREMIUM THEREON, IF ANY.

The Series 2008B Bonds

The following is a summary of certain anticipated federal income tax consequences of the purchase, ownership and disposition of the Series 2008B Bonds. The summary is based upon the provisions of the Internal Revenue Code of 1986, as amended (the "Code"), the regulations promulgated thereunder and the judicial and administrative rulings and decisions now in effect, all of which are subject to change. The summary generally addresses Series 2008B Bonds held as capital assets and does not purport to address all aspects of federal income taxation that may affect particular investors in light of their individual circumstances or certain types of investors subject to special treatment under the federal income tax laws, including but not limited to financial institutions, insurance companies, dealers in securities or currencies, persons holding Series 2008B Bonds as a hedge against currency risks or as a position in a "straddle" for tax purposes, or persons whose functional currency is not the United States dollar. Potential purchasers of the Series 2008B Bonds should consult their own tax advisors in determining the federal, state or local tax consequences to them of the purchase, holding and disposition of the Series 2008B Bonds.

Generally. In the opinion of the Attorney General of the State of Michigan, and in the opinion of Dickinson Wright PLLC and Dykema Gossett PLLC, Co-Bond Counsel, interest on the Series 2008B Bonds is **included** in gross income for federal income tax purposes and so will be fully subject to Federal income taxation. Owners of the Series 2008B Bonds will be subject to Federal income tax accounting rules affecting the timing and/or characterization of payments received with respect to such bonds. In general, interest paid on the Series 2008B Bonds and recovery of accrued original issue and market discount, if any, will be treated as ordinary income to a bond owner and, after adjustment for the foregoing, principal payments will be treated as a return of capital.

State Taxes. The Attorney General of the State of Michigan and Co-Bond Counsel are also of the opinion that, under existing law, the Series 2008B Bonds and the interest thereon are **not exempt** from taxation by the State of Michigan or any political subdivision thereof.

Original Issue Discount. The following summary is a general discussion of certain federal income tax consequences of the purchase, ownership and disposition of Series 2008B Bonds issued with original issue discount **("Discount Series 2008B Bonds").** A Series 2008B Bond will be treated as having been issued at an original issue discount if the excess of its "stated redemption price at maturity" (defined below) over its issue price (defined as the initial offering price to the public at which a substantial amount of the Series 2008B Bonds of the same maturity has first been sold to the public, excluding bond houses and brokers) equals or exceeds one quarter of one percent of such Series 2008B Bond's stated redemption price at maturity multiplied by the number of complete years to its maturity.

A Series 2008B Bond's "stated redemption price at maturity" is the total of all payments provided by the Series 2008B Bond that are not payments of "qualified stated interest." Generally, the term "qualified stated interest" includes stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) at least annually at a single fixed rate.

In general, the amount of original issue discount includible in income by the initial owner of a Discount Series 2008B Bond is the sum of the "daily portions" of original issue discount with respect to such Series 2008B Bond for each day during the taxable year in which such owner held such Series 2008B Bond. The daily portion of original issue discount on any Discount Series 2008B Bond is

determined by allocating to each day in any "accrual period" a ratable portion of the original issue discount allocable to that accrual period.

An accrual period may be of any length, and may vary in length over the term of a Series 2008B Bond, provided that each accrual period is not longer than one year and each scheduled payment of principal or interest occurs either on the final day of the accrual period or on the first day of the accrual period. The amount of original issue discount allocable to each accrual period is equal to the difference between (i) the product of the Series 2008B Bond's "adjusted issue price" at the beginning of such accrual period and its yield to maturity (determined on the basis of compounding at the close of each accrual period and appropriately adjusted to take into account the length of the particular accrual period) and (ii) the amount of any qualified stated interest payments allocable to such accrual period. The "adjusted issue price" of a Discount Series 2008B Bond at the beginning of any accrual period is the sum of the issue price of the Discount Series 2008B Bond plus the amount of original issue discount allocable to all prior accrual periods minus the amount of any prior payments on the Series 2008B Bond that were not qualified stated interest payments. Under these rules, owners will have to include in income increasingly greater amounts of original issue discount in successive accrual periods.

Owners utilizing the accrual method of accounting may generally, upon election, include all interest (including stated interest, acquisition discount, original issue discount, de minimis original issue discount, market discount, de minimis market discount, and unstated interest, as adjusted by any amortizable bond premium or acquisition premium) on the Series 2008B Bond by using the constant yield method applicable to original issue discount, subject to certain limitations and exceptions.

Market Discount. Any owner who purchases a Series 2008B Bond at a price that includes market discount in excess of a prescribed de minimis amount (i.e., at a purchase price that is less by a non-de minimis amount than its adjusted issue price in the hands of an original owner) will be required to recharacterize all or a portion of the gain as ordinary income upon receipt of each scheduled or unscheduled principal payment or upon other disposition. In particular, such owner will generally be required either (a) to allocate each such principal payment to accrued market discount not previously included in income and to recognize ordinary income to that extent and to treat any gain upon sale or other disposition of such a Series 2008B Bond as ordinary income to the extent of any remaining accrued market discount (under this caption) or (b) to elect to include such market discount in income currently as it accrues on all market discount instruments acquired by such owner on or after the first day of the taxable year to which such election applies.

The Code authorizes the Treasury Department to issue regulations providing for the method for accruing market discount on debt instruments the principal of which is payable in more than one installment. Until such time as regulations are issued by the Treasury Department, certain rules described in the legislative history of the Tax Reform Act of 1986 will apply. Under those rules, market discount will be included in income either (a) on a constant interest basis or (b) in proportion to the accrual of stated interest.

An owner of a Series 2008B Bond who acquires such bond at a market discount also may be required to defer, until the maturity date of such Series 2008B Bonds or the earlier disposition in a taxable transaction, the deduction of a portion of the amount of interest that the owner paid or accrued during the taxable year on indebtedness incurred or maintained to purchase or carry a Series 2008B Bond in excess of the aggregate amount of interest (including original issue discount) includable in such owner's gross income for the taxable year with respect to such Series 2008B Bond. The amount of such net interest expense deferred in a taxable year may not exceed the amount of market discount accrued on the Series 2008B Bond for the days during the taxable year on which the owner held the Series 2008B Bond and, in general, would be deductible when such market discount is includable in income. The amount of any remaining deferred deduction is to be taken into account in the taxable year in which the Series 2008B Bond matures or is disposed of in a taxable transaction. In the case of a disposition in which gain or loss

is not normally recognized in whole or in part under federal income tax laws, any remaining deferred deduction will be allowed to the extent gain is recognized (due to remaining accrued market discount) on the disposition. This deferral rule does not apply if the bond owner elects to include such market discount in income currently as described above.

Bond Premium. A purchaser of a Series 2008B Bond who purchases such Series 2008B Bond at a cost greater than the sum of all amounts payable on the Series 2008B Bonds after the acquisition date other than qualified stated interest (or, in the case of a Series 2008B Bond issued with original issue discount, at a price in excess of its adjusted issue price) will have amortizable bond premium. If such bond owner elects to amortize the premium under Section 171 of the Code (which election will apply to all bonds held by the owner on the first day of the taxable year to which the election applies, and to all bonds thereafter acquired by the owner), such a bond owner must amortize the premium using constant yield principles based on the bond owner's yield to maturity. Amortizable bond premium is generally treated as an offset to interest income, and a reduction in basis is required for amortizable bond premium that is applied to reduce interest payments. Different rules apply to Series 2008B Bonds that are acquired with "acquisition premium" (that is, at a price generally in excess of the Bond's adjusted issue price and less than or equal to the sum of all amounts remaining payable other than qualified stated interest). Purchasers of any Series 2008B Bonds who acquire such Bonds at a premium (or with acquisition premium) should consult with their own tax advisors with respect to the determination and treatment of such premium for federal income tax purposes and with respect to state and local tax consequences of owning such Series 2008B Bonds.

Sale or Redemption of Series 2008B Bonds. A bond owner's tax basis for a Series 2008B Bond is the price such owner pays for the Series 2008B Bond plus the amount of any original issue discount and market discount previously included in income, reduced by the amount of any payments received (other than "qualified periodic interest" payments) and any amortized bond premium. Gain or loss recognized on a sale, exchange or redemption of a Series 2008B Bond, measured by the difference between the amount realized and the Series 2008B Bond's basis as so adjusted, will generally give rise to capital gain or loss if the Series 2008B Bond is held as a capital asset (except as discussed above under "Market Discount").

The legal defeasance of the Series 2008B Bonds may result in a deemed sale or exchange of such Series 2008B Bonds under certain circumstances, which would cause the owners to recognize taxable gain or loss. Owners of the Series 2008B Bonds should consult their tax advisors as to the federal income tax consequences of such an event.

Backup Withholding. A bond owner may, under certain circumstances, be subject to "backup withholding" (currently the rate of this backup withholding is 28%) with respect to interest or original issue discount on the Series 2008B Bonds. This withholding generally applies if the owner of a Series 2008B Bond (a) fails to furnish the Indenture Trustee or other payor with its taxpayer identification number; (b) furnishes the Indenture Trustee or other payor an incorrect taxpayer identification number; (c) fails to report properly interest, dividends or other "reportable payments" as defined in the Code; or (d) under certain circumstances, fails to provide the Indenture Trustee or other payor with a certified statement, signed under penalty of perjury, that the taxpayer identification number provided is its correct number and that the owner is not subject to backup withholding. Backup withholding will not apply, however, with respect to certain payments made to bond owners, including payments to certain exempt recipients (such as certain exempt organizations) and to certain Nonresidents (as defined below). Owners of the Series 2008B Bonds should consult their tax advisors as to their qualification for exemption from backup withholding and the procedure for obtaining the exemption.

The amount of "reportable payments" for each calendar year and the amount of tax withheld, if any, with respect to payments on the Series 2008B Bonds will be reported to the bond owners and to the Internal Revenue Service.

Nonresident Bond Owners. Under the Code, interest and original issue discount income with respect to Series 2008B Bonds held by nonresident alien individuals, foreign corporations or other non-United States persons ("Nonresidents") generally will not be subject to the United States tax withholding (or backup withholding) if the Authority (or other person who would otherwise be required to withhold tax from such payments) is provided with an appropriate statement that the beneficial owner of the Series 2008B Bond is a Nonresident. If any such payments are effectively connected with a United States trade or business conducted by a Nonresident bond owner, they will be subject to regular United States income tax, but will ordinarily be exempt from United States withholding tax if an appropriate statement is provided as described above.

ERISA. The Employees Retirement Income Security Act of 1974, as amended ("ERISA"), and the Code generally prohibit certain transactions between a qualified employee benefit plan under ERISA or a tax-qualified retirement plan or an individual retirement account under the Code (collectively, "Plans") and persons who, with respect to a Plan, are fiduciaries or other "parties in interest" within the meaning of ERISA or "disqualified persons" within the meaning of the Code. All fiduciaries of Plans, in consultation with their advisors, should carefully consider the impact of ERISA and the Code on an investment in any Series 2008B Bonds.

In all events, all investors should consult their own tax advisors in determining the federal, state, local and other tax consequences to them of the purchase, ownership and disposition of the Series 2008B Bonds.

The opinions of the Attorney General of the State of Michigan and Co-Bond Counsel are not intended or written by the Attorney General of the State of Michigan or Co-Bond Counsel to be used and cannot be used by an owner of the Series 2008B Bonds for the purpose of avoiding federal tax penalties that may be imposed on the owner of the Series 2008B Bonds. The opinions of the Attorney General of the State of Michigan and Co-Bond Counsel are provided to support the promotion or marketing of the Series 2008B Bonds. In all events, all investors should consult their own tax advisors in determining the federal, state, local and other tax consequences to them of the purchase, ownership and disposition of the Series 2008B Bonds.

LITIGATION

There is no litigation pending in any court (either State or federal) to restrain or enjoin the issuance or delivery of the Series 2008 Bonds or questioning the creation, organization or existence of the Authority, the validity or enforceability of the Indenture, the sale of the 2006 Sold Tobacco Receipts by the State to the Authority, the proceedings for the authorization, execution, authentication and delivery of the Series 2008 Bonds or the validity of the Series 2008 Bonds.

RATINGS

It is a condition to the obligation of the Underwriters to purchase the Series 2008A Bonds that, at the date of delivery thereof to the Underwriters, the Series 2008A Bonds be assigned a rating of "Baa3" by Moody's Investors Service ("**Moody's**") and a rating of "BBB+" by Fitch Ratings ("**Fitch**" and, collectively with Moody's, the "**Rating Agencies**"). It is a condition to the obligation of the Underwriters to purchase the 2008B Bonds that, at the date of the delivery thereof to the Underwriters, the Series 2008B Bonds be assigned a rating of "BBB" by Fitch. It is a condition to the obligation of the Underwriters to purchase the Series 2008C Bonds, that, at the date of the delivery thereof to the Underwriters, the Series 2008C Bonds be assigned a rating of "BBB-" by Fitch.

The Turbo Term Bond Maturities for the Series 2008 Bonds were structured to produce cash flow stress test performance necessary for the Authority to achieve the targeted credit ratings. The ratings address each Rating Agency's assessment of (i) the payment of interest on the Series 2008 Bonds when

due, and (ii) the payment of Principal of Series 2008 Bonds by their Maturity Dates. The ratings will not address the payment of Sinking Fund Installments or Turbo Redemptions on Series 2008 Bonds. A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to revision or withdrawal at any time.

The ratings by Moody's and Fitch of the Series 2008 Bonds reflect only the views of such organizations and any desired explanation of the significance of such ratings and any outlooks or other statements given by such Rating Agencies with respect thereto should be obtained from the Rating Agency furnishing the same, at the following addresses: Moody's Investors Service, 7 World Trade Center, New York, New York 10007; Fitch Ratings, One State Street Plaza, New York, New York 10004.

There is no assurance that the initial ratings assigned to the Series 2008 Bonds will continue for any given period of time or that any of such ratings will not be revised downward, suspended or withdrawn entirely by any of the Rating Agencies. Any such downward revision, suspension or withdrawal of such ratings may have an adverse effect on the availability of a market for or the market price of the Series 2008 Bonds.

It is a condition to the issuance of Additional Bonds and Refunding Bonds that the Authority receive ratings confirmations on any Bonds Outstanding upon issuance of the Additional Bonds or Refunding Bonds. Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("**S&P**") and Moody's have confirmed that, upon the issuance of the Series 2008 Bonds, the ratings on the Series 2006A Bonds will remain "BBB" and "Baa3", respectively.

Moody's has indicated that its ratings on all tobacco securitizations bonds are currently under review with direction uncertain. Fitch's view of the tobacco industry is a key factor in its ratings of tobacco settlement securitizations. Fitch recently revised its outlook on the unsecured credit profile of the tobacco industry from negative to stable. S&P currently indicates that its ratings on all tobacco settlement securitizations have a Negative Outlook.

UNDERWRITING

The underwriters listed on the cover page hereof (the "**Underwriters**") have jointly and severally agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2008 Bonds from the Authority at an underwriters' discount of $1,002,215.48. The Underwriters will be obligated to purchase all of the Series 2008 Bonds if any are purchased. The initial public offering prices of the Series 2008 Bonds may be changed from time to time by the Underwriters.

Citigroup Global Markets Inc. is acting as representative on behalf of the Underwriters.

The Series 2008 Bonds may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Series 2008 Bonds into investment trusts) at prices lower than such public offering prices.

LEGAL MATTERS

Dickinson Wright PLLC, Lansing, Michigan, and Dykema Gossett PLLC, Lansing, Michigan, Co-Bond Counsel, and the Attorney General of the State, will each render an opinion with respect to the validity of the Series 2008 Bonds in substantially the forms set forth in Appendix C hereto.

Certain legal matters with respect to the State and the Authority will be passed upon by the Attorney General of the State and Dickinson Wright PLLC, Lansing, Michigan, and Dykema Gossett PLLC, Lansing, Michigan, as Co-Bond Counsel.

Certain legal matters will be passed upon for the Underwriters by Miller, Canfield, Paddock & Stone P.L.C., Lansing, Michigan, and Nixon Peabody LLP, New York, New York, as Co-Underwriters' Counsel.

OTHER PARTIES

Financial Advisor

First Southwest Company is employed as Financial Advisor to the Authority in connection with the issuance of the Series 2008 Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Series 2008 Bonds is not contingent upon the issuance and delivery of the Series 2008 Bonds. First Southwest, in its capacity as Financial Advisor, does not assume any responsibility for the information, covenants and representations contained in any of the legal documents with respect to the federal income tax status of the Series 2008 Bonds, or the possible impact of any present, pending or future actions taken by any legislative or judicial bodies.

The Financial Advisor to the Authority has provided the following sentence for inclusion in this Offering Circular. The Financial Advisor has reviewed the information in this Offering Circular in accordance with, and as part of, its responsibilities to the Authority and, as applicable, to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Financial Advisor does not guarantee the accuracy or completeness of such information.

Global Insight

Global Insight has been retained on behalf of the Authority as an independent econometric consultant. The Global Insight Consumption Report attached as Appendix A hereto is included herein in reliance on Global Insight as experts in such matters. Global Insight's fees for acting as the Authority's independent economic consultant are not contingent upon the issuance of the Series 2008 Bonds. The Global Insight Consumption Report should be read in its entirety before purchasing any Series 2008 Bonds.

MICHIGAN TOBACCO SETTLEMENT FINANCE AUTHORITY

By: /s/ Joseph L. Fielek
Authorized Officer

APPENDIX A

GLOBAL INSIGHT CONSUMPTION REPORT

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A Forecast of U.S. Cigarette Consumption (2008-2058) for Michigan Tobacco Settlement Finance Authority

Submitted to:

Michigan Tobacco Settlement Finance Authority

Prepared by:

Global Insight (USA), Inc.

June 26, 2008

Jim Diffley
Group Managing Director

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Executive Summary

Global Insight[1] has developed a cigarette consumption model based on historical U.S. data between 1965 and 2003. 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 2008 through 2058. Our Base Case Forecast indicates that total consumption in 2058 will be 144 billion cigarettes (approximately 7 billion packs), a 61% decline from the 2007 level. From 2007 through 2058 the average annual rate of decline is projected to be 1.82%. On a per capita basis consumption is projected to fall at an average rate of 2.47% per year.

We also present alternative forecasts that project higher and lower paths of cigarette consumption. Under these, less likely, scenarios we forecast that by 2058 U.S. cigarette consumption could be as low as 131 billion and as high as 157 billion cigarettes. In addition, we also present scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption.

Another alternative to the Base Case Forecast will result from a sharp increase in the federal excise tax on cigarettes. In September 2007, the U.S. Congress adopted legislation which would raise the excise tax by $0.61. In October, the President vetoed the bill and the Congress failed to override the veto. We forecast that, if the tax increase were to be enacted in 2008 or 2009, U.S. cigarette consumption would fall by an additional 4.5%, or 15.5 billion cigarettes, by 2010, and in 2058 will be 137 billion.

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

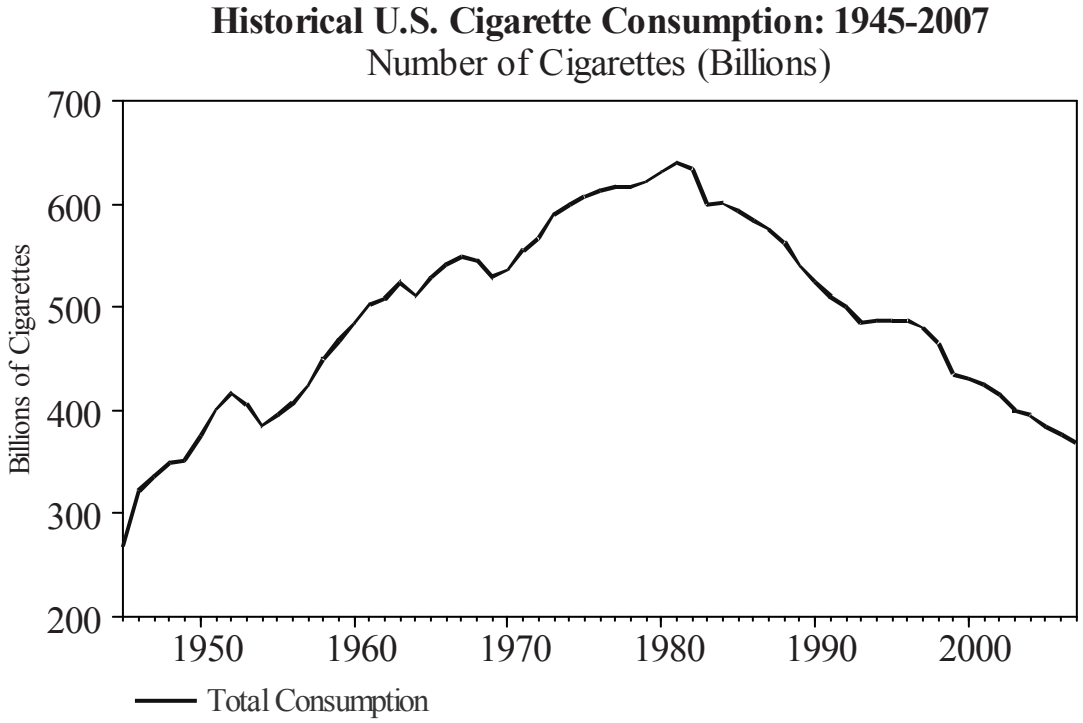
[1] On November 4, 2002, **DRI•WEFA** was re-named **Global Insight**.

Disclaimer

The projections and 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 projections and forecasts. The projections and forecasts contained in this report are based upon assumptions as to future events and, accordingly, are subject to varying degrees of uncertainty. Some assumptions inevitably will not materialize and, additionally, unanticipated events and circumstances may occur. Therefore, for example, actual cigarette consumption inevitably will vary from the projections and forecasts included in this report and the variations may be material and adverse.

Historical Cigarette Consumption

People have used tobacco products for centuries. Tobacco was first brought to Europe from America in the late 15th century and became America's major cash crop in the 17th and 18th centuries[2]. Prior to 1900, tobacco was most frequently used in pipes, cigars and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories[3] as reported by the Bureau of Alcohol Tobacco and Firearms. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion in 1900 to a peak of 640 billion in 1981[4]. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and decreased to less than 400 billion cigarettes in 2003[5] and an estimated 368 billion in 2007.



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, and

[2] *Source*: "Tobacco Timeline," Gene Borio (1998).
[3] Bureau of Alcohol, Tobacco and Firearms reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.
[4] *Source*: "Tobacco Situation and Outlook". U.S. Department of Agriculture-Economic Research Service. September 1999 (USDA-ERS).
[5] *Source*: USDA-ERS. April 2005.

exceeded previous levels by 1934. Following the release of the Surgeon General's Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.20% between 1965 and 1981. Between 1981 and 1990, however, cigarette consumption declined at an average annual rate of 2.2%. 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 recent declines are correlated with large price increases in 1998 and 1999 following the Master Settlement Agreement ("MSA"). In 2000 and 2001, the rate of decline moderated, to 1.2%. More recently, coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2005 to an annual rate of 2.5%

Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) began to decline following the Surgeon General's Report in 1964. Population growth offset this decline until 1981. The adult population grew at an average annual rate of 1.9% for the period 1965 through 1981, 1.2% from 1981 to 1990 and 1.0% from 1990 to 1999. Adult per capita cigarette consumption declined at an average annual rate of 0.7% for the period 1965 to 1981, 3.3% for the period 1981 to 1990 and 2.5% for the period 1990 to 1998. In 1998 the per capita decline in cigarette consumption was 4.2% and in 1999 the decline accelerated to 7.5%. These sharp declines are correlated with large price increases in 1998 and 1999 following the MSA. All percentages are based upon compound annual growth rates.

The following table sets forth United States domestic cigarette consumption for the ten years ended December 31, 2007[6]. The data in this table vary from statistics on cigarette shipments in the United States. While our Report is based on consumption, payments made under the MSA dated November 23, 1998 between certain cigarette manufacturers and certain settling states are computed based in part on shipments in or to the fifty United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

[6] *Source:* USDA-ERS; 2004, 2005, 2006, estimates by 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
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

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according to reports of the manufacturers, the three leading manufacturers accounted for 86.7% of U.S. shipments in 2007. These top companies were Philip Morris, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. These companies commanded 49.0%, 27.4%, and 10.3%, respectively of the domestic market in 2007. The market share of the leading manufacturers has declined from over 96% in 1998 due to inroads by smaller manufacturers and importers following the Master Settlement Agreement.

The United States government has raised revenue through tobacco taxes since the Civil War. Although the federal excise taxes have risen through the years, excise taxes as a percentage of total federal revenue have fallen from 3.4% in 1950 to approximately 0.42% today. In fiscal year 2006, the federal government received $7.7 billion in excise tax revenue from tobacco sales. In addition, state and local governments also raised significant revenues, $14.0 billion in 2006, from excise and sales taxes. Cigarettes constitute the majority of these sales, which include cigars and other tobacco products.

Survey of the Economic Literature on Smoking

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

Incidence of Smoking

Approximately 45.3 million American adults were current smokers in 2006, representing approximately 20.8% of the population age 18 and older, according to a Centers for Disease Control and Prevention ("CDC") study[7] released in November, 2007. 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,[8] the incidence rate declined relatively slowly through the following decade. The decline had accelerated between 2002, when the incidence rate was 22.5%, to 2004, when incidence dropped to 20.9%.

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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 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, the incidence had fallen to 21.9%, a decline of 37.1% over four years. Though the 2005 survey found no further change, by 2007[9], the prevalence declined further, to 20.0%.[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 and tenth graders was lower in 2007 than in 2006, continuing trends that began in 1996.

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[7] *Source*: CDC. Morbidity and Mortality Weekly Report. "Tobacco Use Among Adults – United States, 2005". October 20, 2006.
[8] *Source*: CDC. Office on Smoking and Health.
[9] *Source*: CDC. Morbidity and Mortality Weekly Report. "Cigarette Use Among High School Students --- United States, 1991-2005". July 7, 2006.
[10] *Source*: CDC. Morbidity and Mortality Weekly Report. "Youth Risk Behavior Survey ---United States, 2007". June 6, 2008

Among those students in twelfth grade, incidence remained unchanged from 2006 after having declined in 2005 and 2006. Smoking incidence in all grades is well below where it was in 1991, having fallen below that mark in 2001 for eighth graders and in 2002 for tenth and twelfth graders.

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

Grade	1991 (%)	2006 (%)	2007 (%)	'06-'07 Change (%)	'91-'07 Change (%)
8th	14.3	8.7	7.1	-18.4	-50.4
10th	20.8	14.5	14.0	-3.5	-32.7
12th	28.3	21.6	21.6	0.0	-23.7

A report from the New York City Youth Risk Behavior Survey finds that smoking among New York City high school students decreased by 52% from 1997 to 2007.[11] Over this period New York City has raised excise taxes to the highest in the nation and instituted a comprehensive indoor smoking ban. Youth smoking rates also declined sharply in Massachusetts. The Department of Public Health reported in 2008 that smoking rates among high school students fell from 20.5% in 2005 to 17.7% in 2007. It was the first significant drop this decade and came as renewed efforts were announced by the Commonwealth to discourage adolescent tobacco use.

The 2006 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 estimated that approximately 61.6 million Americans age 12 and older were current cigarette smokers (defined by this survey to mean they had smoked cigarettes at least once during the 30 days prior to the interview). This estimate represents an incidence rate of 25.0%, unchanged from 2005, but down from 26.0% in 2002. The same survey found that an estimated 10.4% of youths age 12 to 17 were current cigarette smokers in 2006, down from 11.9% in 2004 and 13.0% in 2002.

New Jersey recently raised the minimum legal age to purchase cigarettes from 18 to 19 years. Three states, Alabama, Alaska, and Utah, also set the minimum age at 19.

[11] New York City Department of Health and Mental Hygiene. "Smoking among New York City Public High School Students". NYC Vital Signs. January 2008.

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.[12] (In other words, as the price of cigarettes increases by 1.0% the quantity demanded decreases by 0.3% to 0.5%.) A few researchers have estimated price elasticity as high as -1.23. Research focused on youth smoking has found price elasticity levels of up to -1.41.

Two studies published by the National Bureau of Economic Research examine the price elasticity of youth smoking. In their study on youth smoking in the United States, Gruber and Zinman estimate an elasticity of smoking participation (defined as smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to 1997.[13] That is, a 1% increase in cigarette prices would result in a decrease of 0.67% in the number of those seniors who smoked. The study's findings state that the drop in cigarette prices in the early 1990's can explain 26% of the upward trend in youth smoking during the same period. The study also found that price has little effect on the smoking habits of younger teens (8th grade through 11th grade), but that youth access restrictions have a significant impact on limiting the extent to which younger teens smoke. Tauras and Chaloupka also found an inverse relationship between price and cigarette consumption among high school seniors.[14] The price elasticity of cessation for males averaged 1.12 and for females averaged 1.19 in this study. These estimates imply that a 1% increase in the real price of cigarettes will result in an increase in the probability of smoking cessation for high school senior males and females of 1.12% and 1.19%, respectively. A study utilizing more recent data, from 1975 to 2003, by Grossman, estimated an elasticity of smoking participation of just -0.12.[15] Nevertheless it concludes that price increases subsequent to the 1998 MSA explain almost all of the 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

[12] Chalpouka FJ,Warner KE:P.5.
[13] *Source*: Gruber, Jonathon and Zinman, Jonathon. "Youth Smoking in the U.S.:Evidence and Implications". Working Paper No. W7780. National Bureau of Economic Research. 2000.
[14] Source: Tauras, John A. and Chaloupka, Frank, J.. "Determinants of Smoking Cessation: An Analysis of Young Adult Men and Women". Working Paper No. W7262. National Bureau of Economic Research. 1999.
[15] Michael Grossman. "Individual Behaviors and Substance Use: The Role of Price". Working Paper No. W10948. National Bureau of Economic Research. December 2004.

that a 1% increase in cigarette prices, will reduce smoking participation among college students by 0.26% and will reduce the level of smoking among current college students by 0.62%.[16]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[17] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least one to five cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticities of initiation are –0.27 for any smoking, -0.81 for smoking at least one to five cigarettes, and –0.96 for smoking at least one-half pack of cigarettes. These results above indicate that a 10% increase in the price of cigarettes will decrease the probability of smoking initiation between approximately 3% and 10% depending on how initiation is defined. In a related study, Powell et al. (2003) estimated a price elasticity of youth smoking participation of –0.46, implying that a 1% increase in price leads to a 0.46% reduction in smoking participation.[18]

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. One study, by Hu et al., examines the effects of nicotine replacement products on cigarette consumption in the United States.[19] 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 October 2002, the FDA approved the Commit lozenge for over-the-counter sale. This product is similar to the gum and patch nicotine replacement products. It is unclear whether it offers a significant advantage over those other products.[20] NicoBloc, a liquid applied to cigarettes which blocks tar and nicotine from being inhaled, is another new cessation product on the market since 2003. Zyban is

[16] 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.
[17] Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press. Copyright 2001.
[18] Powell et al. "Peer Effects, Tobacco Control Policies, and Youth Smoking Behavior". Impacteen. February 2003.
[19] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. http:\\tc.bmjjournals.com.
[20] Niaura, Raymond and Abrams, David B. "Smoking Cessation: Progress, Priorities, and Prospectus". Journal of Consulting and Clinical Psychology. June 2002.

a non-nicotine drug that has been available since 2000. It has been shown to be effective when combined with intensive behavioral support.[21]

In 2006 the Food and Drug Administration (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. Through June 2007, nearly 2.5 million prescriptions had been filled, and the company reports continued strong growth into 2008. 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.

Several new drugs may also appear on the market in the near future. On May 14, 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. Novartis has acquired the license to the vaccine, and has reported positive results toward Phase III trials. Nabi Biopharmaceuticals has successfully completed its Phase IIB clinical trials for NicVAX, a vaccine to prevent and treat nicotine addiction. It triggers antibodies that bind with Nicotine molecules. In 2006, NicVAX received Fast Track Designation from the FDA, which is intended to expedite its review process. Phase III trials are the remaining step before a license application. The Xenova Group is set to begin Phase II testing of its similar vaccine, Ta-Nic. And positive results were reported in July 2006 by Somaxon Pharmaceuticals from a pilot Phase II study of Nalmefene. Nalmefene has been used for over 10 years for the reversal of opioid drug effects. The company is seeking to develop it as a treatment for impulse control disorders. In 2008, Evotec AG announced it would launch a Phase II study of EVT 302, a drug intended to ease smoker's cravings and nicotine withdrawal symptoms after cigarette deprivation. It is expected that products such as these 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.

Workplace Restrictions

In their 1996 study on the effect of workplace smoking bans on cigarette consumption, Evans, Farrelly, and Montgomery found that between 1986 and 1993 smoking participation rates among workers fell 2.6% more than non-workers.[22] Their results

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

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

suggest that workplace smoking bans reduce smoking prevalence by 5 percentage points and reduce consumption by smokers nearly 10%. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day that a smoker spends working in an environment where there are smoking restrictions, the greater is the decline in the quantity of cigarettes consumed by that smoker.

Factors Affecting Cigarette Consumption

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

General Population Growth. Global Insight forecasts that the United States population will increase from 283 million in 2000 to approximately 425 million in 2058. This forecast is consistent with the Bureau of the Census forecast based on the 2000 Census.

Price Elasticity of Demand & Price Increases. Cigarette price elasticities from recent conventional research studies have generally fallen within an interval of -0.3 to -0.5. Based on Global Insight's multivariate regression analysis using data from 1965 to 2003, 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 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. The cigarette manufacturers then increased wholesale prices on seven occasions between August 1999 and April 2002, with the total change aggregating to $0.82. In addition to the wholesale price increases, in 1999 New York and California each increased its state excise tax by $0.50 per pack. In 2001, five states followed suit, and in January 2002, a scheduled increase in the federal excise tax of $0.05 per pack went into effect. By June 2002 the average price per pack had reached $3.73.

Severe budget shortfalls following the 2001 recession led at least 30 states to consider cigarette excise tax increases in 2002. Ultimately 20 states and New York City imposed excise tax increases that year. These increases ranged from $0.07 per pack in Tennessee

to $1.42 per pack in New York City. They averaged $0.47 per pack, and, when weighted by the state population, boosted the nationwide average retail price by $0.18. This increased the population-weighted average state excise tax to over $0.60 per pack. The trend continued in 2003, as state fiscal difficulties persisted. Excise tax increases were enacted in 13 states, pushing the average price per pack to over $3.80. This was followed by eleven state tax increases in 2004 and eight (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee" which has the same effect on consumer prices. This report will consider any such fees as equivalent to excise taxes.

In 2006 Texas passed a budget that raised the state excise tax by $1.00 in January 2007. Also in 2006 Hawaii, New Jersey, North Carolina, and Vermont enacted legislation which raised excise taxes. As a result the population-weighted average state excise tax increased to $0.932 per pack. In the November elections referenda passed in Arizona and South Dakota raising excise taxes. Increases in California and Missouri were rejected by voters. As a result of these actions the weighted average state excise tax increased to $1.038 per pack.

In 2007 Connecticut, Delaware, Iowa, Indiana, Maryland, New Hampshire, Tennessee, and Wisconsin each increased excise taxes. These actions pushed the average state excise tax to $1.116 in January 2008. New York State in April 2008 enacted an increase of $1.25 per pack, and in May the District of Columbia increased its tax by $1.00 per pack. These increases will raise the weighted average excise tax to $1.197. It is expected that other states will also enact increases in 2008 and in future years. Florida, Georgia, Kansas, Massachusetts, New Hampshire, North Carolina, Pennsylvania, and Utah are now considering excise tax increases. In Massachusetts, the House of Representatives and the Senate have each approved an increase of $1.00 per pack. Though California voters rejected a ballot initiative on November 7, 2006 that would have raised the tax from $0.87 to $3.47 per pack, California lawmakers have introduced a bill which would raise the tax by $2.00 per pack.

The federal excise tax has remained constant, at $0.39 per pack, since 2002. The U.S. Congress adopted legislation which would have raised the tax by $0.61. But on October 3, 2007 the President vetoed the bill, and on October 18 the House of Representatives failed to override the veto. Subsequent override attempts in November and in January 2008 also failed. If the tax increase were to be enacted the federal excise tax would equal $1.00 per pack, and the total state and federal excise tax would exceed $2.00 per pack.

During much of this period, 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 has been stable since 2003. As 2004 came to a close, the

manufacturers raised list prices for the first time since 2002. The major manufacturers have raised prices or reduced discounts and promotions in each year since 2004. The average price in December 2006 was $4.24 per pack. Following further wholesale price and excise tax increases it had increased to $4.64 in April 2008. In May 2008, Philip Morris announced a reduction in promotional discounts that raised the price of its cigarettes by $0.09 per pack. May 2008 data indicates that the average market price was $4.68 per pack.

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

Premium brands are typically $0.50 to $1.00 more expensive per pack than discount brands, allowing a margin for consumers to switch to less costly discount brands in the event of price increases. The increasing availability of cigarette outlets on Indian reservations, where sales are exempt from taxes, provides another opportunity for consumers to reduce the cost of smoking. Similarly, Internet sales of cigarettes are growing rapidly, though a recent decision by credit card companies that they would not handle cigarette sales has started to have an impact and will dampen this growth. While these sales are not technically exempt from taxation, states are currently having a difficult time enforcing existing statutes and collecting excise taxes on these sales.[23] 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.

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.[24] However, a few studies found cigarette consumption decreases as disposable income increases.[25] 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%.

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,[26] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[27] One study examines the effects of youth smoking on future adult smoking.[28] 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

[23] *Source*: United States General Accounting Office. "Internet Cigarette Sales". GAO-02-743. August 2002.
[24] Ippolito, et al.; Fuji.
[25] Wasserman, et al.; Townsend et al.
[26] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.
[27] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."
[28] *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.

are better means for quitting smoking than in the past, and there will be more indoor smoking bans in effect over time.

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

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

Health Warnings. Categorical variables also have been used to capture the effect of different time periods on cigarette consumption. For example, some researchers have identified the United States Surgeon General's Report in 1964 and subsequent mandatory health warnings on cigarette packages as turning points in public attitudes and knowledge of the health effects of smoking. The Cigarette Labeling and Advertising Act of 1965 required a health warning to be placed on all cigarette packages sold in the United States beginning January 1, 1966. The Public Health Smoking Act of 1969 required all cigarette packages sold in the United States to carry an updated version of the warning, stating that it was a Surgeon General's warning, beginning November 1, 1970. The Comprehensive Smoking Education Act of 1984 led to even more specific health warnings on cigarette packages. The dangers of cigarette smoking have been generally known to the public for years. Part of the negative trend in smoking identified in our model may represent the cumulative effect of various health warnings since 1966.

Five states, Alabama, Georgia, Idaho, Kentucky 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.[29]

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

The most comprehensive bans have been enacted since 1998 in 30 states and a number of large cities. In 1998, California imposed a comprehensive smoking ban for all indoor workplaces, including restaurants and bars. Delaware followed suit in 2002, and in 2003, Connecticut, Maine, New York, and Florida passed similar comprehensive bans, as did the cities of Boston and Dallas. Since then, Arizona, Arkansas, Colorado, the District of Columbia, Hawaii, Illinois, Iowa, Louisiana, Maryland, Massachusetts, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Utah, Vermont, Washington, and Puerto Rico established similar bans, as did the cities of Baltimore, Chicago, Houston, and Philadelphia. The New Mexico, Washington State and Chicago restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. It is expected that these restrictions will continue to proliferate. For example, in 2008 at least 7 states, Alabama, Kansas, Michigan, Missouri, North Carolina, South Carolina, and Tennessee, are considering legislation which would enact comprehensive bans.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of April 1, 2008, there were 2,791 municipalities with indoor smoking restrictions. Of these, 554 local governments required workplaces to be 100% smoke-free, and 100% smoke-free conditions were required for restaurants by 522 governments, and for bars by 393. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. 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. These numbers grew to 49 for restaurants and 32 for bars in 1998, and doubled again by 2001, to 100 and 74, respectively.[30]

Based on the regression analysis using data from 1965 to 2003, the restrictions on public smoking appear to have an independent effect on per capita cigarette consumption. We estimate that the restrictions instituted beginning in the late 1970's have reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. Bauer, et al. estimate that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[31] 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.[32] The study predicts that moving from no smoking restrictions at all to the most restrictive bans reduces average smoking by from 5% to 8%.

[30] *Source:* American Nonsmokers' Rights Foundation. http://www.no-smoke.org. April 2008.
[31] 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
[32] Tauras, John A. "Smoke-Free Air Laws, Cigarette Prices, and Adult Cigarette Demand" Economic Inquiry, April 2006.

The first extensive outdoor smoking restrictions were instituted on March 2006 in Calabasas, California. The city of Oakland, and the California municipalities of Belmont, Beverly Hills, Dublin, El Cajon, Emeryville, Hayward, Loma Linda, and Santa Monica have also established extensive outdoor restrictions, as have Davis County and the city of Murray in Utah. Burbank, CA is expected to follow suit. And in the most restrictive version to date, the California cities of Belmont and Calabasas have approved ordinances which restrict smoking anywhere in the city except for single-family detached homes. Many landlords and condominium associations have also established smoke-free apartment policies. In May 2008 the California State Senate passed proposed legislation which would allow landlords to prohibit smoking in apartment buildings. And the Massachusetts Department of Public Health is conducting a survey of landlords, tenants, and condominium associations to assess the feasibility of making residences smoke-free.

In the past year, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties have banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. The beach restrictions may soon become statewide. Chicago approved beach and parkground smoking restrictions in October 2007. Sarasota County and Boca Raton, Florida have banned smoking on their beaches, and Nassau County, New York and Volusia County, Florida are also considering park and beach bans. At least 43 colleges nationwide now prohibit smoking everywhere on campus. California, Illinois, Michigan, and Nevada have banned smoking in 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 Arizona, California, Connecticut, Illinois, Indiana, Iowa, Kansas, Massachusetts, Montana, New Jersey, New York, Oregon, Rhode Island, South Carolina, Utah, and West Virginia.

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.

The trend variable included in our econometric analysis is likely to incorporate some part of the cumulative impact of the various smoking bans and restrictions. Our forecast assumes that the factors, which have contributed to the negative trend in smoking in the U.S. population, continue to contribute to further declines in smoking rates throughout the forecast horizon. However, should there be a proliferation of the most severe bans, such as those extensively limiting outdoor smoking, or smoking anywhere children might be affected, consumption declines would very likely accelerate.

Smokeless Tobacco Products. 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 has been declining in the U.S. in this decade, but moist snuff consumption has increased at an annual rate of more than 5% since 2002, and by 10.4% in 2006, when over 5 million consumers purchased 1.1 billion cans. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco is explicitly targeting adult smoker conversion in its growth strategy. The industry is 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. In 2006 the three largest U.S. cigarette manufacturers entered the market. Philip Morris introduced a snuff product, Taboka, Reynolds American acquired Conwood Company, the second largest domestic producer, and introduced Camel Snus, a snuff product, and Lorillard entered into an agreement with Swedish Match North America to develop smokeless products in the U.S. Product development has continued in 2007 with the introduction by Philip Morris of Marlboro snus and snuff products. In October 2007, Philip Morris announced that it would accelerate the development of snuff and less-harmful cigarettes to counter a decline in smoking. In 2008, Liggett announced it would introduce Grand Prix snus.

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.[33] 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.[34] Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

In 2008 a new firm, Fuisz Tobacco, was formed to commercialize a film-based smokeless tobacco product. The thin film strip would be spitless and would dissolve entirely in the cheek.

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

[34] 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.

Similar to the case of smoking bans, this report assumes that the trend decline in smoking projected in this forecast is sufficient to incorporate the negative impact that increasing use of snuff may have on cigarette consumption.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[35] and the American Medical Association[36] (AMA) both have concluded that nicotine is an addictive drug which produces dependence. The American Psychiatric Association has determined that cigarette smoking causes nicotine dependence in smokers and nicotine withdrawal in those who stop smoking. The American Medical Association Council on Scientific Affairs found that one-third to one-half of all people who experiment with smoking become smokers.

Other Considerations. In August 1999, the CDC published Best Practices for Comprehensive Tobacco Control Programs. Citing the success of programs in California and Massachusetts, the CDC recommends comprehensive tobacco control programs to the states. On August 9, 2000, the Surgeon General issued a report, Reducing Tobacco Use ("Surgeon General's Report"), that comprehensively assesses the value and efficacy of the major approaches that have been used to reduce tobacco use. The report concludes that a comprehensive program of educational strategies, treatment of nicotine addiction, regulation of advertising, clean air regulations, restriction of minors' access to tobacco, and increased excise taxation can significantly reduce the prevalence of smoking. The Surgeon General called for increased spending on anti-smoking initiatives by states, up to 25% of their annual settlement proceeds, which is far higher than the approximately 9% allocated from the first year's settlement payments.

The Surgeon General's Report documents evidence of the effectiveness of five major modalities for reducing tobacco use. Educational strategies are shown to be effective in postponing or preventing adolescent smoking. Pharmacologic treatment of nicotine addiction, combined with behavioral support, can enhance abstinence efforts. Regulation of advertising and promotional activities of manufacturers can reduce smoking, particularly among youth. Clean air regulations and restricted minor's access contribute to lessening smoking prevalence. And excise tax increases will reduce cigarette consumption. Further support for the efficacy of such programs is provided in an analysis by Farrelly, Pechacek, and Chaloupka.[37] They estimate that tobacco control program expenditures between 1988 and 1998 resulted in a decline in cigarette sales of 3%. Tauras, et al. estimate that, had state tobacco control spending been maintained at the levels recommended by the CDC, youth smoking rates would have been from 3.3% to 13.5% lower.[38] Also, Farrelly et al. estimate that 22% of the decline in youth smoking

[35] *Source:* Surgeon General's 1988 Report. "The Health Consequences of Smoking – Nicotine Addiction".
[36] *Source*: Council on Scientific Affairs. "Reducing the Addictiveness of Cigarettes". Report to the AMA House of Delegates. June 1998.
[37] "The Impact of Tobacco Control Program Expenditures on Aggregate Cigarette Sales: 1981-1998." Working Paper No. 8691, National Bureau of Economic Research, 2001.
[38] Tauras, Chaloupka, Farrelly, Giovino, Wakefield, Johnston, O'Malley, Kloska, and Pechacek. "State Tobacco Control Spending and Youth Smoking", *American Journal of Public Health*, February 2005.

from 1999 to 2002 was due to the national "truth" mass media campaign.[39] In 2002, New York City implemented a strategy which sharply increased excise taxes, banned smoking in bars and restaurants, distributed free nicotine patches, and expanded educational efforts. Research by Frieden et al. estimates that smoking prevalence in the City declined by 11% as a result of these measures, an effect consistent with the conclusions of the Surgeon General's Report.[40]

In May 2001 a Commission established by President Clinton in September 2000 released its final report on how to improve economic conditions in tobacco dependent economies while making sure that public health does not suffer in the process.[41] The Commission recommended moving from the current quota system to what would be called a Tobacco Equity Reduction Program (TERP). TERP would allow compensation to be rendered to quota owners for the loss in value of their quota assets as a result of a restructuring to a production permit system where permits would be issued annually to tobacco growers. Also created would be a Center for Tobacco-Dependent Communities, which would address any challenges faced during this period. Three public health proposals that were suggested by the Commission were: that states increase funding on tobacco cessation and prevention programs; that the FDA be allowed to regulate tobacco products in a "fair and equitable" manner; and that funding be included in Medicaid and Medicare coverage for smoking cessation. To be able to fund these recommendations, the Commission called for a 17-cent increase in the excise tax on all packs of cigarettes sold in the United States. The increased revenues would then be deposited into a fund and earmarked for the recommended programs. On February 13, 2003, the Interagency Committee on Smoking and Health, which reports to the U.S. Department of Health and Human Services, issued recommendations, which included raising the federal excise tax on cigarettes from $0.39 to $2.39 per pack. The purpose of the tax increase would be to discourage smoking and to fund anti-tobacco efforts.

Neither the Surgeon General's nor the Presidential Commission's report have resulted in a concerted nationwide program to implement their recommendations, though legislation to establish FDA regulation was re-introduced in 2005 and again on February 15, 2007 as the Family Smoking Prevention and Tobacco Control Act. The bill would give the FDA broad authority over the sale, distribution, and advertising of tobacco products. Such legislation would, among other anticipated changes, permit the FDA to strengthen warning labels, reduce nicotine levels in tobacco products, police false or misleading advertising and marketing aimed at children and would require manufacturers to provide the FDA with lists of ingredients and additives in their products, including nicotine.

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[39] Farrelly, Davis, Haviland, Messeri, and Healton."Evidence of a Dose-Response Relationship Between "truth" Antismoking Ads and Youth Smoking Prevalence". *American Journal of Public Health.* March 2005.

[40] Frieden, Mostashari, Kerker, Miller, Hajat, and Frankel. "Adult Tobacco Use Levels After Intensive Tobacco Control Measures: New York City, 2002-2003". American Journal of Public Health. June 2005.

[41] "Tobacco at a Crossroad: A Call for Action". President's Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production While Protecting Public Health. May 14, 2001.

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.[42] Similarly, the Justice Department has indicated that, as part of a lawsuit against the tobacco companies, it may seek to require graphic health warnings covering 50% of cigarette packs. In addition, it would prohibit in-store promotions and require that all advertising and packaging be black-and-white. A similar proposal is part of the World Health Organization's Framework Convention on Tobacco Control, which the U.S. may sign. As the prevalence of smoking declines, it is likely that the achievement of further declines will require either greater levels of spending, or more effective programs. This is the common economic principle of diminishing returns**.**

In August 2007, the President's Cancer Panel issued a report which included a series of recommendations to reduce Americans' cancer risk. These included FDA regulation of the tobacco industry, increased federal and state excise taxes on tobacco, increased funding of tobacco prevention and cessation programs, and the enactment in all states of smoke-free laws which cover restaurants and bars.

Also in 2007, the Motion Picture Association of America promised to consider the amount of smoking depicted in a film as a determinant in assigning it an R rating, one which limits youth attendance. Researchers at the University of California at San Francisco have concluded that viewing on-screen smoking is linked to smoking among young adults.

In 2000, New York State mandated that manufacturers provide, beginning in 2003, only cigarettes that self-extinguish. These standards went into effect in 2004. Similar laws have been enacted twenty-six other states. We do not believe that these statutes or a nationwide agreement on such standards will affect consumption noticeably. It will probably raise the cost of manufacture slightly, but we view it as a continuation of a long series of government actions that contribute to the trend decline in consumption, which has been incorporated into our model. The expense and availability of technology required in the manufacture of self-extinguishing cigarettes may put the smaller manufacturers at a slight competitive disadvantage, as their cost per pack would increase more relative to the cost per pack increase for the larger manufacturers. Two major manufacturers, Reynolds American and the Liggett Group, have announced that, by 2009, they would sell only fire-safe cigarettes in the U.S.

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

Similarly, in January 2001, Vector Group Ltd. announced plans for a virtually nicotine-free cigarette. The product, Quest, was introduced on January 27, 2003. This non-addictive product might be used as a tool to quit or reduce smoking. We view this as a continuation of efforts to provide products, such as the nicotine patch, that are supposed to reduce smoking addiction. These products have likely contributed to the trend decline in consumption incorporated into our model. In our forecast, we expect such efforts to continue to reduce per capita cigarette consumption.

An Empirical Model of Cigarette Consumption

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

1) the real price of cigarettes (cigprice)
2) the level of real disposable income per capita (ydp96pc)
3) the impact of restrictions on smoking in public places (smokeban)
4) the trend over time in individual behavior and preferences (trend)

We used the tools of standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the U.S. Then, using that relationship, along with Global Insight's standard adult population growth, and adjustment for non-adult smoking, we projected actual cigarette consumption (in billions of cigarettes) out to 2058. It should also be noted that since our entire dataset incorporates the effect of the Surgeon General's health warning (1964), the impact of that variable too is accounted for in the forecast. Similarly the effect of nicotine dependence is incorporated into our entire dataset and influences the trend decline.

Using U.S. data from 1965 through 2003 on the variables described above, we developed the following regression equation. All of the data sources are detailed in Appendix 1 of this Report.

log (cpc)	=	57.7	-	0.024 * trend
	-	0.223 * log (cigprice)	-	0.106 * log (cigprice)(-1)
	+	0.270 * log (ydp96pc)	-	0.020 * smokeban .

The model is estimated in logarithmic form, since that allows the easy computation of the responsiveness (or elasticity) of the dependent variable (adult per capita cigarette consumption) to changes in the various explanatory (or the right hand side) variables.

This model has an R-square in excess of 0.99, meaning that it explains more than 99 percent of the variation in U.S. adult per capita cigarette consumption over the 1965 to 2003 period. In terms of explanatory power this indicates a very strong model with a high level of statistical significance.

Our model is completed with two other equations:

(1) Total adult cigarette consumption =

cpc * U.S. adult population.

(2) Total cigarette consumption =

total adult cigarette consumption + total youth cigarette consumption.

We have measured the consumption level of cigarettes in the 12-17 age group by examining the difference between total consumption and total adult consumption. We then use the expected trend of youth smoking incidence to adjust for the volume of cigarette consumption in this age group. Youth incidence is expected to gradually decline, and our estimated consumption levels will fall to 1.2 billion in 2058.

Dependent Variable

Adult Per Capita Cigarette Consumption (CPC)

CPC measures the average annual cigarette consumption of the American adult. It is calculated by dividing total adult cigarette consumption by the size of the population (18 years and above). Of the different measures of cigarette consumption available, this is considered to be the most reliable. It also directly reflects the changing behavior of individual smokers over the historical period. Data were obtained from the U.S. Department of Agriculture's (USDA) Economic Research Service.

Explanatory Variables

The Real Price of Cigarettes (CIGPRICE)

Reliable data on retail cigarette prices from the consumer price index (CPI) are only available since 1997, an inadequate time frame to build our model. However, tobacco CPI, which is available for the entire period of analysis, closely follows cigarette prices,

since cigarettes constitute over 95 percent of tobacco products. We have, therefore, used the tobacco CPI in our model, as is standard. Further, we have deflated this price of cigarettes (tobacco) by the overall price level to ensure that any change in cigarette consumption is correctly attributed to a change in the price of cigarettes relative to other goods, rather than an overall change in the price level. The overall, as well as tobacco CPI, were obtained from the Bureau of Labor Statistics (BLS).

The coefficient on CIGPRICE in the regression equation measures the elasticity of cigarette consumption with respect to price. In our model this effect consists of two parts. The coefficient of –0.223 measures the short-run elasticity of cigarette demand. That is, a 1% increase in price reduces consumption by 0.223% in the current year. The second coefficient, -0.106 relates to prices in the previous year. It indicates that, following a 1% increase, an additional decrease in cigarette consumption of 0.106% will occur. Thus, according to the data, a one percent increase in price decreases cigarette consumption by 0.329 percent in the long term. The low value of the elasticity indicates that cigarette consumption is price inelastic, or relatively unresponsive to changes in price. This coefficient is estimated such that a statistical confidence interval of 95% places its value between -0.25 and -0.41. This implies that there is a probability of 5% that the price elasticity is outside this range.

Real Disposable Income Per Capita (YDP96PC)

Real disposable income per capita measures the average income per person after tax in constant 1996 dollars. Data used were collected by the Bureau of Economic Analysis (BEA). For goods considered “normal”, consumption increases as incomes rise. Hence the coefficient is positive. On the other hand if the coefficient is negative, it indicates that the good is “inferior” and less is purchased as incomes rise.

Our analysis indicates that the income elasticity of cigarettes, given by the regression coefficient on YDP96PC, is 0.27. The positive sign on the coefficient indicates that cigarettes are a normal good. Specifically, every percent increase in real disposable income per capita has raised adult per capita cigarette consumption by 0.27%. However, the low value of the elasticity indicates that the demand for cigarettes is income inelastic, or relatively unresponsive to changes in income. This coefficient (0.27) is estimated such that a statistical confidence interval of 95% places its value between 0.03 and 0.52. This implies that there is a probability of 5% that the income elasticity is outside this range.

Qualitative Variable

The qualitative variable that we have explicitly included in our model relates to the restrictions on public smoking since the 1980s (SMOKEBAN). The negative coefficient on the variable implies that smoking decreases as a result of smoking bans. The coefficient on SMOKEBAN is estimated such that a statistical confidence interval of

95% for its value is from 0 to -0.53. This implies that there is a probability of 5% that the coefficient is outside this range.

Trend and Constant Term

According to the regression equation specified above, adult cigarette consumption per capita (CPC) displays a trend decline of 2.40% per year. The trend reflects the impact of a systematic change in the underlying data that is **not** explained by the included explanatory variables. In the case of cigarette consumption, the systematic change is in public attitudes toward smoking. The trend may also reflect the cumulative impact of health warnings, advertising restrictions, and other variables which are statistically insignificant when viewed in isolation. This trend, primarily due to an increase in the health-conscious proportion of the population averse to smoking, would by itself account for 90.3% of the variation in consumption. This coefficient is estimated such that a statistical confidence interval of 95% for its value is from 0.0195 to 0.0269 (1.95% to 2.69%). This implies that there is a probability of 5% that the trend rate of decline is outside this range.

The constant term (57.7) also reflects the impact of excluded variables, those that stay fixed over time (e.g., the health warnings on cigarette packs). It should be noted that the actual decline in CPC in any given year could be above or below the trend, depending on the values of the other explanatory variables.

Forecast Assumptions

Our forecast is based on assumptions regarding the future path of the explanatory variables in the regression equation. Projections of U.S. population and real per capita personal disposable income are standard Global Insight forecasts. Annual population growth is projected to average 0.8%, and real per capita personal disposable income is projected to increase over the long term at just over 2.1% per year.

The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the tobacco settlement. Cigarette prices increased dramatically in November 1998, as manufacturers raised prices by $0.45 per pack. Subsequent increases 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, and to $4.47 in 2007. After a long period of fighting to maintain market share, the large cigarette manufacturers are expected to reduce discounts and other promotions. Price increases were announced in the fourth quarter of 2006 and again, by $0.05, in the third quarter of 2007, and $0.09 by Philip Morris in May 2008. In addition many states continue to discuss excise tax increases.

Our model, intended for long-term forecasting, uses annual data to describe changes in prices and other variables. When viewed over long intervals of time, the changes will

appear to be gradual. The purpose of the model is to capture these broad changes and their influence on consumption. Because cigarette manufacturing is dominated by a few firms, price changes will typically be discrete events, with jumps such as occurred in August 1999 and December 2004, followed by plateaus, rather than small and continuous changes. The exact timing during the year of price changes influences only the short-term path of consumption.

The forecast assumes that average prices will reach $4.68 per pack in 2008 and $4.92 in 2009. Our forecast assumptions have incorporated price increases in excess of general inflation in order to meet the requirements of the MSA and offset excise and other taxes. Based upon our general inflation and cost assumptions, we anticipate that the nominal price per pack of cigarettes will rise to $44.46 by 2058, which is $9.87 in 2000 dollars. 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.

Prior to the MSA, only once, in 1983, have real cigarette prices appreciated at a double digit, or greater than 10%, rate. If a 10% rate of price increase were to continue, the annual rate of decline in cigarette consumption predicted by our model would increase to approximately 4%.

Our Base Case Forecast assumes that the incidence of youth smoking will continue to decline. By 2058 we assume that youth smoking will have declined at an average annual rate of 2.8% since 2001, or by 80% overall.

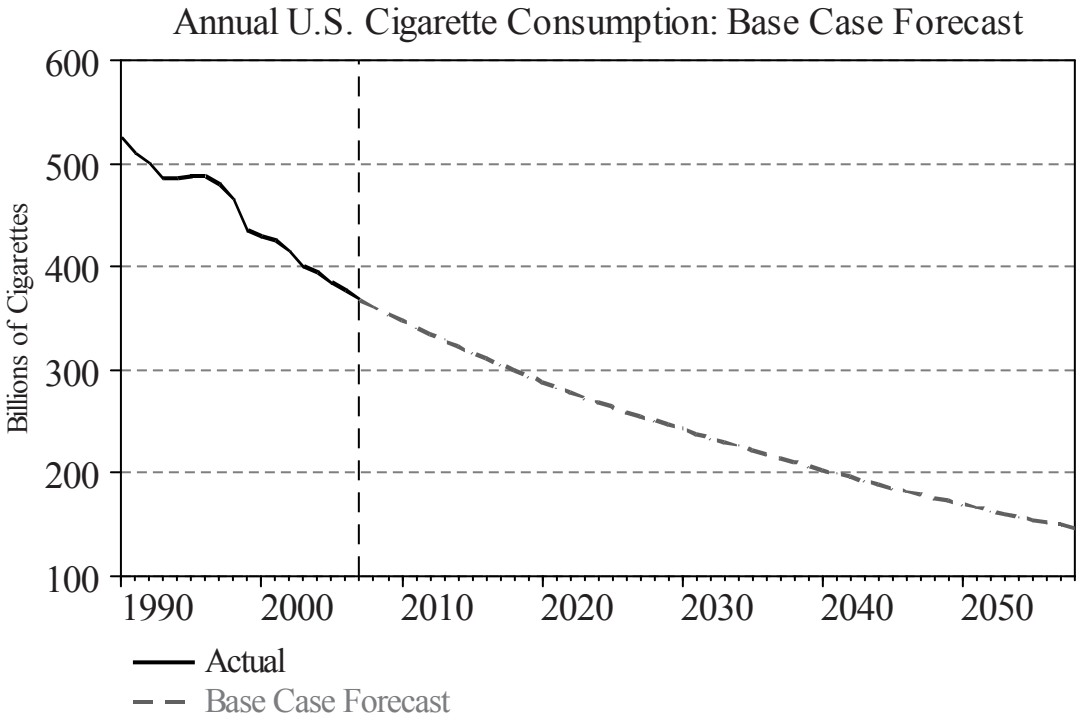
We believe the assumptions on which the Base Case Forecast are based to be reasonable.

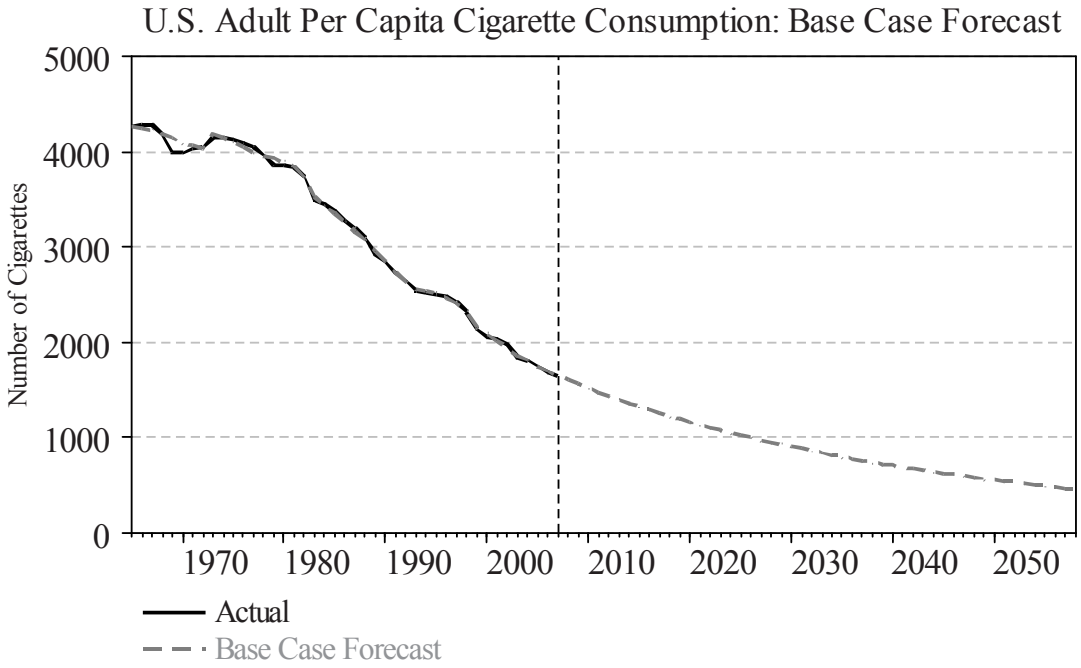
Forecast of Cigarette Consumption

After developing the regression equation specified above, we used it to project CPC for the period 2004 through 2058. Then using the standard adult population projections of Global Insight's macroeconomic model, we converted per capita consumption to aggregate adult consumption. We then added our estimate of teenage smoking volume going forward.

In using regression equations developed on the basis of historical data to project future values of the dependent variable, we must also assume that the underlying economic structure captured in the equation will remain essentially the same. While past performance is no guarantee of future patterns, it is still the best tool we have to make such projections.

The graphs below display the projected time trend of U.S. cigarette consumption. The first graph illustrates total actual and projected cigarette consumption in the United States. The second graph illustrates actual and projected CPC in the United States. For the period 1965 through 2007 the forecast line on the second graph indicates the value of CPC our model would have projected for those years.





In addition to the expected trend decline in cigarette consumption, the sharp upward shock to cigarette prices in late 1998 and 1999 contributed to a 6.5% reduction in consumption in 1999. The rate of decline has moderated considerably since that time,

averaging -2.1% from 1999 to 2007. The deep discount share of the market has been reported by the manufacturers as having stabilized at about 12% since 2003 and 2004. These cigarettes are produced by a large number of manufacturers, including many who participate in the MSA. After significant gains earlier in the decade, imports to the U.S. have declined from a high of 23.1 billion sticks in 2003 to 13.3 billion in 2007.

In 2005 industry shipments of 381 billion cigarettes were 3.4% lower than in 2004.[43] Part of this decline can be attributed to two extra shipping days in the leap year 2004. We also estimate that there was an inventory reduction of 3 billion units in 2005. This leads us to estimate that consumption in 2005 was somewhat higher than shipments, at approximately 384 billion. For 2006, industry shipments, as reported by the manufacturers, were 372.5 billion, 2.4% less than the 381.7 billion reported for 2005. The US Tobacco and Tax Bureau (TTB) reported for 2006 that domestic shipments totaled 364.4 billion and that there were 16.2 billion imported cigarettes.[44] The total, 380.7 billion, was only 0.1% fewer than in 2005. The manufacturers note significant inventory increases at the wholesale level in the fourth quarter of 2006 in advance of price and tax increases, most significantly that in Texas of $1.00 per pack. We estimate that this inventory accumulation equaled 4 billion cigarettes. Thus consumption in 2006 was 377 billion, a decline of 1.9%.

As a result shipments in the first half of 2007 were temporarily depressed as wholesalers reduced the accumulated stock. In addition, the manufacturers report that in the fourth quarter of 2007 that wholesalers moved to reduce the inventory they carry by 2.5 billion sticks. The net result is that shipments by manufacturers in 2007 understate consumption by 6.5 million cigarettes. TTB reports 2007 shipments of 361.6 billion. The addition of 6.5 billion consumed out of inventories results in a consumption estimate of 368.1 billion.

Data released by the manufacturers for the first quarter of 2008 indicate that shipments declined by 3.3% from their level in the first quarter of 2007. This was an especially weak performance in light of the low levels of 2007 shipments as a result of the 2006 and 2007 inventory adjustments. As a result we project that full year 2008 consumption will be 357 billion cigarettes, a 3.13% decline from 2007. The economic downturn in the US is deeper than foreseen earlier in the year, and the rapid increase in gasoline and energy prices has significantly reduced the discretionary spending of consumers. Cigarette price increases continue, and state excise taxes will rise further. As a result we have incorporated these impacts into our forecast for 2008 and 2009. In 2009 we estimate a further consumption decline of 2.38%.

After 2009, the rate of decline of consumption is projected to moderate and average less than 2% per year. From 2007 through 2058 the average annual rate of decline is projected to be 1.82%. On a per capita basis consumption is projected to fall at an average rate of 2.47% per year. Total consumption of cigarettes in the U.S. is projected to fall from an estimated 368 billion in 2007 to 357 billion in 2008, under 300 billion by 2017, and to under 200 billion by 2040.

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[44] Statistical Report – Tobacco, December 2006. http:www.ttb.gov. 26-Feb-2007.

Statistical Confidence and Forecast Error

In addition to potential forecast errors due to incorrect forecast assumptions, there also exists possible error in the statistical estimation. The estimation and development of an econometric model is a statistical exercise. Thus, our parameters are estimated with some degree of error. We have provided confidence intervals for the coefficient (elasticity) estimates. For instance, there is a 2.5% probability (5%/2) that the price elasticity exceeds 0.38. There is similarly a 2.5% chance that the income elasticity is less than 0.03. But if these events were independent, the probability of both would be .025 x .025 = .000625, or .0625%, less than one tenth of one percent.

Comparison With Prior Forecasts

In August 2007 Global Insight presented a similar study, "A Forecast of U.S. Cigarette Consumption (2000-2052)." Its long run conclusions were quite similar to this study. The current forecast of consumption for the year 2052 is 1.7% less than that of the previous study, 160.75 billion vs. 163.47 billion.

This forecast also differs from earlier forecasts in 2008. Subsequent to the release of industry shipment data for the first quarter of 2008, which indicated a sharp decline in cigarette shipments, we adjusted our forecast downward to account for the industry and economic conditions. Cigarette consumption in 2008 and 2009 is projected in this report to be lower by 4.0 and 5.8, billion sticks, respectively. The difference by 2052 is 2.7 billion sticks, or 1.7%.

Alternative Forecasts

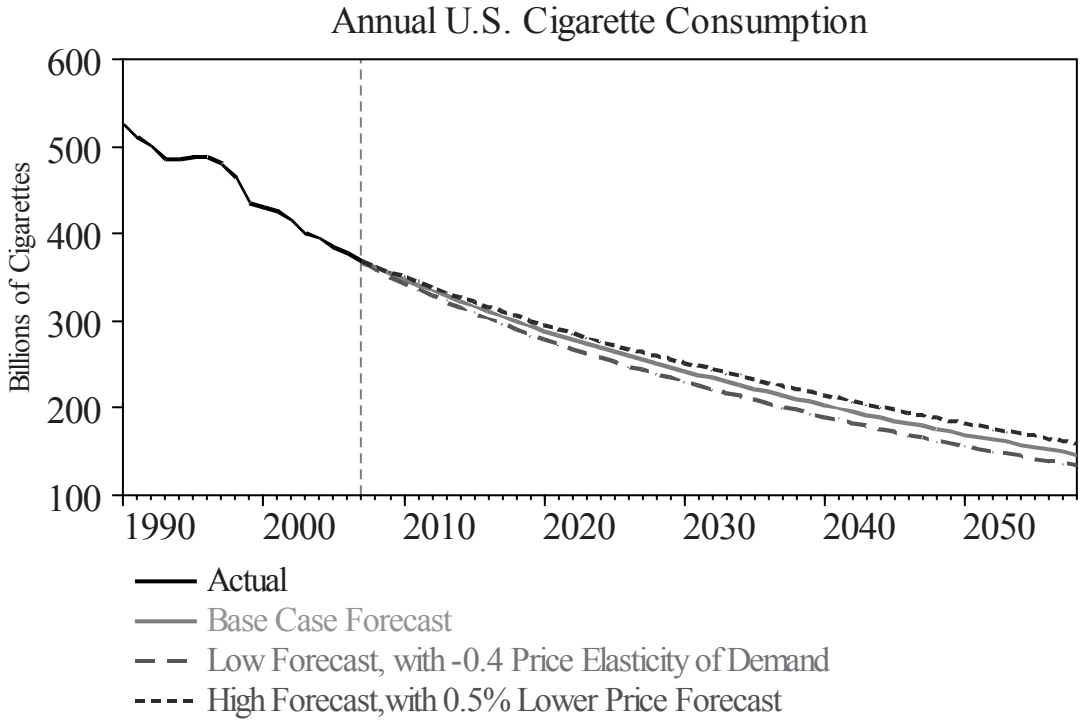
Two sources of variance may appear in the forecast derived by our model. First, as detailed in the Explanatory Variables section, there is some degree of forecast error in the parameters of the model. Second, the time paths of the explanatory variables may differ from our Base Case Forecast assumptions. Alternative forecasts are included in order to provide an interval forecast that, in our opinion, encompasses all of the likely potential realizations over time.

The high and low alternative forecasts are derived as follows. For the high scenario, we use a lower price forecast, under which prices are increasing at an annual rate of 0.5% more slowly than our current base case forecast. Under this scenario, the rate of decline is moderated slightly, from an average rate of 1.82% to 1.66%, resulting in consumption of 157 billion in 2058.

In the low forecast, Low Case 1, we posit a sharper price elasticity of demand. Our estimate of the price elasticity, -0.33, is on the low end of the range when compared to

that of certain other economic researchers. Recent economic research has forged a consensus that the elasticity lies between –0.3 and –0.5. We have, therefore, used a higher elasticity of –0.4, to generate the lowest consumption forecast which might be reasonably anticipated by our model. This increases the average rate of decline to 2.00% and results in cigarette consumption of 131 billion in 2058.

Should the federal excise tax increase to $1.00 per pack in 2009 the resulting price increase would, according to our model, lead to a sharper, one-time, consumption decline of 4.5%, or 15.5 billion cigarettes, by 2010. This is illustrated in FET Increase Case. The difference with our Base Case forecast would be somewhat lower over the longer term, because our base case forecast assumptions incorporate the likelihood of significant excise tax increases over time. By 2058 consumption would equal 137 billion, resulting in an average rate of decline of 1.91%.



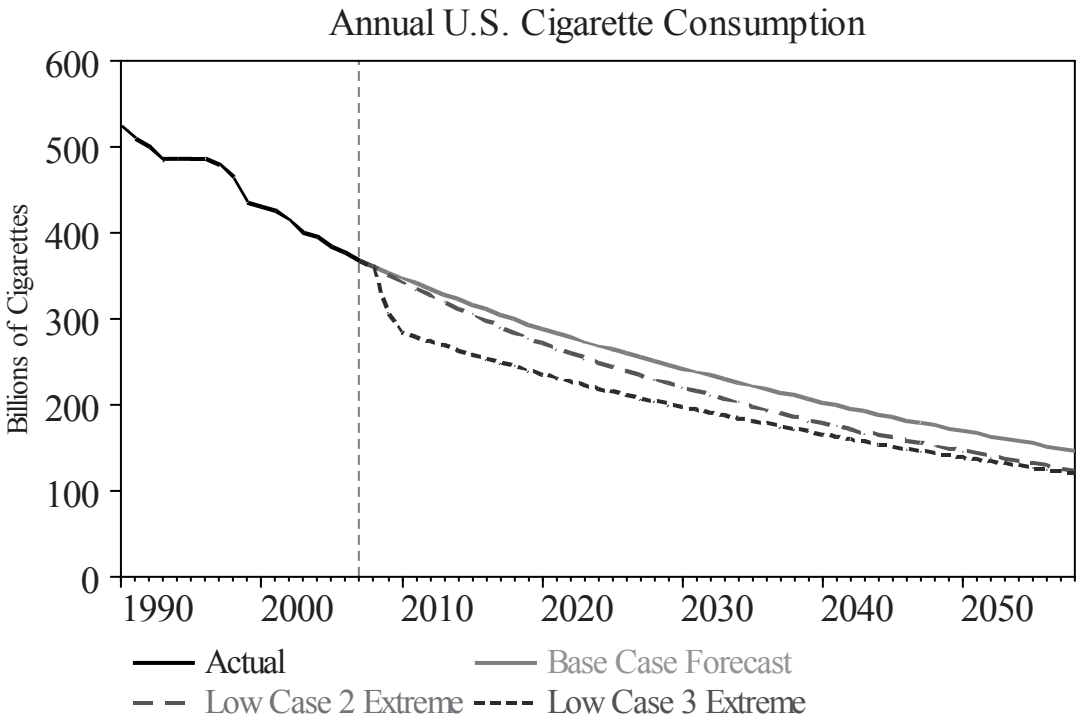
Hypothetical Stress Scenarios

The model was also tested under more extreme, and concurrently, less likely conditions. These exercises do not represent informed anticipation of possible future conditions. Rather, they are meant only to test the model under extreme conditions. First, we increased the negative response of consumer demand to recent price increases by assuming a much larger, -0.5, elasticity. This sharpens the fall in total consumption to an average annual rate of 2.18%, and results in demand of 120 billion cigarettes in 2058 (Low Case 2). This scenario would also be the result if, instead of a greater price sensitivity of smokers, we postulated an increased rate of cigarette price increase. Indeed, if cigarette prices, instead of averaging increases in real terms of 1.9% per year, accelerated to a pace of 3.4% annually, demand would also fall to 120 billion in 2058.

A second large negative stress is placed by postulating, in 2009, either an adverse federal government settlement, or tort claims of three times the size of the MSA. This would result in a real price increase of 57%, and a large decline, 18% over two years, in consumption. Under this scenario, consumption would fall to 118 billion cigarettes by 2058, an average annual rate of decline of 2.20% (Low Case 3).

Alternative Forecasts

	2058 Consumption Level (Bil.)	Average Annual Decline (%)
Base Case Forecast	144	1.82
FET Increase Case	137	1.91
Low Case 1	131	2.00
High Alternative	157	1.66
Low Case 2	120	2.18
Low Case 3	1180	2.20



Finally, for comparative purposes we have calculated the volume of total cigarette consumption under four alternative annual rates of decline, 2.5%, 3%, 3.5% and 4%. Under these scenarios consumption in 2058 falls to 101 billion, 78 billion, 60 billion, and 46 billion respectively. These calculations are simple arithmetic examples, and are neither forecasts nor projections.

Base Case Forecast: Assumptions for Explanatory Variables

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Nominal Price Per Pack
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*Fraction*	*Billions*	*$ (Current)*
1965	4.84	4.13	1.95	0.04		
1966	4.06	0.92	1.28	0.04		
1967	3.27	0.72	1.39	0.05		
1968	3.50	1.89	1.56	0.05		
1969	2.06	0.00	1.69	0.06		
1970	3.02	2.24	2.00	0.05		
1971	3.28	0.12	2.27	0.06		
1972	3.66	2.08	2.85	0.06		
1973	5.73	-3.29	2.03	0.07		
1974	-1.62	-5.49	2.05	0.07		
1975	1.30	-1.87	2.12	0.05		
1976	2.92	-1.40	2.07	0.05		
1977	2.46	-1.60	1.91	0.07		
1978	3.58	-2.05	1.91	0.06		
1979	1.35	-4.73	2.00	0.05		
1980	0.06	-5.03	1.96	0.05		
1981	1.63	-2.11	1.73	0.06		
1982	1.20	4.80	1.64	0.05		
1983	2.35	15.84	1.46	0.04		
1984	6.63	2.10	1.48	0.05		
1985	2.45	2.31	1.16	0.05		
1986	2.21	4.84	1.38	0.06		
1987	0.83	3.36	1.23	0.05		
1988	3.32	4.83	1.26	0.05		
1989	1.82	7.64	1.35	0.05		
1990	0.72	4.71	0.89	0.06	7.96	
1991	-0.81	7.16	0.96	0.06	7.72	
1992	2.08	5.24	0.99	0.06	7.62	
1993	-0.24	0.91	1.02	0.06	7.12	
1994	1.48	-6.11	0.95	0.07	7.21	
1995	1.58	-0.21	0.85	0.07	7.76	
1996	1.77	0.18	0.89	0.08	7.54	
1997	2.30	2.31	1.27	0.08	6.58	
1998	4.63	11.03	1.15	0.08	6.30	2.20
1999	1.80	26.72	1.13	0.08	5.92	2.88
2000	3.71	7.47	1.14	0.08	5.92	3.20
2001	0.89	4.36	1.10	0.08	5.92	3.45
2002	2.06	5.76	1.02	0.08	5.91	3.71
2003	1.32	-0.64	0.96	0.08	5.87	3.77
2004	2.43	-0.75	0.96	0.08	5.84	3.84
2005	0.48	1.68	0.98	0.08	5.82	4.04
2006	2.24	1.87	0.99	0.08	5.80	4.18
2007	2.19	5.09	1.00	0.08	5.78	4.47
2008	2.22	2.71	1.00	0.08	5.77	4.73
2009	1.20	3.10	1.02	0.07	5.77	4.97
2010	2.17	2.61	1.00	0.07	5.62	5.22
2011	2.10	2.57	0.93	0.07	5.47	5.47
2012	2.02	2.52	0.88	0.07	5.32	5.76
2013	2.02	2.48	0.81	0.07	5.18	6.07
2014	2.02	2.84	0.80	0.07	5.18	6.41
2015	2.04	2.02	0.84	0.07	5.18	6.72

Base Case Forecast: Assumptions for Explanatory Variables (Cont.)

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Nominal Price Per Pack
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*Fraction*	*Billions*	*$ (Current)*
2016	2.04	2.37	0.82	0.07	5.18	7.07
2017	2.05	2.34	0.77	0.07	5.18	7.44
2018	2.05	2.31	0.76	0.07	5.18	7.82
2019	2.06	2.27	0.74	0.06	5.03	8.21
2020	2.08	1.89	0.76	0.06	4.88	8.60
2021	2.09	2.22	0.77	0.06	4.73	9.03
2022	2.10	1.85	0.77	0.06	4.59	9.45
2023	2.11	2.17	0.78	0.06	4.44	9.92
2024	2.11	1.81	0.78	0.06	4.44	10.38
2025	2.11	1.79	0.79	0.05	4.29	10.86
2026	2.11	1.78	0.79	0.05	4.14	11.35
2027	2.11	1.76	0.79	0.05	3.99	11.87
2028	2.11	1.75	0.80	0.05	3.85	12.41
2029	2.11	1.73	0.80	0.05	3.70	12.97
2030	2.11	2.02	0.80	0.05	3.70	13.60
2031	2.11	1.70	0.79	0.04	3.55	14.21
2032	2.11	1.68	0.77	0.04	3.40	14.85
2033	2.11	1.67	0.76	0.04	3.25	15.51
2034	2.11	1.66	0.75	0.04	3.11	16.20
2035	2.11	2.50	0.74	0.04	2.96	17.06
2036	2.11	1.62	0.72	0.04	2.96	17.82
2037	2.11	1.89	0.71	0.04	2.96	18.65
2038	2.11	1.59	0.7	0.04	2.96	19.47
2039	2.11	1.85	0.69	0.03	2.81	20.38
2040	2.11	1.57	0.68	0.03	2.66	21.27
2041	2.11	1.56	0.67	0.03	2.51	22.19
2042	2.11	1.81	0.66	0.03	2.37	23.21
2043	2.11	1.53	0.66	0.03	2.22	24.22
2044	2.11	1.68	0.66	0.03	2.12	25.24
2045	2.11	1.68	0.67	0.03	2.02	26.31
2046	2.11	1.66	0.68	0.03	2.02	27.41
2047	2.11	1.67	0.69	0.03	2.02	28.56
2048	2.11	1.64	0.7	0.02	2.02	29.76
2049	2.11	1.65	0.71	0.02	1.92	31.01
2050	2.11	1.67	0.7	0.02	1.82	32.31
2051	2.11	1.65	0.69	0.02	1.71	33.67
2052	2.11	1.66	0.68	0.02	1.62	35.08
2053	2.11	1.66	0.67	0.02	1.52	36.56
2054	2.11	1.66	0.66	0.02	1.45	38.09
2055	2.11	1.66	0.65	0.02	1.38	39.69
2056	2.11	1.66	0.64	0.02	1.31	41.36
2057	2.11	1.66	0.63	0.02	1.23	42.67
2058	2.11	1.66	0.62	0.02	1.16	44.46

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2058)

	Per Capita Consumption	Growth Rate	Total Consumption	Total Consumption	Growth Rate
		(%)	*(billions)*	*(billions of packs)*	*(%)*
1965	4259	1.53	528.70	26.44	3.42
1966	4287	0.66	541.20	27.06	2.36
1967	4280	-0.16	549.20	27.46	1.48
1968	4186	-2.20	545.70	27.29	-0.64
1969	3993	-4.61	528.90	26.45	-3.08
1970	3985	-0.20	536.40	26.82	1.42
1971	4037	1.30	555.10	27.76	3.49
1972	4043	0.15	566.80	28.34	2.11
1973	4148	2.60	589.70	29.49	4.04
1974	4141	-0.17	599.00	29.95	1.58
1975	4123	-0.43	607.20	30.36	1.37
1976	4092	-0.75	613.50	30.68	1.04
1977	4051	-1.00	617.00	30.85	0.57
1978	3967	-2.07	616.00	30.80	-0.16
1979	3861	-2.67	621.50	31.08	0.89
1980	3849	-0.31	631.50	31.58	1.61
1981	3836	-0.34	640.00	32.00	1.35
1982	3739	-2.53	634.00	31.70	-0.94
1983	3488	-6.71	600.00	30.00	-5.36
1984	3446	-1.20	600.40	30.02	0.07
1985	3370	-2.21	594.00	29.70	-1.07
1986	3274	-2.85	583.80	29.19	-1.72
1987	3197	-2.35	575.00	28.75	-1.51
1988	3096	-3.16	562.50	28.13	-2.17
1989	2926	-5.49	540.00	27.00	-4.00
1990	2826	-3.14	525.00	26.25	-2.78
1991	2727	-3.50	510.00	25.50	-2.86
1992	2647	-2.93	500.00	25.00	-1.96
1993	2542	-3.97	485.00	24.25	-3.00
1994	2524	-0.71	486.00	24.30	0.21
1995	2505	-0.75	487.00	24.35	0.21
1996	2482	-0.84	487.00	24.35	0.00
1997	2423	-2.50	480.00	24.00	-1.44
1998	2320	-4.25	465.00	23.25	-3.13
1999	2136	-7.93	435.00	21.75	-6.45
2000	2056	-3.75	430.00	21.50	-1.15
2001	2026	-1.46	425.00	21.25	-1.16
2002	1979	-2.32	415.00	20.75	-2.35
2003	1837	-7.18	399.80	19.99	-3.66
2004	1799	-2.03	394.70	19.74	-1.28
2005	1733	-3.63	384.10	19.21	-2.69
2006	1686	-2.77	376.70	18.84	-1.93
2007	1631	-3.25	368.10	18.40	-2.28
2008	1563	-4.14	356.56	17.83	-3.13
2009	1511	-3.36	348.08	17.40	-2.38
2010	1469	-2.76	341.85	17.09	-1.79
2011	1429	-2.72	335.60	16.78	-1.83
2012	1390	-2.70	329.36	16.47	-1.86
2013	1353	-2.69	323.08	16.15	-1.91
2014	1316	-2.76	316.78	15.84	-1.95
2015	1281	-2.62	311.19	15.56	-1.77

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2058) (Cont.)

	Per Capita Consumption	Growth Rate	Total Consumption	Total Consumption	Growth Rate
		(%)	*(billions)*	*(billions of packs)*	*(%)*
2016	1248	-2.61	305.65	15.28	-1.78
2017	1215	-2.63	299.99	15.00	-1.85
2018	1183	-2.62	294.43	14.72	-1.85
2019	1152	-2.61	288.83	14.44	-1.90
2020	1123	-2.53	283.64	14.18	-1.80
2021	1094	-2.56	278.46	13.92	-1.83
2022	1067	-2.51	273.49	13.67	-1.79
2023	1040	-2.54	268.55	13.43	-1.81
2024	1014	-2.49	263.97	13.20	-1.71
2025	989	-2.45	259.46	12.97	-1.71
2026	965	-2.44	255.04	12.75	-1.70
2027	942	-2.44	250.74	12.54	-1.69
2028	919	-2.43	246.52	12.33	-1.68
2029	896	-2.43	242.38	12.12	-1.68
2030	874	-2.49	238.31	11.92	-1.68
2031	853	-2.45	234.20	11.71	-1.72
2032	832	-2.42	230.23	11.51	-1.70
2033	812	-2.41	226.32	11.32	-1.70
2034	792	-2.41	222.43	11.12	-1.72
2035	772	-2.59	218.19	10.91	-1.91
2036	753	-2.49	214.36	10.72	-1.76
2037	734	-2.45	210.63	10.53	-1.74
2038	717	-2.42	207.03	10.35	-1.71
2039	699	-2.44	203.29	10.16	-1.81
2040	682	-2.41	199.65	9.98	-1.79
2041	666	-2.38	196.13	9.81	-1.77
2042	650	-2.43	192.54	9.63	-1.83
2043	634	-2.42	189.04	9.45	-1.82
2044	640	-2.41	185.62	9.59	-1.81
2045	625	-2.42	182.26	9.11	-1.81
2046	609	-2.41	178.99	8.95	-1.79
2047	595	-2.41	175.80	8.79	-1.78
2048	580	-2.41	172.69	8.63	-1.77
2049	566	-2.41	169.65	8.48	-1.76
2050	553	-2.41	166.65	8.33	-1.77
2051	539	-2.41	163.68	8.18	-1.78
2052	526	-2.41	160.75	8.04	-1.79
2053	514	-2.41	157.85	7.89	-1.80
2054	501	-2.41	154.99	7.75	-1.81
2055	489	-2.41	152.17	7.61	-1.82
2056	478	-2.38	149.39	7.47	-1.83
2057	466	-2.38	146.64	7.33	-1.84
2058	455	-2.38	143.92	7.20	-1.85

Base Case Forecast and Low Case Projections

Year	Base Case Forecast			FET Increase Case: $0.61 FET Increase			Low Case 1: -0.4 Price Elasticity of Demand			High Forecast: Lower Price Assumption		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
2006	376.70	18.84	-1.93	376.70	18.84	-1.93	376.70	18.84	-1.93	376.70	18.84	-1.93
2007	368.10	18.41	-2.28	368.10	18.41	-2.28	368.10	18.41	-2.28	368.10	18.41	-2.28
2008	356.56	17.83	-3.13	356.56	17.83	-3.13	353.78	17.69	-3.89	358.18	17.91	-2.69
2009	348.08	17.40	-2.38	337.57	16.88	-5.33	344.37	17.22	-2.66	350.19	17.51	-2.23
2010	341.85	17.09	-1.79	326.35	16.32	-3.32	337.38	16.87	-2.03	344.45	17.22	-1.64
2011	335.60	16.78	-1.83	320.38	16.02	-1.83	330.43	16.52	-2.06	338.71	16.94	-1.67
2012	329.36	16.47	-1.86	314.43	15.72	-1.86	323.54	16.18	-2.09	332.92	16.65	-1.71
2013	323.08	16.15	-1.91	308.43	15.42	-1.91	316.62	15.83	-2.14	327.07	16.35	-1.76
2014	316.78	15.84	-1.95	302.42	15.12	-1.95	309.66	15.48	-2.20	321.22	16.06	-1.79
2015	311.19	15.56	-1.77	297.08	14.85	-1.77	303.63	15.18	-1.95	316.03	15.80	-1.62
2016	305.65	15.28	-1.78	291.79	14.59	-1.78	297.59	14.88	-1.99	310.88	15.54	-1.63
2017	299.99	15.00	-1.85	286.39	14.32	-1.85	291.45	14.57	-2.06	305.62	15.28	-1.69
2018	294.43	14.72	-1.85	281.08	14.05	-1.85	285.47	14.27	-2.05	300.44	15.02	-1.69
2019	288.83	14.44	-1.90	275.73	13.79	-1.90	279.44	13.97	-2.11	295.18	14.76	-1.75
2020	283.64	14.18	-1.80	270.78	13.54	-1.80	273.92	13.70	-1.98	290.32	14.52	-1.65
2021	278.46	13.92	-1.83	265.83	13.29	-1.83	268.37	13.42	-2.03	285.45	14.27	-1.68
2022	273.49	13.67	-1.79	261.09	13.05	-1.79	263.14	13.16	-1.95	280.81	14.04	-1.63
2023	268.55	13.43	-1.81	256.37	12.82	-1.81	257.89	12.89	-2.00	276.19	13.81	-1.65
2024	263.97	13.20	-1.71	252.00	12.60	-1.71	253.08	12.65	-1.87	271.92	13.60	-1.55
2025	259.46	12.97	-1.71	247.69	12.38	-1.71	248.35	12.42	-1.87	267.71	13.39	-1.55
2026	255.04	12.75	-1.70	243.48	12.17	-1.70	243.73	12.19	-1.86	263.58	13.18	-1.54
2027	250.74	12.54	-1.69	239.37	11.97	-1.69	239.22	11.96	-1.85	259.52	12.98	-1.54
2028	246.52	12.33	-1.68	235.35	11.77	-1.68	234.82	11.74	-1.84	255.56	12.78	-1.53
2029	242.38	12.12	-1.68	231.39	11.57	-1.68	230.53	11.53	-1.83	251.67	12.58	-1.52
2030	238.31	11.92	-1.68	227.50	11.38	-1.68	226.21	11.31	-1.87	247.82	12.39	-1.53
2031	234.20	11.71	-1.72	223.58	11.18	-1.72	221.98	11.10	-1.87	243.95	12.20	-1.56
2032	230.23	11.51	-1.70	219.79	10.99	-1.70	217.87	10.89	-1.85	240.19	12.01	-1.54
2033	226.32	11.32	-1.70	216.06	10.80	-1.70	213.85	10.69	-1.85	236.48	11.82	-1.55
2034	222.43	11.12	-1.72	212.35	10.62	-1.72	209.86	10.49	-1.87	232.79	11.64	-1.56
2035	218.19	10.91	-1.91	208.30	10.41	-1.91	205.37	10.27	-2.14	228.71	11.44	-1.76
2036	214.36	10.72	-1.76	204.64	10.23	-1.76	201.48	10.07	-1.90	225.05	11.25	-1.60
2037	210.63	10.53	-1.74	201.08	10.05	-1.74	197.63	9.88	-1.91	221.50	11.07	-1.58
2038	207.03	10.35	-1.71	197.64	9.88	-1.71	193.97	9.70	-1.85	218.07	10.90	-1.55
2039	203.29	10.16	-1.81	194.07	9.70	-1.81	190.14	9.51	-1.98	214.45	10.72	-1.66
2040	199.65	9.98	-1.79	190.60	9.53	-1.79	186.47	9.32	-1.93	210.96	10.55	-1.63
2041	196.13	9.81	-1.77	187.23	9.36	-1.77	182.92	9.15	-1.91	207.55	10.38	-1.62
2042	192.54	9.63	-1.83	183.81	9.19	-1.83	179.26	8.96	-2.00	204.07	10.20	-1.68
2043	189.04	9.45	-1.82	180.47	9.02	-1.82	175.77	8.79	-1.95	200.71	10.04	-1.65
2044	185.62	9.59	-1.81	177.20	8.86	-1.81	172.36	8.89	-1.94	197.42	10.22	-1.64
2045	182.26	9.11	-1.81	174.00	8.70	-1.81	169.04	8.45	-1.93	194.17	9.71	-1.64
2046	178.99	8.95	-1.79	170.88	8.54	-1.79	165.81	8.29	-1.91	191.01	9.55	-1.63
2047	175.80	8.79	-1.78	167.83	8.39	-1.78	162.66	8.13	-1.90	187.92	9.40	-1.62
2048	172.69	8.63	-1.77	164.86	8.24	-1.77	159.60	7.98	-1.88	184.90	9.25	-1.60
2049	169.65	8.48	-1.76	161.96	8.10	-1.76	156.61	7.83	-1.87	181.96	9.10	-1.59
2050	166.65	8.33	-1.77	159.09	7.95	-1.77	153.65	7.68	-1.89	179.03	8.95	-1.61
2051	163.68	8.18	-1.78	156.26	7.81	-1.78	150.74	7.54	-1.89	176.14	8.81	-1.61
2052	160.75	8.04	-1.79	153.46	7.67	-1.79	147.86	7.39	-1.91	173.28	8.66	-1.63
2053	157.85	7.89	-1.80	150.70	7.53	-1.80	145.03	7.25	-1.92	170.44	8.52	-1.64
2054	154.99	7.75	-1.81	147.97	7.40	-1.81	142.23	7.11	-1.93	167.64	8.38	-1.65
2055	152.17	7.61	-1.82	145.27	7.26	-1.82	139.48	6.97	-1.94	164.86	8.24	-1.66
2056	149.39	7.47	-1.83	142.61	7.13	-1.83	136.76	6.84	-1.95	162.11	8.11	-1.67
2057	146.64	7.33	-1.84	139.99	7.00	-1.84	134.08	6.70	-1.96	159.40	7.97	-1.68
2058	143.92	7.20	-1.85	137.40	6.87	-1.85	131.45	6.57	-1.97	156.71	7.84	-1.69

Base Case Forecast and Low Case Extreme Projections

Year	Base Case Forecast			Low Case 2: -0.5 Price Elasticity of Demand			Low Case 3: Large MSA in 2009		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
2006	376.70	18.84	-1.93	376.70	18.84	-1.93	376.70	18.84	-1.93
2007	368.10	18.41	-2.28	368.10	18.41	-2.28	368.10	18.41	-2.28
2008	356.56	17.83	-3.13	355.72	17.79	-3.36	356.56	17.83	-3.13
2009	348.08	17.40	-2.38	345.15	17.26	-2.97	304.90	15.24	-14.49
2010	341.85	17.09	-1.79	337.25	16.86	-2.29	281.26	14.06	-7.75
2011	335.60	16.78	-1.83	329.43	16.47	-2.32	276.12	13.81	-1.83
2012	329.36	16.47	-1.86	321.73	16.09	-2.34	270.99	13.55	-1.86
2013	323.08	16.15	-1.91	314.09	15.70	-2.38	265.82	13.29	-1.91
2014	316.78	15.84	-1.95	306.26	15.31	-2.49	260.64	13.03	-1.95
2015	311.19	15.56	-1.77	299.69	14.98	-2.15	256.04	12.80	-1.77
2016	305.65	15.28	-1.78	293.01	14.65	-2.23	251.48	12.57	-1.78
2017	299.99	15.00	-1.85	286.29	14.31	-2.29	246.82	12.34	-1.85
2018	294.43	14.72	-1.85	279.76	13.99	-2.28	242.25	12.11	-1.85
2019	288.83	14.44	-1.90	273.21	13.66	-2.34	237.64	11.88	-1.90
2020	283.64	14.18	-1.80	267.31	13.37	-2.16	233.37	11.67	-1.80
2021	278.46	13.92	-1.83	261.31	13.07	-2.25	229.11	11.46	-1.83
2022	273.49	13.67	-1.79	255.73	12.79	-2.14	225.02	11.25	-1.79
2023	268.55	13.43	-1.81	250.06	12.50	-2.22	220.95	11.05	-1.81
2024	263.97	13.20	-1.71	244.95	12.25	-2.05	217.19	10.86	-1.71
2025	259.46	12.97	-1.71	239.93	12.00	-2.05	213.47	10.67	-1.71
2026	255.04	12.75	-1.70	235.03	11.75	-2.04	209.84	10.49	-1.70
2027	250.74	12.54	-1.69	230.26	11.51	-2.03	206.30	10.31	-1.69
2028	246.52	12.33	-1.68	225.63	11.28	-2.01	202.83	10.14	-1.68
2029	242.38	12.12	-1.68	221.10	11.05	-2.01	199.43	9.97	-1.68
2030	238.31	11.92	-1.68	216.52	10.83	-2.07	196.07	9.80	-1.68
2031	234.20	11.71	-1.72	212.10	10.60	-2.04	192.70	9.63	-1.72
2032	230.23	11.51	-1.70	207.82	10.39	-2.02	189.42	9.47	-1.70
2033	226.32	11.32	-1.70	203.62	10.18	-2.02	186.21	9.31	-1.70
2034	222.43	11.12	-1.72	199.50	9.97	-2.03	183.01	9.15	-1.72
2035	218.19	10.91	-1.91	194.74	9.74	-2.39	179.52	8.98	-1.91
2036	214.36	10.72	-1.76	190.71	9.54	-2.07	176.37	8.82	-1.76
2037	210.63	10.53	-1.74	186.73	9.34	-2.09	173.30	8.66	-1.74
2038	207.03	10.35	-1.71	182.97	9.15	-2.01	170.34	8.52	-1.71
2039	203.29	10.16	-1.81	179.01	8.95	-2.17	167.26	8.36	-1.81
2040	199.65	9.98	-1.79	175.27	8.76	-2.09	164.26	8.21	-1.79
2041	196.13	9.81	-1.77	171.65	8.58	-2.07	161.37	8.07	-1.77
2042	192.54	9.63	-1.83	167.91	8.40	-2.18	158.42	7.92	-1.83
2043	189.04	9.45	-1.82	164.39	8.22	-2.10	155.54	7.78	-1.82
2044	185.62	9.59	-1.81	160.94	8.05	-2.10	152.72	7.64	-1.81
2045	182.26	9.11	-1.81	157.57	7.88	-2.10	149.96	7.50	-1.81
2046	178.99	8.95	-1.79	154.30	7.72	-2.08	147.27	7.36	-1.79
2047	175.80	8.79	-1.78	151.11	7.56	-2.07	144.64	7.23	-1.78
2048	172.69	8.63	-1.77	148.02	7.40	-2.05	142.08	7.10	-1.77
2049	169.65	8.48	-1.76	145.00	7.25	-2.04	139.59	6.98	-1.76
2050	166.65	8.33	-1.77	142.02	7.10	-2.06	137.11	6.86	-1.77
2051	163.68	8.18	-1.78	139.09	6.95	-2.06	134.67	6.73	-1.78
2052	160.75	8.04	-1.79	136.21	6.81	-2.07	132.26	6.61	-1.79
2053	157.85	7.89	-1.80	133.37	6.67	-2.08	129.88	6.49	-1.80
2054	154.99	7.75	-1.81	130.58	6.53	-2.09	127.52	6.38	-1.81
2055	152.17	7.61	-1.82	127.83	6.39	-2.10	125.20	6.26	-1.82
2056	149.39	7.47	-1.83	125.13	6.26	-2.11	122.91	6.15	-1.83
2057	146.64	7.33	-1.84	122.48	6.12	-2.12	120.65	6.03	-1.84
2058	143.92	7.20	-1.85	119.86	5.99	-2.13	118.42	5.92	-1.85

Alternative Constant Rate Decline Projections

Year	2.5%			3.0%		
	Cigarettes	*Packs (billions)*	*Growth Rate*	*Cigarettes*	*Packs (billions)*	*Growth Rate*
2007	368.10	18.41	-2.28	368.10	18.41	-2.28
2008	358.90	17.94	-2.50	357.06	17.85	-3.00
2009	349.93	17.50	-2.50	346.35	17.32	-3.00
2010	341.18	17.06	-2.50	335.95	16.80	-3.00
2011	332.65	16.63	-2.50	325.88	16.29	-3.00
2012	324.33	16.22	-2.50	316.10	15.80	-3.00
2013	316.22	15.81	-2.50	306.62	15.33	-3.00
2014	308.32	15.42	-2.50	297.42	14.87	-3.00
2015	300.61	15.03	-2.50	288.50	14.42	-3.00
2016	293.09	14.65	-2.50	279.84	13.99	-3.00
2017	285.77	14.29	-2.50	271.45	13.57	-3.00
2018	278.62	13.93	-2.50	263.30	13.17	-3.00
2019	271.66	13.58	-2.50	255.40	12.77	-3.00
2020	264.87	13.24	-2.50	247.74	12.39	-3.00
2021	258.24	12.91	-2.50	240.31	12.02	-3.00
2022	251.79	12.59	-2.50	233.10	11.65	-3.00
2023	245.49	12.27	-2.50	226.11	11.31	-3.00
2024	239.36	11.97	-2.50	219.32	10.97	-3.00
2025	233.37	11.67	-2.50	212.74	10.64	-3.00
2026	227.54	11.38	-2.50	206.36	10.32	-3.00
2027	221.85	11.09	-2.50	200.17	10.01	-3.00
2028	216.30	10.82	-2.50	194.17	9.71	-3.00
2029	210.90	10.54	-2.50	188.34	9.42	-3.00
2030	205.62	10.28	-2.50	182.69	9.13	-3.00
2031	200.48	10.02	-2.50	177.21	8.86	-3.00
2032	195.47	9.77	-2.50	171.89	8.59	-3.00
2033	190.58	9.53	-2.50	166.74	8.34	-3.00
2034	185.82	9.29	-2.50	161.73	8.09	-3.00
2035	181.17	9.06	-2.50	156.88	7.84	-3.00
2036	176.64	8.83	-2.50	152.18	7.61	-3.00
2037	172.23	8.61	-2.50	147.61	7.38	-3.00
2038	167.92	8.40	-2.50	143.18	7.16	-3.00
2039	163.72	8.19	-2.50	138.89	6.94	-3.00
2040	159.63	7.98	-2.50	134.72	6.74	-3.00
2041	155.64	7.78	-2.50	130.68	6.53	-3.00
2042	151.75	7.59	-2.50	126.76	6.34	-3.00
2043	147.96	7.40	-2.50	122.96	6.15	-3.00
2044	144.26	7.21	-2.50	119.27	5.96	-3.00
2045	140.65	7.03	-2.50	115.69	5.78	-3.00
2046	137.13	6.86	-2.50	112.22	5.61	-3.00
2047	133.71	6.69	-2.50	108.85	5.44	-3.00
2048	130.36	6.52	-2.50	105.59	5.28	-3.00
2049	127.10	6.36	-2.50	102.42	5.12	-3.00
2050	123.93	6.20	-2.50	99.35	4.97	-3.00
2051	120.83	6.04	-2.50	96.37	4.82	-3.00
2052	117.81	5.89	-2.50	93.47	4.67	-3.00
2053	114.86	5.74	-2.50	90.67	4.53	-3.00
2054	111.99	5.60	-2.50	87.95	4.40	-3.00
2055	109.19	5.46	-2.50	85.31	4.27	-3.00
2056	106.46	5.32	-2.50	82.75	4.14	-3.00
2057	103.80	5.19	-2.50	80.27	4.01	-3.00
2058	101.20	5.06	-2.50	77.86	3.89	-3.00

Alternative Constant Rate Decline Projections (Cont)

Year	3.5%			4.0%		
	Cigarettes	*Packs (billions)*	*Growth Rate*	*Cigarettes*	*Packs (billions)*	*Growth Rate*
2007	368.10	18.41	-2.28	368.10	18.41	-2.28
2008	355.22	17.76	-3.50	353.38	17.67	-4.00
2009	342.78	17.14	-3.50	339.24	16.96	-4.00
2010	330.79	16.54	-3.50	325.67	16.28	-4.00
2011	319.21	15.96	-3.50	312.64	15.63	-4.00
2012	308.04	15.40	-3.50	300.14	15.01	-4.00
2013	297.26	14.86	-3.50	288.13	14.41	-4.00
2014	286.85	14.34	-3.50	276.61	13.83	-4.00
2015	276.81	13.84	-3.50	265.54	13.28	-4.00
2016	267.12	13.36	-3.50	254.92	12.75	-4.00
2017	257.77	12.89	-3.50	244.72	12.24	-4.00
2018	248.75	12.44	-3.50	234.94	11.75	-4.00
2019	240.05	12.00	-3.50	225.54	11.28	-4.00
2020	231.64	11.58	-3.50	216.52	10.83	-4.00
2021	223.54	11.18	-3.50	207.86	10.39	-4.00
2022	215.71	10.79	-3.50	199.54	9.98	-4.00
2023	208.16	10.41	-3.50	191.56	9.58	-4.00
2024	200.88	10.04	-3.50	183.90	9.19	-4.00
2025	193.85	9.69	-3.50	176.54	8.83	-4.00
2026	187.06	9.35	-3.50	169.48	8.47	-4.00
2027	180.51	9.03	-3.50	162.70	8.14	-4.00
2028	174.20	8.71	-3.50	156.19	7.81	-4.00
2029	168.10	8.40	-3.50	149.95	7.50	-4.00
2030	162.22	8.11	-3.50	143.95	7.20	-4.00
2031	156.54	7.83	-3.50	138.19	6.91	-4.00
2032	151.06	7.55	-3.50	132.66	6.63	-4.00
2033	145.77	7.29	-3.50	127.36	6.37	-4.00
2034	140.67	7.03	-3.50	122.26	6.11	-4.00
2035	135.75	6.79	-3.50	117.37	5.87	-4.00
2036	131.00	6.55	-3.50	112.68	5.63	-4.00
2037	126.41	6.32	-3.50	108.17	5.41	-4.00
2038	121.99	6.10	-3.50	103.84	5.19	-4.00
2039	117.72	5.89	-3.50	99.69	4.98	-4.00
2040	113.60	5.68	-3.50	95.70	4.79	-4.00
2041	109.62	5.48	-3.50	91.87	4.59	-4.00
2042	105.78	5.29	-3.50	88.20	4.41	-4.00
2043	102.08	5.10	-3.50	84.67	4.23	-4.00
2044	98.51	4.93	-3.50	81.28	4.06	-4.00
2045	95.06	4.75	-3.50	78.03	3.90	-4.00
2046	91.73	4.59	-3.50	74.91	3.75	-4.00
2047	88.52	4.43	-3.50	71.91	3.60	-4.00
2048	85.43	4.27	-3.50	69.04	3.45	-4.00
2049	82.44	4.12	-3.50	66.28	3.31	-4.00
2050	79.55	3.98	-3.50	63.63	3.18	-4.00
2051	76.77	3.84	-3.50	61.08	3.05	-4.00
2052	74.08	3.70	-3.50	58.64	2.93	-4.00
2053	71.49	3.57	-3.50	56.29	2.81	-4.00
2054	68.98	3.45	-3.50	54.04	2.70	-4.00
2055	66.57	3.33	-3.50	51.88	2.59	-4.00
2056	64.24	3.21	-3.50	49.80	2.49	-4.00
2057	61.99	3.10	-3.50	47.81	2.39	-4.00
2058	59.82	2.99	-3.50	45.90	2.29	-4.00

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APPENDIX B

MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

(AS AMENDED BY THE ADDENDUM OF CLARIFICATIONS)

TABLE OF CONTENTS

Page

MASTER SETTLEMENT AGREEMENT

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

MASTER SETTLEMENT AGREEMENT

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

I. RECITALS

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

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

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

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

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

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

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

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

II. DEFINITIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) the use of comically exaggerated features;

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

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

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

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

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

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

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

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

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

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

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

(u) "Final Approval" means the earlier of:

(1) the date by which State-Specific Finality in a sufficient number of Settling States has occurred; or

(2) June 30, 2000.

For the purposes of this subsection (u), "State-Specific Finality in a sufficient number of Settling States" means that State-Specific Finality has occurred in both:

(A) a number of Settling States equal to at least 80% of the total number of Settling States; and

(B) Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all Settling States.

Notwithstanding the foregoing, the Original Participating Manufacturers may, by unanimous written agreement, waive any requirement for Final Approval set forth in subsections (A) or (B) hereof.

(v) "Foundation" means the foundation described in section VI.

(w) "Independent Auditor" means the firm described in subsection XI(b).

(x) "Inflation Adjustment" means an adjustment in accordance with the formulas for inflation adjustments set forth in Exhibit C.

(y) "Litigating Releasing Parties Offset" means the offset described in subsection XII(b).

(z) "Market Share" means a Tobacco Product Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes sold in the fifty United States, the District of Columbia and Puerto Rico during the applicable calendar year, as measured by excise taxes collected by the federal government and, in the case of sales in Puerto Rico, arbitrios de cigarillos collected by the Puerto Rico taxing authority. For purposes of the definition and determination of "Market Share" with respect to calculations under subsection IX(i), 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette; for purposes of the definition and determination of "Market Share" with respect to all other calculations, 0.0325 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(aa) "MSA Execution Date" means November 23, 1998.

(bb) "NAAG" means the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement.

(cc) "Non-Participating Manufacturer" means any Tobacco Product Manufacturer that is not a Participating Manufacturer.

(dd) "Non-Settling States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by the aggregate Allocable Shares of those States that are not Settling States on the date 15 days before such payment is due.

(ee) "Notice Parties" means each Participating Manufacturer, each Settling State, the Escrow Agent, the Independent Auditor and NAAG.

(ff) "NPM Adjustment" means the adjustment specified in subsection IX(d).

(gg) "NPM Adjustment Percentage" means the percentage determined pursuant to subsection IX(d).

(hh) "Original Participating Manufacturers" means the following: Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company, and the respective successors of each of the foregoing. Except as expressly provided in this Agreement, once an entity becomes an Original Participating Manufacturer, such entity shall permanently retain the status of Original Participating Manufacturer.

(ii) "Outdoor Advertising" means (1) billboards, (2) signs and placards in arenas, stadiums, shopping malls and Video Game Arcades (whether any of the foregoing are open air or enclosed) (but not including any such sign or placard located in an Adult-Only Facility), and (3) any other advertisements placed (A) outdoors, or (B) on the inside surface of a window facing outward. Provided, however, that the term "Outdoor Advertising" does not mean (1) an advertisement on the outside of a Tobacco Product manufacturing facility; (2) an individual advertisement that does not occupy an area larger than 14 square feet (and that neither is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet, nor functions solely as a segment of a larger advertising unit or series), and that is placed (A) on the outside of any retail establishment that sells Tobacco Products (other than solely through a vending machine), (B) outside (but on the property of) any such establishment, or (C) on the inside surface of a window facing

outward in any such establishment; (3) an advertisement inside a retail establishment that sells Tobacco Products (other than solely through a vending machine) that is not placed on the inside surface of a window facing outward; or (4) an outdoor advertisement at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(jj) "Participating Manufacturer" means a Tobacco Product Manufacturer that is or becomes a signatory to this Agreement, provided that (1) in the case of a Tobacco Product Manufacturer that is not an Original Participating Manufacturer, such Tobacco Product Manufacturer is bound by this Agreement and the Consent Decree (or, in any Settling State that does not permit amendment of the Consent Decree, a consent decree containing terms identical to those set forth in the Consent Decree) in all Settling States in which this Agreement and the Consent Decree binds Original Participating Manufacturers (provided, however, that such Tobacco Product Manufacturer need only become bound by the Consent Decree in those Settling States in which the Settling State has filed a Released Claim against it), and (2) in the case of a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, such Tobacco Product Manufacturer, within a reasonable period of time after signing this Agreement, makes any payments (including interest thereon at the Prime Rate) that it would have been obligated to make in the intervening period had it been a signatory as of the MSA Execution Date. "Participating Manufacturer" shall also include the successor of a Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Participating Manufacturer such entity shall permanently retain the status of Participating Manufacturer. Each Participating Manufacturer shall regularly report its shipments of Cigarettes in or to the fifty United States, the District of Columbia and Puerto Rico to Management Science Associates, Inc. (or a successor entity as set forth in subsection (mm)). Solely for purposes of calculations pursuant to subsection IX(d), a Tobacco Product Manufacturer that is not a signatory to this Agreement shall be deemed to be a "Participating Manufacturer" if the Original Participating Manufacturers unanimously consent in writing.

(kk) "Previously Settled States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by 12.4500000%, in the case of payments due in or prior to 2007; 12.2373756%, in the case of payments due after 2007 but before 2018; and 11.0666667%, in the case of payments due in or after 2018.

(ll) "Prime Rate" shall mean the prime rate as published from time to time by the Wall Street Journal or, in the event the Wall Street Journal is no longer published or no longer publishes such rate, an equivalent successor reference rate determined by the Independent Auditor.

(mm) "Relative Market Share" means an Original Participating Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers during the calendar year immediately preceding the year in which the payment at issue is due (regardless of when such payment is made), as measured by the Original Participating Manufacturers' reports of shipments of Cigarettes to Management Science Associates, Inc. (or a successor entity acceptable to both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question). A Cigarette shipped by more than one Participating Manufacturer shall be deemed to have been shipped solely by the first Participating Manufacturer to do so. For purposes of the definition and determination of "Relative Market Share," 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(nn) "Released Claims" means:

(1) for past conduct, acts or omissions (including any damages incurred in the future arising from such past conduct, acts or omissions), those Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to (A) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (B) the exposure to, or (C) research, statements, or warnings regarding, Tobacco Products (including, but not limited to, the Claims asserted in the actions identified in Exhibit D, or any comparable Claims that were, could be or could have been asserted now or in the future in those actions or in any comparable action in federal, state or local court brought by a Settling State or a Releasing Party (whether or not such Settling State or Releasing Party has brought such action)), except for claims not asserted in the actions identified in Exhibit D for outstanding liability under existing licensing (or similar) fee laws or existing tax laws (but not excepting claims for any tax liability of the Tobacco-Related Organizations or of any Released Party with respect to such Tobacco-Related Organizations, which claims are covered by the release and covenants set forth in this Agreement);

(2) for future conduct, acts or omissions, only those monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future Claims for reimbursement of health care costs allegedly associated with the use of or exposure to Tobacco Products.

(oo) "Released Parties" means all Participating Manufacturers, their past, present and future Affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any Participating Manufacturer or of any such Affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). Provided, however, that "Released Parties" does not include any person or entity (including, but not limited to, an Affiliate) that is itself a Non-Participating Manufacturer at any time after the MSA Execution Date, unless such person or entity becomes a Participating Manufacturer.

(pp) "Releasing Parties" means each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions; and also means, to the full extent of the power of the signatories hereto to release past, present and future claims, the following: (1) any Settling State's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (2) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in this settlement, (A) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of the State, as opposed solely to private or individual relief for separate and distinct injuries, or (B) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State.

(qq) "Settling State" means any State that signs this Agreement on or before the MSA Execution Date. Provided, however, that the term "Settling State" shall not include (1) the States of Mississippi, Florida, Texas and Minnesota; and (2) any State as to which this Agreement has been terminated.

(rr) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas.

(ss) "State-Specific Finality" means, with respect to the Settling State in question:

(1) this Agreement and the Consent Decree have been approved and entered by the Court as to all Original Participating Manufacturers, or, in the event of an appeal from or review of a decision of the Court to withhold its approval and entry of this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review;

(2) entry by the Court has been made of an order dismissing with prejudice all claims against Released Parties in the action as provided herein; and

(3) the time for appeal or to seek review of or permission to appeal ("Appeal") from the approval and entry as described in subsection (1) hereof and entry of such order described in subsection (2) hereof has expired; or, in the event of an Appeal from such approval and entry, the Appeal has been dismissed, or the approval and entry described in (1) hereof and the order described in subsection (2) hereof have been affirmed in all material respects by the court of last resort to which such Appeal has been taken and such dismissal or affirmance has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court).

(tt) "Subsequent Participating Manufacturer" means a Tobacco Product Manufacturer (other than an Original Participating Manufacturer) that: (1) is a Participating Manufacturer, and (2) is a signatory to this Agreement, regardless of when such Tobacco Product Manufacturer became a signatory to this Agreement. "Subsequent Participating Manufacturer" shall also include the successors of a Subsequent Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Subsequent Participating Manufacturer such entity shall permanently retain the status of Subsequent Participating Manufacturer, unless it agrees to assume the obligations of an Original Participating Manufacturer as provided in subsection XVIII(c).

(uu) "Tobacco Product Manufacturer" means an entity that after the MSA Execution Date directly (and not exclusively through any Affiliate):

(1) manufactures Cigarettes anywhere that such manufacturer intends to be sold in the States, including Cigarettes intended to be sold in the States through an importer (except where such importer is an Original Participating Manufacturer that will be responsible for the payments under this Agreement with respect to such Cigarettes as a result of the provisions of subsections II(mm) and that pays the taxes specified in subsection II(z) on such Cigarettes, and provided that the manufacturer of such Cigarettes does not market or advertise such Cigarettes in the States);

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

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

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

(vv) "Tobacco Products" means Cigarettes and smokeless tobacco products.

(ww) "Tobacco-Related Organizations" means the Council for Tobacco Research-U.S.A., Inc., The Tobacco Institute, Inc. ("TI"), and the Center for Indoor Air Research, Inc. ("CIAR") and the successors, if any, of TI or CIAR.

(xx) "Transit Advertisements" means advertising on or within private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, transportation waiting area, train station, airport or any similar location. Notwithstanding the foregoing, the term "Transit Advertisements" does not include (1) any advertisement placed in, on or outside the premises of any retail establishment that sells Tobacco Products (other than solely through a vending machine) (except if such individual advertisement (A) occupies an area larger than 14 square feet; (B) is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet; or (C) functions solely as a segment of a larger advertising unit or series); or (2) advertising at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no

event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(yy) "Underage" means younger than the minimum age at which it is legal to purchase or possess (whichever minimum age is older) Cigarettes in the applicable Settling State.

(zz) "Video Game Arcade" means an entertainment establishment primarily consisting of video games (other than video games intended primarily for use by persons 18 years of age or older) and/or pinball machines.

(aaa) "Volume Adjustment" means an upward or downward adjustment in accordance with the formula for volume adjustments set forth in Exhibit E.

(bbb) "Youth" means any person or persons under 18 years of age.

III. PERMANENT RELIEF

(a) Prohibition on Youth Targeting. No Participating Manufacturer may take any action, directly or indirectly, to target Youth within any Settling State in the advertising, promotion or marketing of Tobacco Products, or take any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within any Settling State.

(b) Ban on Use of Cartoons. Beginning 180 days after the MSA Execution Date, no Participating Manufacturer may use or cause to be used any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

(c) Limitation of Tobacco Brand Name Sponsorships.

(1) Prohibited Sponsorships. After the MSA Execution Date, no Participating Manufacturer may engage in any Brand Name Sponsorship in any State consisting of:

(A) concerts; or

(B) events in which the intended audience is comprised of a significant percentage of Youth; or

(C) events in which any paid participants or contestants are Youth; or

(D) any athletic event between opposing teams in any football, basketball, baseball, soccer or hockey league.

(2) Limited Sponsorships.

(A) No Participating Manufacturer may engage in more than one Brand Name Sponsorship in the States in any twelve-month period (such period measured from the date of the initial sponsored event).

(B) Provided, however, that

(i) nothing contained in subsection (2)(A) above shall require a Participating Manufacturer to breach or terminate any sponsorship contract in existence as of August 1, 1998 (until the earlier of (x) the current term of any existing contract, without regard to any renewal or option that may be exercised by such Participating Manufacturer or (y) three years after the MSA Execution Date); and

(ii) notwithstanding subsection (1)(A) above, Brown & Williamson Tobacco Corporation may sponsor either the GPC country music festival or the Kool jazz festival as its one annual Brand Name Sponsorship permitted pursuant to subsection (2)(A) as well as one Brand Name Sponsorship permitted pursuant to subsection (2)(B)(i).

(3) Related Sponsorship Restrictions. With respect to any Brand Name Sponsorship permitted under this subsection (c):

(A) advertising of the Brand Name Sponsorship event shall not advertise any Tobacco Product (other than by using the Brand Name to identify such Brand Name Sponsorship event);

(B) no Participating Manufacturer may refer to a Brand Name Sponsorship event or to a celebrity or other person in such an event in its advertising of a Tobacco Product;

(C) nothing contained in the provisions of subsection III(e) of this Agreement shall apply to actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to the provisions of subsections (2)(A) and (2)(B)(i); the Brand Name Sponsorship permitted by subsection (2)(B)(ii) shall be subject to the restrictions of subsection III(e) except that such restrictions shall not prohibit use of the Brand Name to identify the Brand Name Sponsorship;

(D) nothing contained in the provisions of subsections III(f) and III(i) shall apply to apparel or other merchandise: (i) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsections (2)(A) or (2)(B)(i) by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise; or (ii) used at the site of a Brand Name Sponsorship permitted pursuant to subsection (2)(A) or (2)(B)(i) (during such event) that are not distributed (by sale or otherwise) to any member of the general public; and

(E) nothing contained in the provisions of subsection III(d) shall: (i) apply to the use of a Brand Name on a vehicle used in a Brand Name Sponsorship; or (ii) apply to Outdoor Advertising advertising the Brand Name

Sponsorship, to the extent that such Outdoor Advertising is placed at the site of a Brand Name Sponsorship no more than 90 days before the start of the initial sponsored event, is removed within 10 days after the end of the last sponsored event, and is not prohibited by subsection (3)(A) above.

(4) Corporate Name Sponsorships. Nothing in this subsection (c) shall prevent a Participating Manufacturer from sponsoring or causing to be sponsored any athletic, musical, artistic, or other social or cultural event, or any entrant, participant or team in such event (or series of events) in the name of the corporation which manufactures Tobacco Products, provided that the corporate name does not include any Brand Name of domestic Tobacco Products.

(5) Naming Rights Prohibition. No Participating Manufacturer may enter into any agreement for the naming rights of any stadium or arena located within a Settling State using a Brand Name, and shall not otherwise cause a stadium or arena located within a Settling State to be named with a Brand Name.

(6) Prohibition on Sponsoring Teams and Leagues. No Participating Manufacturer may enter into any agreement pursuant to which payment is made (or other consideration is provided) by such Participating Manufacturer to any football, basketball, baseball, soccer or hockey league (or any team involved in any such league) in exchange for use of a Brand Name.

(d) Elimination of Outdoor Advertising and Transit Advertisements. Each Participating Manufacturer shall discontinue Outdoor Advertising and Transit Advertisements advertising Tobacco Products within the Settling States as set forth herein.

(1) Removal. Except as otherwise provided in this section, each Participating Manufacturer shall remove from within the Settling States within 150 days after the MSA Execution Date all of its (A) billboards (to the extent that such billboards constitute Outdoor Advertising) advertising Tobacco Products; (B) signs and placards (to the extent that such signs and placards constitute Outdoor Advertising) advertising Tobacco Products in arenas, stadiums, shopping malls and Video Game Arcades; and (C) Transit Advertisements advertising Tobacco Products.

(2) Prohibition on New Outdoor Advertising and Transit Advertisements. No Participating Manufacturer may, after the MSA Execution Date, place or cause to be placed any new Outdoor Advertising advertising Tobacco Products or new Transit Advertisements advertising Tobacco Products within any Settling State.

(3) Alternative Advertising. With respect to those billboards required to be removed under subsection (1) that are leased (as opposed to owned) by any Participating Manufacturer, the Participating Manufacturer will allow the Attorney General of the Settling State within which such billboards are located to substitute, at the Settling State's option, alternative advertising intended to discourage the use of Tobacco Products by Youth and their exposure to second-hand smoke for the remaining term of the applicable contract (without regard to any renewal or option term that may be exercised by such Participating Manufacturer). The Participating Manufacturer will bear the cost of the lease through the end of such remaining term. Any other costs associated with such alternative advertising will be borne by the Settling State.

(4) Ban on Agreements Inhibiting Anti-Tobacco Advertising. Each Participating Manufacturer agrees that it will not enter into any agreement that prohibits a third party from selling, purchasing or displaying advertising discouraging the use of Tobacco Products or exposure to second-hand smoke. In the event and to the extent that any Participating Manufacturer has entered into an agreement containing any such prohibition, such Participating Manufacturer agrees to waive such prohibition in such agreement.

(5) Designation of Contact Person. Each Participating Manufacturer that has Outdoor Advertising or Transit Advertisements advertising Tobacco Products within a Settling State shall, within 10 days after the MSA Execution Date, provide the Attorney General of such Settling State with the name of a contact person to whom the Settling State may direct inquiries during the time such Outdoor Advertising and Transit Advertisements are being eliminated, and from whom the Settling State may obtain periodic reports as to the progress of their elimination.

(6) Adult-Only Facilities. To the extent that any advertisement advertising Tobacco Products located within an Adult-Only Facility constitutes Outdoor Advertising or a Transit Advertisement, this subsection (d) shall not apply to such advertisement, provided such advertisement is not visible to persons outside such Adult-Only Facility.

(e) Prohibition on Payments Related to Tobacco Products and Media. No Participating Manufacturer may, beginning 30 days after the MSA Execution Date, make, or cause to be made, any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any motion picture, television show, theatrical production or other live performance, live or recorded performance of music, commercial film or video, or video game ("Media"); provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; or (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults.

(f) Ban on Tobacco Brand Name Merchandise. Beginning July 1, 1999, no Participating Manufacturer may, within any Settling State, market, distribute, offer, sell, license or cause to be marketed, distributed, offered, sold or licensed (including, without limitation, by catalogue or direct mail), any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this subsection shall (1) require any Participating Manufacturer to breach or

terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed, or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; or (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public.

(g) Ban on Youth Access to Free Samples. After the MSA Execution Date, no Participating Manufacturer may, within any Settling State, distribute or cause to be distributed any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Agreement, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

(h) Ban on Gifts to Underage Persons Based on Proofs of Purchase. Beginning one year after the MSA Execution Date, no Participating Manufacturer may provide or cause to be provided to any person without sufficient proof that such person is an Adult any item in exchange for the purchase of Tobacco Products, or the furnishing of credits, proofs-of-purchase, or coupons with respect to such a purchase. For purposes of the preceding sentence only, (1) a driver's license or other government-issued identification (or legible photocopy thereof), the validity of which is certified by the person to whom the item is provided, shall by itself be deemed to be a sufficient form of proof of age; and (2) in the case of items provided (or to be redeemed) at retail establishments, a Participating Manufacturer shall be entitled to rely on verification of proof of age by the retailer, where such retailer is required to obtain verification under applicable federal, state or local law.

(i) Limitation on Third-Party Use of Brand Names. After the MSA Execution Date, no Participating Manufacturer may license or otherwise expressly authorize any third party to use or advertise within any Settling State any Brand Name in a manner prohibited by this Agreement if done by such Participating Manufacturer itself. Each Participating Manufacturer shall, within 10 days after the MSA Execution Date, designate a person (and provide written notice to NAAG of such designation) to whom the Attorney General of any Settling State may provide written notice of any such third-party activity that would be prohibited by this Agreement if done by such Participating Manufacturer itself. Following such written notice, the Participating Manufacturer will promptly take commercially reasonable steps against any such non-de minimis third-party activity. Provided, however, that nothing in this subsection shall require any Participating Manufacturer to (1) breach or terminate any licensing agreement or other contract in existence as of July 1, 1998 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); or (2) retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer.

(j) Ban on Non-Tobacco Brand Names. No Participating Manufacturer may, pursuant to any agreement requiring the payment of money or other valuable consideration, use or cause to be used as a brand name of any Tobacco Product any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this subsection, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

(k) Minimum Pack Size of Twenty Cigarettes. No Participating Manufacturer may, beginning 60 days after the MSA Execution Date and through and including December 31, 2001, manufacture or cause to be manufactured for sale in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). No Participating Manufacturer may, beginning 150 days after the MSA Execution Date and through and including December 31, 2001, sell or distribute in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). Each Participating Manufacturer further agrees that following the MSA Execution Date it shall not oppose, or cause to be opposed (including through any third party or Affiliate), the passage by any Settling State of any legislative proposal or administrative rule applicable to all Tobacco Product Manufacturers and all retailers of Tobacco Products prohibiting the manufacture and sale of any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

(l) Corporate Culture Commitments Related to Youth Access and Consumption. Beginning 180 days after the MSA Execution Date each Participating Manufacturer shall:

promulgate or reaffirm corporate principles that express and explain its commitment to comply with the provisions of this Agreement and the reduction of use of Tobacco Products by Youth, and clearly and regularly communicate to its employees and customers its commitment to assist in the reduction of Youth use of Tobacco Products;

designate an executive level manager (and provide written notice to NAAG of such designation) to identify methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products; and

encourage its employees to identify additional methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products.

(m) Limitations on Lobbying. Following State-Specific Finality in a Settling State:

(1) No Participating Manufacturer may oppose, or cause to be opposed (including through any third party or Affiliate), the passage by such Settling State (or any political subdivision thereof) of those state or local legislative proposals or administrative rules described in Exhibit F hereto intended by their terms to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products. Provided, however, that the foregoing does not prohibit any Participating Manufacturer from (A) challenging enforcement of, or suing for declaratory or injunctive relief with respect to, any such legislation or rule on any grounds; (B) continuing, after State-Specific Finality in such Settling State, to oppose or cause to be opposed, the passage during the legislative session in which State-Specific Finality in such Settling State occurs of any specific state or local legislative proposals or administrative rules introduced prior to the time of State-Specific Finality in such Settling State; (C) opposing, or causing to be opposed, any excise tax or income tax provision or user fee or other payments relating to Tobacco Products or Tobacco Product Manufacturers; or (D) opposing, or causing to be opposed, any state or local legislative proposal or administrative rule that also includes measures other than those described in Exhibit F.

(2) Each Participating Manufacturer shall require all of its officers and employees engaged in lobbying activities in such Settling State after State-Specific Finality, contract lobbyists engaged in lobbying activities in such Settling State after State-Specific Finality, and any other third parties who engage in lobbying activities in such Settling State after State-Specific Finality on behalf of such Participating Manufacturer ("lobbyist" and "lobbying activities" having the meaning such terms have under the law of the Settling State in question) to certify in writing to the Participating Manufacturer that they:

(A) will not support or oppose any state, local or federal legislation, or seek or oppose any governmental action, on behalf of the Participating Manufacturer without the Participating Manufacturer's express authorization (except where such advance express authorization is not reasonably practicable);

(B) are aware of and will fully comply with this Agreement and all laws and regulations applicable to their lobbying activities, including, without limitation, those related to disclosure of financial contributions. Provided, however, that if the Settling State in question has in existence no laws or regulations relating to disclosure of financial contributions regarding lobbying activities, then each Participating Manufacturer shall, upon request of the Attorney General of such Settling State, disclose to such Attorney General any payment to a lobbyist that the Participating Manufacturer knows or has reason to know will be used to influence legislative or administrative actions of the state or local government relating to Tobacco Products or their use. Disclosures made pursuant to the preceding sentence shall be filed in writing with the Office of the Attorney General on the first day of February and the first day of August of each year for any and all payments made during the six month period ending on the last day of the preceding December and June, respectively, with the following information: (1) the name, address, telephone number and e-mail address (if any) of the recipient; (2) the amount of each payment; and (3) the aggregate amount of all payments described in this subsection (2)(B) to the recipient in the calendar year; and

(C) have reviewed and will fully abide by the Participating Manufacturer's corporate principles promulgated pursuant to this Agreement when acting on behalf of the Participating Manufacturer.

(3) No Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) in Congress or any other forum legislation or rules that would preempt, override, abrogate or diminish such Settling State's rights or recoveries under this Agreement. Except as specifically provided in this Agreement, nothing herein shall be deemed to restrain any Settling State or Participating Manufacturer from advocating terms of any national settlement or taking any other positions on issues relating to tobacco.

(n) Restriction on Advocacy Concerning Settlement Proceeds. After the MSA Execution Date, no Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) the diversion of any proceeds of this settlement to any program or use that is neither tobacco-related nor health-related in connection with the approval of this Agreement or in any subsequent legislative appropriation of settlement proceeds.

(o) Dissolution of The Tobacco Institute, Inc., the Council for Tobacco Research-U.S.A., Inc. and the Center for Indoor Air Research, Inc.

(1) The Council for Tobacco Research-U.S.A., Inc. ("CTR") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to the plan of dissolution previously negotiated and agreed to between the Attorney General of the State of New York and CTR, cease all operations and be dissolved in accordance with the laws of the State of New York (and with the preservation of all applicable privileges held by any member company of CTR).

(2) The Tobacco Institute, Inc. ("TI") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to a plan of dissolution to be negotiated by the Attorney General of the State of New York and the Original Participating Manufacturers in accordance with Exhibit G hereto, cease all operations and be dissolved in

accordance with the laws of the State of New York and under the authority of the Attorney General of the State of New York (and with the preservation of all applicable privileges held by any member company of TI).

(3) Within 45 days after Final Approval, the Center for Indoor Air Research, Inc. ("CIAR") shall cease all operations and be dissolved in a manner consistent with applicable law and with the preservation of all applicable privileges (including, without limitation, privileges held by any member company of CIAR).

(4) The Participating Manufacturers shall direct the Tobacco-Related Organizations to preserve all records that relate in any way to issues raised in smoking-related health litigation.

(5) The Participating Manufacturers may not reconstitute CTR or its function in any form.

(6) The Participating Manufacturers represent that they have the authority to and will effectuate subsections (1) through (5) hereof.

(p) Regulation and Oversight of New Tobacco-Related Trade Associations.

(1) A Participating Manufacturer may form or participate in new tobacco-related trade associations (subject to all applicable laws), provided such associations agree in writing not to act in any manner contrary to any provision of this Agreement. Each Participating Manufacturer agrees that if any new tobacco-related trade association fails to so agree, such Participating Manufacturer will not participate in or support such association.

(2) Any tobacco-related trade association that is formed or controlled by one or more of the Participating Manufacturers after the MSA Execution Date shall adopt by-laws governing the association's procedures and the activities of its members, board, employees, agents and other representatives with respect to the tobacco-related trade association. Such by-laws shall include, among other things, provisions that:

(A) each officer of the association shall be appointed by the board of the association, shall be an employee of such association, and during such officer's term shall not be a director of or employed by any member of the association or by an Affiliate of any member of the association;

(B) legal counsel for the association shall be independent, and neither counsel nor any member or employee of counsel's law firm shall serve as legal counsel to any member of the association or to a manufacturer of Tobacco Products that is an Affiliate of any member of the association during the time that it is serving as legal counsel to the association; and

(C) minutes describing the substance of the meetings of the board of directors of the association shall be prepared and shall be maintained by the association for a period of at least five years following their preparation.

(3) Without limitation on whatever other rights to access they may be permitted by law, for a period of seven years from the date any new tobacco-related trade association is formed by any of the Participating Manufacturers after the MSA Execution Date the antitrust authorities of any Settling State may, for the purpose of enforcing this Agreement, upon reasonable cause to believe that a violation of this Agreement has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days):

(A) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of such association insofar as they pertain to such believed violation; and

(B) interview the association's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation.

Documents and information provided to Settling State antitrust authorities shall be kept confidential by and among such authorities, and shall be utilized only by the Settling States and only for the purpose of enforcing this Agreement or the criminal law. The inspection and discovery rights provided to the Settling States pursuant to this subsection shall be coordinated so as to avoid repetitive and excessive inspection and discovery.

(q) Prohibition on Agreements to Suppress Research. No Participating Manufacturer may enter into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in this subsection shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

(r) Prohibition on Material Misrepresentations. No Participating Manufacturer may make any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Nothing in this subsection shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

IV. PUBLIC ACCESS TO DOCUMENTS

(a) After the MSA Execution Date, the Original Participating Manufacturers and the Tobacco-Related Organizations will support an application for the dissolution of any protective orders entered in each Settling State's lawsuit identified in Exhibit D with respect only to those documents, indices and privilege logs that have been produced as of the MSA Execution Date to such Settling State and (1) as to which defendants have made no claim, or have withdrawn any claim, of attorney-client privilege, attorney work-product protection, common interest/joint defense privilege (collectively, "privilege"), trade-secret protection, or confidential or proprietary business information; and (2) that are not inappropriate for public disclosure because of personal privacy interests or contractual rights of third parties that may not be abrogated by the Original Participating Manufacturers or the Tobacco-Related Organizations.

(b) Notwithstanding State-Specific Finality, if any order, ruling or recommendation was issued prior to September 17, 1998 rejecting a claim of privilege or trade-secret protection with respect to any document or documents in a lawsuit identified in Exhibit D, the Settling State in which such order, ruling or recommendation was made may, no later than 45 days after the occurrence of State-Specific Finality in such Settling State, seek public disclosure of such document or documents by application to the court that issued such order, ruling or recommendation and the court shall retain jurisdiction for such purposes. The Original Participating Manufacturers and Tobacco-Related Organizations do not consent to, and may object to, appeal from or otherwise oppose any such application for disclosure. The Original Participating Manufacturers and Tobacco-Related Organizations will not assert that the settlement of such lawsuit has divested the court of jurisdiction or that such Settling State lacks standing to seek public disclosure on any applicable ground.

(c) The Original Participating Manufacturers will maintain at their expense their Internet document websites accessible through "TobaccoResolution.com" or a similar website until June 30, 2010. The Original Participating Manufacturers will maintain the documents that currently appear on their respective websites and will add additional documents to their websites as provided in this section IV.

(d) Within 180 days after the MSA Execution Date, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of the following documents, except as provided in subsections IV(e) and IV(f) below:

(1) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in any action identified in Exhibit D or any action identified in section 2 of Exhibit H that was filed by an Attorney General. Among these documents, each Original Participating Manufacturer and Tobacco-Related Organization will give the highest priority to (A) the documents that were listed by the State of Washington as trial exhibits in the State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King); and (B) the documents as to which such Original Participating Manufacturer or Tobacco-Related Organization withdrew any claim of privilege as a result of the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County);

(2) all documents that can be identified as having been produced by, and copies of transcripts of depositions given by, such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in the litigation matters specified in section 1 of Exhibit H; and

(3) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date and listed by the plaintiffs as trial exhibits in the litigation matters specified in section 2 of Exhibit H.

(e) Unless copies of such documents are already on its website, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of documents produced in any production of documents that takes place on or after the date 30 days before the MSA Execution Date in any federal or state court civil action concerning smoking and health. Copies of any documents required to be placed on a website pursuant to this subsection will be placed on such website within the later of 45 days after the MSA Execution Date or within 45 days after the production of such documents in any federal or state court action concerning smoking and health. This obligation will continue until June 30, 2010. In placing such newly produced documents on its website, each Original Participating Manufacturer or Tobacco-Related Organization will identify, as part of its index to be created pursuant to subsection IV(h), the action in which it produced such documents and the date on which such documents were added to its website.

(f) Nothing in this section IV shall require any Original Participating Manufacturer or Tobacco-Related Organization to place on its website or otherwise disclose documents that: (1) it continues to claim to be privileged, a trade secret, confidential or proprietary business information, or that contain other information not appropriate for public disclosure because of personal privacy interests or contractual rights of third parties; or (2) continue to be subject to any protective order, sealing order or other order or ruling that prevents or limits a litigant from disclosing such documents.

(g) Oversized or multimedia records will not be required to be placed on the Website, but each Original Participating Manufacturers and Tobacco-Related Organizations will make any such records available to the public by placing copies of them in the document depository established in The State of Minnesota, et al. v. Philip Morris Incorporated, et al., C1-94-8565 (County of Ramsey, District Court, 2d Judicial Cir.).

(h) Each Original Participating Manufacturer will establish an index and other features to improve searchable access to the document images on its website, as set forth in Exhibit I.

(i) Within 90 days after the MSA Execution Date, the Original Participating Manufacturers will furnish NAAG with a project plan for completing the Original Participating Manufacturers' obligations under subsection IV(h) with respect to documents currently on their websites and documents being placed on their websites pursuant to subsection IV(d). NAAG may engage a computer consultant at the Original Participating Manufacturers' expense for a period not to exceed two years and at a cost not to exceed $100,000. NAAG's computer consultant may review such plan and make recommendations consistent with this Agreement. In addition, within 120 days after the completion of the Original Participating Manufacturers' obligations under subsection IV(d), NAAG's computer consultant may make final recommendations with respect to the websites consistent with this Agreement. In preparing these recommendations, NAAG's computer consultant may seek input from Settling State officials, public health organizations and other users of the websites.

(j) The expenses incurred pursuant to subsection IV(i), and the expenses related to documents of the Tobacco-Related Organizations, will be severally shared among the Original Participating Manufacturers (allocated among them according to their Relative Market Shares). All other expenses incurred under this section will be borne by the Original Participating Manufacturer that incurs such expense.

V. TOBACCO CONTROL AND UNDERAGE USE LAWS

Each Participating Manufacturer agrees that following State-Specific Finality in a Settling State it will not initiate, or cause to be initiated, a facial challenge against the enforceability or constitutionality of such Settling State's (or such Settling State's political subdivisions') statutes, ordinances and administrative rules relating to tobacco control enacted prior to June 1, 1998 (other than a statute, ordinance or rule challenged in any lawsuit listed in Exhibit M).

VI. ESTABLISHMENT OF A NATIONAL FOUNDATION

(a) Foundation Purposes. The Settling States believe that a comprehensive, coordinated program of public education and study is important to further the remedial goals of this Agreement. Accordingly, as part of the settlement of claims described herein, the payments specified in subsections VI(b), VI(c), and IX(e) shall be made to a charitable foundation, trust or similar organization (the "Foundation") and/or to a program to be operated within the Foundation (the "National Public Education Fund"). The purposes of the Foundation will be to support (1) the study of and programs to reduce Youth Tobacco Product usage and Youth substance abuse in the States, and (2) the study of and educational programs to prevent diseases associated with the use of Tobacco Products in the States.

(b) Base Foundation Payments. On March 31, 1999, and on March 31 of each subsequent year for a period of nine years thereafter, each Original Participating Manufacturer shall severally pay its Relative Market Share of $25,000,000 to fund the Foundation. The payments to be made by each of the Original Participating Manufacturers pursuant to this subsection (b) shall be subject to no adjustments, reductions, or offsets, and shall be paid to the Escrow Agent (to be credited to the Subsection VI(b) Account), who shall disburse such payments to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State.

(c) National Public Education Fund Payments.

(1) Each Original Participating Manufacturer shall severally pay its Relative Market Share of the following base amounts on the following dates to the Escrow Agent for the benefit of the Foundation's National Public Education Fund to be used for the purposes and as described in subsections VI(f)(1), VI(g) and VI(h) below: $250,000,000 on March 31, 1999; $300,000,000 on March 31, 2000; $300,000,000 on March 31, 2001; $300,000,000 on March 31, 2002; and $300,000,000 on March 31, 2003, as such amounts are modified in accordance with this subsection (c). The payment due on March 31, 1999 pursuant to this subsection (c)(1) is to be credited to the Subsection VI(c) Account (First). The payments due on or after March 31, 2000 pursuant to this subsection VI(c)(1) are to be credited to the Subsection VI(c) Account (Subsequent).

(2) The payments to be made by the Original Participating Manufacturers pursuant to this subsection (c), other than the payment due on March 31, 1999, shall be subject to the Inflation Adjustment, the Volume Adjustment and the offset for miscalculated or disputed payments described in subsection XI(i).

(3) The payment made pursuant to this subsection (c) on March 31, 1999 shall be disbursed by the Escrow Agent to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State. Each remaining payment pursuant to this subsection (c) shall be disbursed by the Escrow Agent to the Foundation only when State-Specific Finality has occurred in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date.

(4) In addition to the payments made pursuant to this subsection (c), the National Public Education Fund will be funded (A) in accordance with subsection IX(e), and (B) through monies contributed by other entities directly to the Foundation and designated for the National Public Education Fund ("National Public Education Fund Contributions").

(5) The payments made by the Original Participating Manufacturers pursuant to this subsection (c) and/or subsection IX(e) and monies received from all National Public Education Fund Contributions will be deposited and invested in accordance with the laws of the state of incorporation of the Foundation.

(d) Creation and Organization of the Foundation. NAAG, through its executive committee, will provide for the creation of the Foundation. The Foundation shall be organized exclusively for charitable, scientific, and educational purposes within the meaning of Internal Revenue Code section 501(c)(3). The organizational documents of the Foundation shall specifically incorporate the provisions of this Agreement relating to the Foundation, and will provide for payment of the Foundation's administrative expenses from the funds paid pursuant to subsection VI(b) or VI(c). The Foundation shall be governed by a board of directors. The board of directors shall be comprised of eleven directors. NAAG, the National Governors' Association ("NGA"), and the National Conference of State Legislatures ("NCSL") shall each select from its membership two directors. These six directors shall select the five additional directors. One of these five additional directors shall have expertise in public health issues. Four of these five additional directors shall have expertise in medical, child psychology, or public health disciplines. The board of directors shall be nationally geographically diverse.

(e) Foundation Affiliation. The Foundation shall be formally affiliated with an educational or medical institution selected by the board of directors.

(f) Foundation Functions. The functions of the Foundation shall be:

(1) carrying out a nationwide sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products;

(2) developing and disseminating model advertising and education programs to counter the use by Youth of substances that are unlawful for use or purchase by Youth, with an emphasis on reducing Youth smoking; monitoring and testing the effectiveness of such model programs; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs, as appropriate;

(3) developing and disseminating model classroom education programs and curriculum ideas about smoking and substance abuse in the K-12 school system, including specific target programs for special at-risk populations; monitoring and testing the effectiveness of such model programs and ideas; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs or ideas, as appropriate;

(4) developing and disseminating criteria for effective cessation programs; monitoring and testing the effectiveness of such criteria; and continuing to develop and disseminate revised versions of such criteria, as appropriate;

(5) commissioning studies, funding research, and publishing reports on factors that influence Youth smoking and substance abuse and developing strategies to address the conclusions of such studies and research;

(6) developing other innovative Youth smoking and substance abuse prevention programs;

(7) providing targeted training and information for parents;

(8) maintaining a library open to the public of Foundation-funded studies, reports and other publications related to the cause and prevention of Youth smoking and substance abuse;

(9) tracking and monitoring Youth smoking and substance abuse, with a focus on the reasons for any increases or failures to decrease Youth smoking and substance abuse and what actions can be taken to reduce Youth smoking and substance abuse;

(10) receiving, controlling, and managing contributions from other entities to further the purposes described in this Agreement; and

(11) receiving, controlling, and managing such funds paid by the Participating Manufacturers pursuant to subsections VI(b) and VI(c) above.

(g) Foundation Grant-Making. The Foundation is authorized to make grants from the National Public Education Fund to Settling States and their political subdivisions to carry out sustained advertising and education programs to (1) counter the use by Youth of Tobacco Products, and (2) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products. In making such grants, the Foundation shall consider whether the Settling State or political subdivision applying for such grant:

(1) demonstrates the extent of the problem regarding Youth smoking in such Settling State or political subdivision;

(2) either seeks the grant to implement a model program developed by the Foundation or provides the Foundation with a specific plan for such applicant's intended use of the grant monies, including demonstrating such applicant's ability to develop an effective advertising/education campaign and to assess the effectiveness of such advertising/education campaign;

(3) has other funds readily available to carry out a sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products; and

(4) is a Settling State that has not severed this section VI from its settlement with the Participating Manufacturers pursuant to subsection VI(i) below, or is a political subdivision in such a Settling State.

(h) Foundation Activities. The Foundation shall not engage in, nor shall any of the Foundation's money be used to engage in, any political activities or lobbying, including, but not limited to, support of or opposition to candidates, ballot initiatives, referenda or other similar activities. The National Public Education Fund shall be used only for public education and advertising regarding the addictiveness, health effects, and social costs related to the use of tobacco products and shall not be used for any personal attack on, or vilification of, any person (whether by name or business affiliation), company, or governmental agency, whether individually or collectively. The Foundation shall work to ensure that its activities are carried out in a culturally and linguistically appropriate manner. The Foundation's activities (including the National Public Education Fund) shall be carried out solely within the States. The payments described in subsections VI(b) and VI(c) above are made at the direction and on behalf of Settling States. By making such payments in such manner, the Participating Manufacturers do not undertake and expressly disclaim any responsibility with respect to the creation, operation, liabilities, or tax status of the Foundation or the National Public Education Fund.

(i) Severance of this Section. If the Attorney General of a Settling State determines that such Settling State may not lawfully enter into this section VI as a matter of applicable state law, such Attorney General may sever this section VI from its settlement with the Participating Manufacturers by giving written notice of such severance to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k) hereof. If any Settling State exercises its right to sever this section VI, this section VI shall not be considered a part of the specific settlement between such Settling State and the Participating Manufacturers, and this section VI shall not be enforceable by or in such Settling State. The payment obligation of subsections VI(b) and VI(c) hereof shall apply regardless of a determination by one or more Settling States to sever section VI hereof; provided, however, that if all Settling States sever section VI hereof, the payment obligations of subsections (b) and (c) hereof shall be null and void. If the Attorney General of a Settling State that severed this section VI subsequently determines that such Settling State may lawfully enter into this section VI as a matter of applicable state law, such Attorney General may rescind such Settling State's previous severance of this section VI by giving written notice of such rescission to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k). If any Settling State rescinds such severance, this section VI shall be considered a part of the specific settlement between such Settling State and the Participating Manufacturers (including for purposes of subsection (g)(4)), and this section VI shall be enforceable by and in such Settling State.

VII. ENFORCEMENT

(a) Jurisdiction. Each Participating Manufacturer and each Settling State acknowledge that the Court: (1) has jurisdiction over the subject matter of the action identified in Exhibit D in such Settling State and over each Participating Manufacturer; (2) shall retain exclusive jurisdiction for the purposes of implementing and enforcing this Agreement and the Consent Decree as to such Settling State; and (3) except as provided in subsections IX(d), XI(c) and XVII(d) and Exhibit O, shall be the only court to which disputes under this Agreement or the Consent Decree are presented as to such Settling State. Provided, however, that notwithstanding the foregoing, the Escrow Court (as defined in the Escrow Agreement) shall have exclusive jurisdiction, as provided in section 15 of the Escrow Agreement, over any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, the Escrow Agreement.

(b) Enforcement of Consent Decree. Except as expressly provided in the Consent Decree, any Settling State or Released Party may apply to the Court to enforce the terms of the Consent Decree (or for a declaration construing any such term) with respect to alleged violations within such Settling State. A Settling State may not seek to enforce the Consent Decree of another Settling State; provided, however, that nothing contained herein shall affect the ability of any Settling State to (1) coordinate state enforcement actions or proceedings, or (2) file or join any amicus brief. In the event that the Court determines that any Participating Manufacturer or Settling State has violated the Consent Decree within such Settling State, the party that initiated the proceedings may request any and all relief available within such Settling State pursuant to the Consent Decree.

(c) Enforcement of this Agreement.

(1) Except as provided in subsections IX(d), XI(c), XVII(d) and Exhibit O, any Settling State or Participating Manufacturer may bring an action in the Court to enforce the terms of this Agreement (or for a declaration construing any such term ("Declaratory Order")) with respect to disputes, alleged violations or alleged breaches within such Settling State.

(2) Before initiating such proceedings, a party shall provide 30 days' written notice to the Attorney General of each Settling State, to NAAG, and to each Participating Manufacturer of its intent to initiate proceedings pursuant to this subsection. The 30-day notice period may be shortened in the event that the relevant Attorney General reasonably determines that a compelling time-sensitive public health and safety concern requires more immediate action.

(3) In the event that the Court determines that any Participating Manufacturer or Settling State has violated or breached this Agreement, the party that initiated the proceedings may request an order restraining such violation or breach, and/or ordering compliance within such Settling State (an "Enforcement Order").

(4) If an issue arises as to whether a Participating Manufacturer has failed to comply with an Enforcement Order, the Attorney General for the Settling State in question may seek an order for interpretation or for monetary, civil contempt or criminal sanctions to enforce compliance with such Enforcement Order.

(5) If the Court finds that a good-faith dispute exists as to the meaning of the terms of this Agreement or a Declaratory Order, the Court may in its discretion determine to enter a Declaratory Order rather than an Enforcement Order.

(6) Whenever possible, the parties shall seek to resolve an alleged violation of this Agreement by discussion pursuant to subsection XVIII(m) of this Agreement. In addition, in determining whether to seek an Enforcement Order, or in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation of an Enforcement Order, the Attorney General shall give good-faith consideration to whether the Participating Manufacturer that is claimed to have violated this Agreement has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless such party has been guilty of a pattern of violations of like nature.

(d) Right of Review. All orders and other judicial determinations made by any court in connection with this Agreement or any Consent Decree shall be subject to all available appellate review, and nothing in this Agreement or any Consent Decree shall be deemed to constitute a waiver of any right to any such review.

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

(f) Coordination of Enforcement. The Attorneys General of the Settling States (through NAAG) shall monitor potential conflicting interpretations by courts of different States of this Agreement and the Consent Decrees. The Settling States shall use their best efforts, in cooperation with the Participating Manufacturers, to coordinate and resolve the effects of such conflicting interpretations as to matters that are not exclusively local in nature.

(g) Inspection and Discovery Rights. Without limitation on whatever other rights to access they may be permitted by law, following State-Specific Finality in a Settling State and for seven years thereafter, representatives of the Attorney General of such Settling State may, for the purpose of enforcing this Agreement and the Consent Decree, upon reasonable cause to believe that a violation of this Agreement or the Consent Decree has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days): (1) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of each Participating Manufacturer insofar as they pertain to such believed violation; and (2) interview each Participating Manufacturer's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation. Documents and information provided to representatives of the Attorney General of such Settling State pursuant to this section VII shall be kept confidential by the Settling States, and shall be utilized only by the Settling States and only for purposes of enforcing this Agreement, the Consent Decree and the criminal law. The inspection and discovery rights provided to such Settling State pursuant to this subsection shall be coordinated through NAAG so as to avoid repetitive and excessive inspection and discovery.

VIII. CERTAIN ONGOING RESPONSIBILITIES OF THE SETTLING STATES

(a) Upon approval of the NAAG executive committee, NAAG will provide coordination and facilitation for the implementation and enforcement of this Agreement on behalf of the Attorneys General of the Settling States, including the following:

(1) NAAG will assist in coordinating the inspection and discovery activities referred to in subsections III(p)(3) and VII(g) regarding compliance with this Agreement by the Participating Manufacturers and any new tobacco-related trade associations.

(2) NAAG will convene at least two meetings per year and one major national conference every three years for the Attorneys General of the Settling States, the directors of the Foundation and three persons designated by each Participating Manufacturer. The purpose of the meetings and conference is to evaluate the success of this Agreement and coordinate efforts by the Attorneys General and the Participating Manufacturers to continue to reduce Youth smoking.

(3) NAAG will periodically inform NGA, NCSL, the National Association of Counties and the National League of Cities of the results of the meetings and conferences referred to in subsection (a)(2) above.

(4) NAAG will support and coordinate the efforts of the Attorneys General of the Settling States in carrying out their responsibilities under this Agreement.

(5) NAAG will perform the other functions specified for it in this Agreement, including the functions specified in section IV.

(b) Upon approval by the NAAG executive committee to assume the responsibilities outlined in subsection VIII(a) hereof, each Original Participating Manufacturer shall cause to be paid, beginning on December 31, 1998, and on December 31 of each year thereafter through and including December 31, 2007, its Relative Market Share of $150,000 per year to the Escrow Agent (to be credited to the Subsection VIII(b) Account), who shall disburse such monies to NAAG within 10 Business Days, to fund the activities described in subsection VIII(a).

(c) The Attorneys General of the Settling States, acting through NAAG, shall establish a fund ("The States' Antitrust/Consumer Protection Tobacco Enforcement Fund") in the form attached as Exhibit J, which will be maintained by

such Attorneys General to supplement the Settling States' (1) enforcement and implementation of the terms of this Agreement and the Consent Decrees, and (2) investigation and litigation of potential violations of laws with respect to Tobacco Products, as set forth in Exhibit J. Each Original Participating Manufacturer shall on March 31, 1999, severally pay its Relative Market Share of $50,000,000 to the Escrow Agent (to be credited to the Subsection VIII(c) Account), who shall disburse such monies to NAAG upon the occurrence of State-Specific Finality in at least one Settling State. Such funds will be used in accordance with the provisions of Exhibit J.

IX. PAYMENTS

(a) All Payments Into Escrow. All payments made pursuant to this Agreement (except those payments made pursuant to section XVII) shall be made into escrow pursuant to the Escrow Agreement, and shall be credited to the appropriate Account established pursuant to the Escrow Agreement. Such payments shall be disbursed to the beneficiaries or returned to the Participating Manufacturers only as provided in section XI and the Escrow Agreement. No payment obligation under this Agreement shall arise (1) unless and until the Escrow Court has approved and retained jurisdiction over the Escrow Agreement or (2) if such approval is reversed (unless and until such reversal is itself reversed). The parties agree to proceed as expeditiously as possible to resolve any issues that prevent approval of the Escrow Agreement. If any payment (other than the first initial payment under subsection IX(b)) is delayed because the Escrow Agreement has not been approved, such payment shall be due and payable (together with interest at the Prime Rate) within 10 Business Days after approval of the Escrow Agreement by the Escrow Court.

(b) Initial Payments. On the second Business Day after the Escrow Court approves and retains jurisdiction over the Escrow Agreement, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(b) Account (First)) its Market Capitalization Percentage (as set forth in Exhibit K) of the base amount of $2,400,000,000. On January 10, 2000, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,472,000,000. On January 10, 2001, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,546,160,000. On January 10, 2002, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,622,544,800. On January 10, 2003, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,701,221,144. The payments pursuant to this subsection (b) due on or after January 10, 2000 shall be credited to the Subsection IX(b) Account (Subsequent). The foregoing payments shall be modified in accordance with this subsection (b). The payments made by the Original Participating Manufacturers pursuant to this subsection (b) (other than the first such payment) shall be subject to the Volume Adjustment, the Non-Settling States Reduction and the offset for miscalculated or disputed payments described in subsection XI(i). The first payment due under this subsection (b) shall be subject to the Non-Settling States Reduction, but such reduction shall be determined as of the date one day before such payment is due (rather than the date 15 days before).

(c) Annual Payments and Strategic Contribution Payments.

(1) On April 15, 2000 and on April 15 of each year thereafter in perpetuity, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(1) Account) its Relative Market Share of the base amounts specified below, as such payments are modified in accordance with this subsection (c)(1):

Year	Base Amount
2000	$4,500,000,000
2001	$5,000,000,000
2002	$6,500,000,000
2003	$6,500,000,000
2004	$8,000,000,000
2005	$8,000,000,000
2006	$8,000,000,000
2007	$8,000,000,000
2008	$8,139,000,000
2009	$8,139,000,000
2010	$8,139,000,000
2011	$8,139,000,000
2012	$8,139,000,000
2013	$8,139,000,000
2014	$8,139,000,000
2015	$8,139,000,000
2016	$8,139,000,000
2017	$8,139,000,000
2018 and each year thereafter	$9,000,000,000

The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(1) shall be subject to the Inflation Adjustment, the Volume Adjustment, the Previously Settled States Reduction, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal

Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8).

(2) On April 15, 2008 and on April 15 of each year thereafter through 2017, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(2) Account) its Relative Market Share of the base amount of $861,000,000, as such payments are modified in accordance with this subsection (c)(2). The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be subject to the Inflation Adjustment, the Volume Adjustment, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8). Such payments shall also be subject to the Non-Settling States Reduction; provided, however, that for purposes of payments due pursuant to this subsection (c)(2) (and corresponding payments by Subsequent Participating Manufacturers under subsection IX(i)), the Non-Settling States Reduction shall be derived as follows: (A) the payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be allocated among the Settling States on a percentage basis to be determined by the Settling States pursuant to the procedures set forth in Exhibit U, and the resulting allocation percentages disclosed to the Escrow Agent, the Independent Auditor and the Original Participating Manufacturers not later than June 30, 1999; and (B) the Non-Settling States Reduction shall be based on the sum of the Allocable Shares so established pursuant to subsection (c)(2)(A) for those States that were Settling States as of the MSA Execution Date and as to which this Agreement has terminated as of the date 15 days before the payment in question is due.

(d) Non-Participating Manufacturer Adjustment.

(1) Calculation of NPM Adjustment for Original Participating Manufacturers. To protect the public health gains achieved by this Agreement, certain payments made pursuant to this Agreement shall be subject to an NPM Adjustment. Payments by the Original Participating Manufacturers to which the NPM Adjustment applies shall be adjusted as provided below:

(A) Subject to the provisions of subsections (d)(1)(C), (d)(1)(D) and (d)(2) below, each Allocated Payment shall be adjusted by subtracting from such Allocated Payment the product of such Allocated Payment amount multiplied by the NPM Adjustment Percentage. The "NPM Adjustment Percentage" shall be calculated as follows:

(i) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is less than or equal to 0 (zero), then the NPM Adjustment Percentage shall equal zero.

(ii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 0 (zero) and less than or equal to 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the product of (x) such Market Share Loss and (y) 3 (three).

(iii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the sum of (x) 50 percentage points and (y) the product of (*1*) the Variable Multiplier and (*2*) the result of such Market Share Loss minus 16 2/3 percentage points.

(B) Definitions:

(i) "Base Aggregate Participating Manufacturer Market Share" means the result of (x) the sum of the applicable Market Shares (the applicable Market Share to be that for 1997) of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due minus (y) 2 (two) percentage points.

(ii) "Actual Aggregate Participating Manufacturer Market Share" means the sum of the applicable Market Shares of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question is due).

(iii) "Market Share Loss" means the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) the Actual Aggregate Participating Manufacturer Market Share.

(iv) "Variable Multiplier" equals 50 percentage points divided by the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) 16 2/3 percentage points.

(C) On or before February 2 of each year following a year in which there was a Market Share Loss greater than zero, a nationally recognized firm of economic consultants (the "Firm") shall determine whether the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall apply. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were not a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall not apply. The Original Participating Manufacturers, the Settling States, and the Attorneys General for the Settling States shall cooperate to ensure that the determination described in this subsection (1)(C) is timely made. The Firm shall be acceptable to (and the principals responsible for this assignment shall be acceptable to) both the Original Participating Manufacturers and a majority of those Attorneys General who are both the

Attorney General of a Settling State and a member of the NAAG executive committee at the time in question (or in the event no such firm or no such principals shall be acceptable to such parties, National Economic Research Associates, Inc., or its successors by merger, acquisition or otherwise ("NERA"), acting through a principal or principals acceptable to such parties, if such a person can be identified and, if not, acting through a principal or principals identified by NERA, or a successor firm selected by the CPR Institute for Dispute Resolution). As soon as practicable after the MSA Execution Date, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of making the foregoing determination, and the Firm shall provide written notice to each Settling State, to NAAG, to the Independent Auditor and to each Participating Manufacturer of such determination. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable. The reasonable fees and expenses of the Firm shall be paid by the Original Participating Manufacturers according to their Relative Market Shares. Only the Participating Manufacturers and the Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (1)(C).

(D) No NPM Adjustment shall be made with respect to a payment if the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico in the year immediately preceding the year in which the payment in question is due by those Participating Manufacturers that had become Participating Manufacturers prior to 14 days after the MSA Execution Date is greater than the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico in 1997 by such Participating Manufacturers (and any of their Affiliates that made such shipments in 1997, as demonstrated by certified audited statements of such Affiliates' shipments, and that do not continue to make such shipments after the MSA Execution Date because the responsibility for such shipments has been transferred to one of such Participating Manufacturers). Measurements of shipments for purposes of this subsection (D) shall be made in the manner prescribed in subsection II(mm); in the event that such shipment data is unavailable for any Participating Manufacturer for 1997, such Participating Manufacturer's shipment volume for such year shall be measured in the manner prescribed in subsection II(z).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(C) Adjustments:

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

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

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

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

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

In the event that in any year a reallocation of the shares of the Available NPM Adjustment between Lorillard and Philip Morris pursuant to this subsection (d)(3)(D) results in Philip Morris's share of the Available NPM Adjustment in such year exceeding the greater of (x) Philip Morris's Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding such year), or (y) Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C), Philip Morris's share of the Available NPM Adjustment in such year shall be reduced to equal the greater of (x) or (y) above. In such instance, the dollar amount by which Philip Morris's share of the Available NPM Adjustment is reduced pursuant to the preceding sentence shall be reallocated to Lorillard and used to increase Lorillard's share of the Available NPM Adjustment in such year.

(iv) In the event that either Philip Morris or Lorillard is treated as a Non-Participating Manufacturer for purposes of this subsection IX(d)(3) pursuant to subsection XVIII(w)(2)(A), this subsection (3)(D) shall not be applied, and the Original Participating Manufacturers' shares of the Available NPM Adjustment shall be determined solely as described in subsections (3)(A)-(C).

(4) NPM Adjustment for Subsequent Participating Manufacturers. Subject to the provisions of subsection IX(i)(3), a Subsequent Participating Manufacturer shall be entitled to an NPM Adjustment with respect to payments due from such Subsequent Participating Manufacturer in any year during which an NPM Adjustment is applicable under subsection (d)(1) above to payments due from the Original Participating Manufacturers. The amount of such NPM Adjustment shall equal the product of (A) the NPM Adjustment Percentage for such year multiplied by (B) the sum of the payments due in the year in question from such Subsequent Participating Manufacturer that correspond to payments due from Original Participating Manufacturers pursuant to subsection IX(c) (as such payment amounts due from such Subsequent Participating Manufacturer have been adjusted and allocated pursuant to clauses "First" through "Fifth" of subsection IX(j)). The NPM Adjustment to payments by each Subsequent Participating Manufacturer shall be allocated and reallocated among the Settling States in a manner consistent with subsection (d)(2) above.

(e) Supplemental Payments. Beginning on April 15, 2004, and on April 15 of each year thereafter in perpetuity, in the event that the sum of the Market Shares of the Participating Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question would be due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question would be due) equals or exceeds 99.0500000%, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(e) Account) for the benefit of the Foundation its Relative Market Share of the base amount of $300,000,000, as such payments are modified in accordance with this subsection (e). Such payments shall be utilized by the Foundation to fund the national public education functions of the Foundation described in subsection VI(f)(1), in the manner described in and subject to the provisions of subsections VI(g) and VI(h). The payments made by the Original Participating Manufacturers pursuant to this subsection shall be subject to the Inflation Adjustment, the Volume Adjustment, the Non-Settling States Reduction, and the offset for miscalculated or disputed payments described in subsection XI(i).

(f) Payment Responsibility. The payment obligations of each Participating Manufacturer pursuant to this Agreement shall be the several responsibility only of that Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any Affiliate of such Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any other Participating Manufacturer. Provided, however, that no provision of this Agreement shall waive or excuse liability under any state or federal fraudulent conveyance or fraudulent transfer law. Any Participating Manufacturer whose Market Share (or Relative Market Share) in any given year equals zero shall have no payment obligations under this Agreement in the succeeding year.

(g) Corporate Structures. Due to the particular corporate structures of R.J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("B&W") with respect to their non-domestic tobacco operations, Reynolds and B&W shall be severally liable for their respective shares of each payment due pursuant to this Agreement up to (and their liability hereunder shall not exceed) the full extent of their assets used in and earnings derived from, the manufacture and/or sale in the States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of their other assets or earnings to satisfy such obligations.

(h) Accrual of Interest. Except as expressly provided otherwise in this Agreement, any payment due hereunder and not paid when due (or payments requiring the accrual of interest under subsection XI(d)) shall accrue interest from and including the date such payment is due until (but not including) the date paid at the Prime Rate plus three percentage points.

(i) Payments by Subsequent Participating Manufacturers.

(1) A Subsequent Participating Manufacturer shall have payment obligations under this Agreement only in the event that its Market Share in any calendar year exceeds the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share (subject to the provisions of subsection (i)(4)). In the year following any such calendar year, such Subsequent Participating Manufacturer shall make payments corresponding to those due in that same following year from the Original Participating Manufacturers pursuant to subsections VI(c) (except for the payment due on March 31, 1999), IX(c)(1), IX(c)(2) and IX(e). The amounts of such corresponding payments by a Subsequent Participating Manufacturer are in addition to the corresponding payments that are due from the Original Participating Manufacturers and shall be determined as described in subsections (2) and (3) below. Such payments by a Subsequent Participating Manufacturer shall (A) be due on the same dates as the corresponding payments are due from Original Participating Manufacturers; (B) be for the same

purpose as such corresponding payments; and (C) be paid, allocated and distributed in the same manner as such corresponding payments.

(2) The base amount due from a Subsequent Participating Manufacturer on any given date shall be determined by multiplying (A) the corresponding base amount due on the same date from all of the Original Participating Manufacturers (as such base amount is specified in the corresponding subsection of this Agreement and is adjusted by the Volume Adjustment (except for the provisions of subsection (B)(ii) of Exhibit E), but before such base amount is modified by any other adjustments, reductions or offsets) by (B) the quotient produced by dividing (i) the result of (x) such Subsequent Participating Manufacturer's applicable Market Share (the applicable Market Share being that for the calendar year immediately preceding the year in which the payment in question is due) minus (y) the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share, by (ii) the aggregate Market Shares of the Original Participating Manufacturers (the applicable Market Shares being those for the calendar year immediately preceding the year in which the payment in question is due).

(3) Any payment due from a Subsequent Participating Manufacturer under subsections (1) and (2) above shall be subject (up to the full amount of such payment) to the Inflation Adjustment, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8), to the extent that such adjustments, reductions or offsets would apply to the corresponding payment due from the Original Participating Manufacturers. Provided, however, that all adjustments and offsets to which a Subsequent Participating Manufacturer is entitled may only be applied against payments by such Subsequent Participating Manufacturer, if any, that are due within 12 months after the date on which the Subsequent Participating Manufacturer becomes entitled to such adjustment or makes the payment that entitles it to such offset, and shall not be carried forward beyond that time even if not fully used.

(4) For purposes of this subsection (i), the 1997 (or 1998, as applicable) Market Share (and 125 percent thereof) of those Subsequent Participating Manufacturers that either (A) became a signatory to this Agreement more than 60 days after the MSA Execution Date or (B) had no Market Share in 1997 (or 1998, as applicable), shall equal zero.

(j) Order of Application of Allocations, Offsets, Reductions and Adjustments. The payments due under this Agreement shall be calculated as set forth below. The "base amount" referred to in clause "First" below shall mean (1) in the case of payments due from Original Participating Manufacturers, the base amount referred to in the subsection establishing the payment obligation in question; and (2) in the case of payments due from a Subsequent Participating Manufacturer, the base amount referred to in subsection (i)(2) for such Subsequent Participating Manufacturer. In the event that a particular adjustment, reduction or offset referred to in a clause below does not apply to the payment being calculated, the result of the clause in question shall be deemed to be equal to the result of the immediately preceding clause. (If clause "First" is inapplicable, the result of clause "First" will be the base amount of the payment in question prior to any offsets, reductions or adjustments.)

First: the Inflation Adjustment shall be applied to the base amount of the payment being calculated;

Second: the Volume Adjustment (other than the provisions of subsection (B)(iii) of Exhibit E) shall be applied to the result of clause "First";

Third: the result of clause "Second" shall be reduced by the Previously Settled States Reduction;

Fourth: the result of clause "Third" shall be reduced by the Non-Settling States Reduction;

Fifth: in the case of payments due under subsections IX(c)(1) and IX(c)(2), the results of clause "Fourth" for each such payment due in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together to form such Settling State's Allocated Payment. In the case of payments due under subsection IX(i) that correspond to payments due under subsections IX(c)(1) or IX(c)(2), the results of clause "Fourth" for all such payments due from a particular Subsequent Participating Manufacturer in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together. (In the case of all other payments made pursuant to this Agreement, this clause "Fifth" is inapplicable.);

Sixth: the NPM Adjustment shall be applied to the results of clause "Fifth" pursuant to subsections IX(d)(1) and (d)(2) (or, in the case of payments due from the Subsequent Participating Manufacturers, pursuant to subsection IX(d)(4));

Seventh: in the case of payments due from the Original Participating Manufacturers to which clause "Fifth" (and therefore clause "Sixth") does not apply, the result of clause "Fourth" shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares. In the case of payments due from the Original Participating Manufacturers to which clause "Fifth" applies: (A) the Allocated Payments of all Settling States determined pursuant to clause "Fifth" (prior to reduction pursuant to clause "Sixth") shall be added together; (B) the resulting sum shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares and subsection (B)(iii) of Exhibit E hereto (if such subsection is applicable); (C) the Available NPM Adjustment (as determined pursuant to clause "Sixth") shall be allocated among the Original Participating Manufacturers pursuant to subsection IX(d)(3); (D) the respective result of step (C) above for each Original Participating Manufacturer shall be subtracted from the respective result of step (B) above

for such Original Participating Manufacturer; and (E) the resulting payment amount due from each Original Participating Manufacturer shall then be allocated among the Settling States in proportion to the respective results of clause "Sixth" for each Settling State. The offsets described in clauses "Eighth" through "Twelfth" shall then be applied separately against each Original Participating Manufacturer's resulting payment shares (on a Settling State by Settling State basis) according to each Original Participating Manufacturer's separate entitlement to such offsets, if any, in the calendar year in question. (In the case of payments due from Subsequent Participating Manufacturers, this clause "Seventh" is inapplicable.)

Eighth: the offset for miscalculated or disputed payments described in subsection XI(i) (and any carry-forwards arising from such offset) shall be applied to the results of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or to the results of clause "Sixth" (in the case of payments due from Subsequent Participating Manufacturers);

Ninth: the Federal Tobacco Legislation Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eighth";

Tenth: the Litigating Releasing Parties Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Ninth";

Eleventh: the offset for claims over pursuant to subsection XII(a)(4)(B) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Tenth";

Twelfth: the offset for claims over pursuant to subsection XII(a)(8) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eleventh"; and

Thirteenth: in the case of payments to which clause "Fifth" applies, the Settling States' allocated shares of the payments due from each Participating Manufacturer (as such shares have been determined in step (E) of clause "Seventh" in the case of payments from the Original Participating Manufacturers or in clause "Sixth" in the case of payments from the Subsequent Participating Manufacturers, and have been reduced by clauses "Eighth" through "Twelfth") shall be added together to state the aggregate payment obligation of each Participating Manufacturer with respect to the payments in question. (In the case of a payment to which clause "Fifth" does not apply, the aggregate payment obligation of each Participating Manufacturer with respect to the payment in question shall be stated by the results of clause "Eighth.")

X. EFFECT OF FEDERAL TOBACCO-RELATED LEGISLATION

(a) If federal tobacco-related legislation is enacted after the MSA Execution Date and on or before November 30, 2002, and if such legislation provides for payment(s) by any Original Participating Manufacturer (whether by settlement payment, tax or any other means), all or part of which are actually made available to a Settling State ("Federal Funds"), each Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any and all amounts that are paid by such Original Participating Manufacturer pursuant to such legislation and actually made available to such Settling State (except as described in subsections (b) and (c) below). Such offset shall be applied against the applicable Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of such Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment and has been reduced by offset, if any, pursuant to the offset for miscalculated or disputed payments). Such offset shall be made against such Original Participating Manufacturer's share of the first Allocated Payment due after such Federal Funds are first available for receipt by such Settling State. In the event that such offset would in any given year exceed such Original Participating Manufacturer's share of such Allocated Payment: (1) the offset to which such Original Participating Manufacturer is entitled under this section in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment, and (2) all amounts not offset by reason of subsection (1) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(b) The offset described in subsection (a) shall apply only to that portion of Federal Funds, if any, that are either unrestricted as to their use, or restricted to any form of health care or to any use related to tobacco (including, but not limited to, tobacco education, cessation, control or enforcement) (other than that portion of Federal Funds, if any, that is specifically applicable to tobacco growers or communities dependent on the production of tobacco or Tobacco Products). Provided, however, that the offset described in subsection (a) shall not apply to that portion of Federal Funds, if any, whose receipt by such Settling State is conditioned upon or appropriately allocable to:

(1) the relinquishment of rights or benefits under this Agreement (including the Consent Decree); or

(2) actions or expenditures by such Settling State, unless:

(A) such Settling State chooses to undertake such action or expenditure;

(B) such actions or expenditures do not impose significant constraints on public policy choices; or

(C) such actions or expenditures are both: (i) related to health care or tobacco (including, but not limited to, tobacco education, cessation, control or enforcement) and (ii) do not require such Settling State to expend state matching funds in an amount that is significant in relation to the amount of the Federal Funds made available to such Settling State.

(c) Subject to the provisions of subsection IX(i)(3), Subsequent Participating Manufacturers shall be entitled to the offset described in this section X to the extent that they are required to pay Federal Funds that would give rise to an offset under subsections (a) and (b) if paid by an Original Participating Manufacturer.

(d) Nothing in this section X shall (1) reduce the payments to be made to the Settling States under this Agreement other than those described in subsection IX(c) (or corresponding payments under subsection IX(i)) of this Agreement; or (2) alter the Allocable Share used to determine each Settling State's share of the payments described in subsection IX(c) (or corresponding payments under subsection IX(i)) of this Agreement. Nothing in this section X is intended to or shall reduce the total amounts payable by the Participating Manufacturers to the Settling States under this Agreement by an amount greater than the amount of Federal Funds that the Settling States could elect to receive.

XI. CALCULATION AND DISBURSEMENT OF PAYMENTS

(a) Independent Auditor to Make All Calculations.

(1) Beginning with payments due in the year 2000, an Independent Auditor shall calculate and determine the amount of all payments owed pursuant to this Agreement, the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the Participating Manufacturers and among the Settling States, and shall perform all other calculations in connection with the foregoing (including, but not limited to, determining Market Share, Relative Market Share, Base Aggregate Participating Manufacturer Market Share and Actual Aggregate Participating Manufacturer Market Share). The Independent Auditor shall promptly collect all information necessary to make such calculations and determinations. Each Participating Manufacturer and each Settling State shall provide the Independent Auditor, as promptly as practicable, with information in its possession or readily available to it necessary for the Independent Auditor to perform such calculations. The Independent Auditor shall agree to maintain the confidentiality of all such information, except that the Independent Auditor may provide such information to Participating Manufacturers and the Settling States as set forth in this Agreement. The Participating Manufacturers and the Settling States agree to maintain the confidentiality of such information.

(2) Payments due from the Original Participating Manufacturers prior to January 1, 2000 (other than the first payment due pursuant to subsection IX(b)) shall be based on the 1998 Relative Market Shares of the Original Participating Manufacturers or, if the Original Participating Manufacturers are unable to agree on such Relative Market Shares, on their 1997 Relative Market Shares specified in Exhibit Q.

(b) Identity of Independent Auditor. The Independent Auditor shall be a major, nationally recognized, certified public accounting firm jointly selected by agreement of the Original Participating Manufacturers and those Attorneys General of the Settling States who are members of the NAAG executive committee, who shall jointly retain the power to replace the Independent Auditor and appoint its successor. Fifty percent of the costs and fees of the Independent Auditor (but in no event more than $500,000 per annum), shall be paid by the Fund described in Exhibit J hereto, and the balance of such costs and fees shall be paid by the Original Participating Manufacturers, allocated among them according to their Relative Market Shares. The agreement retaining the Independent Auditor shall provide that the Independent Auditor shall perform the functions specified for it in this Agreement, and that it shall do so in the manner specified in this Agreement.

(c) Resolution of Disputes. Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge. Each of the two sides to the dispute shall select one arbitrator. The two arbitrators so selected shall select the third arbitrator. The arbitration shall be governed by the United States Federal Arbitration Act.

(d) General Provisions as to Calculation of Payments.

(1) Not less than 90 days prior to the scheduled due date of any payment due pursuant to this Agreement ("Payment Due Date"), the Independent Auditor shall deliver to each other Notice Party a detailed itemization of all information required by the Independent Auditor to complete its calculation of (A) the amount due from each Participating Manufacturer with respect to such payment, and (B) the portion of such amount allocable to each entity for whose benefit such payment is to be made. To the extent practicable, the Independent Auditor shall specify in such itemization which Notice Party is requested to produce which information. Each Participating Manufacturer and each Settling State shall use its best efforts to promptly supply all of the required information that is within its possession or is readily available to it to the Independent Auditor, and in any event not less than 50 days prior to such Payment Due Date. Such best efforts obligation shall be continuing in the case of information that comes within the possession of, or becomes readily available to, any Settling State or Participating Manufacturer after the date 50 days prior to such Payment Due Date.

(2) Not less than 40 days prior to the Payment Due Date, the Independent Auditor shall deliver to each other Notice Party (A) detailed preliminary calculations ("Preliminary Calculations") of the amount due from each Participating Manufacturer and of the amount allocable to each entity for whose benefit such payment is to be made, showing all applicable offsets, adjustments, reductions and carry-forwards and setting forth all the information on which the Independent Auditor relied in preparing such Preliminary Calculations, and (B) a statement of any information still required by the Independent Auditor to complete its calculations.

(3) Not less than 30 days prior to the Payment Due Date, any Participating Manufacturer or any Settling State that disputes any aspect of the Preliminary Calculations (including, but not limited to, disputing the methodology that the Independent Auditor employed, or the information on which the Independent Auditor relied, in preparing such calculations) shall notify each other Notice Party of such dispute, including the reasons and basis therefor.

(4) Not less than 15 days prior to the Payment Due Date, the Independent Auditor shall deliver to each other Notice Party a detailed recalculation (a "Final Calculation") of the amount due from each Participating Manufacturer, the amount allocable to each entity for whose benefit such payment is to be made, and the Account to which such payment is to be credited, explaining any changes from the Preliminary Calculation. The Final Calculation may include estimates of amounts in the circumstances described in subsection (d)(5).

(5) The following provisions shall govern in the event that the information required by the Independent Auditor to complete its calculations is not in its possession by the date as of which the Independent Auditor is required to provide either a Preliminary Calculation or a Final Calculation.

(A) If the information in question is not readily available to any Settling State, any Original Participating Manufacturer or any Subsequent Participating Manufacturer, the Independent Auditor shall employ an assumption as to the missing information producing the minimum amount that is likely to be due with respect to the payment in question, and shall set forth its assumption as to the missing information in its Preliminary Calculation or Final Calculation, whichever is at issue. Any Original Participating Manufacturer, Subsequent Participating Manufacturer or Settling State may dispute any such assumption employed by the Independent Auditor in its Preliminary Calculation in the manner prescribed in subsection (d)(3) or any such assumption employed by the Independent Auditor in its Final Calculation in the manner prescribed in subsection (d)(6). If the missing information becomes available to the Independent Auditor prior to the Payment Due Date, the Independent Auditor shall promptly revise its Preliminary Calculation or Final Calculation (whichever is applicable) and shall promptly provide the revised calculation to each Notice Party, showing the newly available information. If the missing information does not become available to the Independent Auditor prior to the Payment Due Date, the minimum amount calculated by the Independent Auditor pursuant to this subsection (A) shall be paid on the Payment Due Date, subject to disputes pursuant to subsections (d)(6) and (d)(8) and without prejudice to a later final determination of the correct amount. If the missing information becomes available to the Independent Auditor after the Payment Due Date, the Independent Auditor shall calculate the correct amount of the payment in question and shall apply any overpayment or underpayment as an offset or additional payment in the manner described in subsection (i).

(B) If the information in question is readily available to a Settling State, Original Participating Manufacturer or Subsequent Participating Manufacturer, but such Settling State, Original Participating Manufacturer or Subsequent Participating Manufacturer does not supply such information to the Independent Auditor, the Independent Auditor shall base the calculation in question on its best estimate of such information, and shall show such estimate in its Preliminary Calculation or Final Calculation, whichever is applicable. Any Original Participating Manufacturer, Subsequent Participating Manufacturer or Settling State (except the entity that withheld the information) may dispute such estimate employed by the Independent Auditor in its Preliminary Calculation in the manner prescribed in subsection (d)(3) or such estimate employed by the Independent Auditor in its Final Calculation in the manner prescribed in subsection (d)(6). If the withheld information is not made available to the Independent Auditor more than 30 days prior to the Payment Due Date, the estimate employed by the Independent Auditor (as revised by the Independent Auditor in light of any dispute filed pursuant to the preceding sentence) shall govern the amounts to be paid on the Payment Due Date, subject to disputes pursuant to subsection (d)(6) and without prejudice to a later final determination of the correct amount. In the event that the withheld information subsequently becomes available, the Independent Auditor shall calculate the correct amount and shall apply any overpayment or underpayment as an offset or additional payment in the manner described in subsection (i).

(6) Not less than five days prior to the Payment Due Date, each Participating Manufacturer and each Settling State shall deliver to each Notice Party a statement indicating whether it disputes the Independent Auditor's Final Calculation and, if so, the disputed and undisputed amounts and the basis for the dispute. Except to the extent a Participating Manufacturer or a Settling State delivers a statement indicating the existence of a dispute by such date, the amounts set forth in the Independent Auditor's Final Calculation shall be paid on the Payment Due Date. Provided, however, that (A) in the event that the Independent Auditor revises its Final Calculation within five days of the Payment Due Date as provided in subsection (5)(A) due to receipt of previously missing information, a Participating Manufacturer or Settling State may dispute such revision pursuant to the procedure set forth in this subsection (6) at any time prior to the Payment Due Date; and (B) prior to the date four years after the Payment Due Date, neither failure to dispute a calculation made by the Independent Auditor nor actual agreement with any calculation or payment to the Escrow Agent or to another payee shall waive any Participating Manufacturer's or Settling State's rights to dispute any payment (or the Independent Auditor's calculations with respect to any payment) after the Payment Due Date. No Participating Manufacturer and no Settling State shall have a right to raise any dispute with respect to any payment or calculation after the date four years after such payment's Payment Due Date.

(7) Each Participating Manufacturer shall be obligated to pay by the Payment Due Date the undisputed portion of the total amount calculated as due from it by the Independent Auditor's Final Calculation. Failure to pay such portion shall render the Participating Manufacturer liable for interest thereon as provided in subsection IX(h) of this Agreement, in addition to any other remedy available under this Agreement.

(8) As to any disputed portion of the total amount calculated to be due pursuant to the Final Calculation, any Participating Manufacturer that by the Payment Due Date pays such disputed portion into the Disputed Payments Account (as defined in the Escrow Agreement) shall not be liable for interest thereon even if the amount disputed was in fact properly due and owing. Any Participating Manufacturer that by the Payment Due Date does not pay such disputed portion into the Disputed Payments Account shall be liable for interest as provided in subsection IX(h) if the amount disputed was in fact properly due and owing.

(9) On the same date that it makes any payment pursuant to this Agreement, each Participating Manufacturer shall deliver a notice to each other Notice Party showing the amount of such payment and the Account to which such payment is to be credited.

(10) On the first Business Day after the Payment Due Date, the Escrow Agent shall deliver to each other Notice Party a statement showing the amounts received by it from each Participating Manufacturer and the Accounts credited with such amounts.

(e) General Treatment of Payments. The Escrow Agent may disburse amounts from an Account only if permitted, and only at such time as permitted, by this Agreement and the Escrow Agreement. No amounts may be disbursed to a Settling State other than funds credited to such Settling State's State-Specific Account (as defined in the Escrow Agreement). The Independent Auditor, in delivering payment instructions to the Escrow Agent, shall specify: the amount to be paid; the Account or Accounts from which such payment is to be disbursed; the payee of such payment (which may be an Account); and the Business Day on which such payment is to be made by the Escrow Agent. Except as expressly provided in subsection (f) below, in no event may any amount be disbursed from any Account prior to Final Approval.

(f) Disbursements and Charges Not Contingent on Final Approval. Funds may be disbursed from Accounts without regard to the occurrence of Final Approval in the following circumstances and in the following manner:

(1) Payments of Federal and State Taxes. Federal, state, local or other taxes imposed with respect to the amounts credited to the Accounts shall be paid from such amounts. The Independent Auditor shall prepare and file any tax returns required to be filed with respect to the escrow. All taxes required to be paid shall be allocated to and charged against the Accounts on a reasonable basis to be determined by the Independent Auditor. Upon receipt of written instructions from the Independent Auditor, the Escrow Agent shall pay such taxes and charge such payments against the Account or Accounts specified in those instructions.

(2) Payments to and from Disputed Payments Account. The Independent Auditor shall instruct the Escrow Agent to credit funds from an Account to the Disputed Payments Account when a dispute arises as to such funds, and shall instruct the Escrow Agent to credit funds from the Disputed Payments Account to the appropriate payee when such dispute is resolved with finality. The Independent Auditor shall provide the Notice Parties not less than 10 Business Days prior notice before instructing the Escrow Agent to disburse funds from the Disputed Payments Account.

(3) Payments to a State-Specific Account. Promptly following the occurrence of State-Specific Finality in any Settling State, such Settling State and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such State-Specific Finality and of the portions of the amounts in the Subsection IX(b) Account (First), Subsection IX(b) Account (Subsequent), Subsection IX(c)(1) Account and Subsection IX(c)(2) Account, respectively (as such Accounts are defined in the Escrow Agreement), that are at such time held in such Accounts for the benefit of such Settling State, and which are to be transferred to the appropriate State-Specific Account for such Settling State. If neither the Settling State in question nor any Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to make such transfer. If the Settling State in question or any Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (f)(3), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and the undisputed portion to the appropriate State-Specific Account. No amounts may be transferred or credited to a State-Specific Account for the benefit of any State as to which State-Specific Finality has not occurred or as to which this Agreement has terminated.

(4) Payments to Parties other than Particular Settling States.

(A) Promptly following the occurrence of State-Specific Finality in one Settling State, such Settling State and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of State-Specific Finality in at least one Settling State and of the amounts held in the Subsection VI(b) Account, Subsection VI(c) Account (First), and Subsection VIII(c) Account (as such Accounts are defined in the Escrow Agreement), if any. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts or disputes the occurrence of State-Specific Finality in one Settling State, by notice delivered to each Notice Party not later than ten Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in such Accounts to the Foundation or to the Fund specified in subsection VIII(c), as appropriate. If any Settling State or Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the

Independent Auditor of the notice described in the second sentence of this subsection (4)(A), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to the Foundation or to the Fund specified in subsection VIII(c), as appropriate.

(B) The Independent Auditor shall instruct the Escrow Agent to disburse funds on deposit in the Subsection VIII(b) Account and Subsection IX(e) Account (as such Accounts are defined in the Escrow Agreement) to NAAG or to the Foundation, as appropriate, within 10 Business Days after the date on which such amounts were credited to such Accounts.

(C) Promptly following the occurrence of State-Specific Finality in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date, the Settling States and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of such State-Specific Finality and of the amounts held in the Subsection VI(c) Account (Subsequent) (as such Account is defined in the Escrow Agreement), if any. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts or disputes the occurrence of such State-Specific Finality, by notice delivered to each Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in such Account to the Foundation. If any Settling State or Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (4)(C), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to the Foundation.

(5) Treatment of Payments Following Termination.

(A) As to amounts held for Settling States. Promptly upon the termination of this Agreement with respect to any Settling State (whether or not as part of the termination of this Agreement as to all Settling States) such State or any Participating Manufacturer shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection IX(b) Account (First), the Subsection IX(b) Account (Subsequent), the Subsection IX(c)(1) Account, the Subsection IX(c)(2) Account, and the State-Specific Account for the benefit of such Settling State. If neither the State in question nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If the State in question or any Participating Manufacturer disputes the amounts held in the Accounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(A), the Independent Auditor shall promptly instruct the Escrow Agent to transfer the amount disputed to the Disputed Payments Account and the undisputed portion to the Participating Manufacturers (on the basis of their respective contributions of such funds).

(B) As to amounts held for others. If this Agreement is terminated with respect to all of the Settling States, the Original Participating Manufacturers shall promptly notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection VI(b) Account, the Subsection VI(c) Account (First), the Subsection VIII(b) Account, the Subsection VIII(c) Account and the Subsection IX(e) Account. If neither any such State nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If any such State or any Participating Manufacturer disputes the amounts held in the Accounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(B), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and transfer the undisputed portion to the Participating Manufacturers (on the basis of their respective contribution of such funds).

(C) As to amounts held in the Subsection VI(c) Account (Subsequent). If this Agreement is terminated with respect to Settling States having aggregate Allocable Shares equal to more than 20% of the total aggregate Allocable Shares assigned to those States that were Settling States as of the MSA Execution Date, the Original Participating Manufacturers shall promptly notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection VI(c) Account (Subsequent) (as defined in the Escrow Agreement). If neither any such State with respect to which this Agreement has terminated nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If any such State or

any Participating Manufacturer disputes the amounts held in the Account or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(C), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and transfer the undisputed portion to the Participating Manufacturers (on the basis of their respective contribution of such funds).

(6) Determination of amounts paid or held for the benefit of each individual Settling State. For purposes of subsections (f)(3), (f)(5)(A) and (i)(2), the portion of a payment that is made or held for the benefit of each individual Settling State shall be determined: (A) in the case of a payment credited to the Subsection IX(b) Account (First) or the Subsection IX(b) Account (Subsequent), by allocating the results of clause "Eighth" of subsection IX(j) among those Settling States who were Settling States at the time that the amount of such payment was calculated, pro rata in proportion to their respective Allocable Shares; and (B) in the case of a payment credited to the Subsection IX(c)(1) Account or the Subsection IX(c)(2) Account, by the results of clause "Twelfth" of subsection IX(j) for each individual Settling State. Provided, however, that, solely for purposes of subsection (f)(3), the Settling States may by unanimous agreement agree on a different method of allocation of amounts held in the Accounts identified in this subsection (f)(6).

(g) Payments to be Made Only After Final Approval. Promptly following the occurrence of Final Approval, the Settling States and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of Final Approval and of the amounts held in the State-Specific Accounts. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts, disputes the occurrence of Final Approval or claims that this Agreement has terminated as to any Settling State for whose benefit the funds are held in a State-Specific Account, by notice delivered to each Notice Party not later than 10 Business Days after delivery by the Independent Auditor of such notice of Final Approval, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in the State-Specific Accounts to (or as directed by) the respective Settling States. If any Notice Party disputes such amounts or the occurrence of Final Approval, or claims that this Agreement has terminated as to any Settling State for whose benefit the funds are held in a State-Specific Account, by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of such notice of Final Approval, the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to (or as directed by) the respective Settling States.

(h) Applicability to Section XVII Payments. This section XI shall not be applicable to payments made pursuant to section XVII; provided, however, that the Independent Auditor shall be responsible for calculating Relative Market Shares in connection with such payments, and the Independent Auditor shall promptly provide the results of such calculation to any Original Participating Manufacturer or Settling State that requests it do so.

(i) Miscalculated or Disputed Payments.

(1) Underpayments.

(A) If information becomes available to the Independent Auditor not later than four years after a Payment Due Date, and such information shows that any Participating Manufacturer was instructed to make an insufficient payment on such date ("original payment"), the Independent Auditor shall promptly determine the additional payment owed by such Participating Manufacturer and the allocation of such additional payment among the applicable payees. The Independent Auditor shall then reduce such additional payment (up to the full amount of such additional payment) by any adjustments or offsets that were available to the Participating Manufacturer in question against the original payment at the time it was made (and have not since been used) but which such Participating Manufacturer was unable to use against such original payment because such adjustments or offsets were in excess of such original payment (provided that any adjustments or offsets used against such additional payment shall reduce on a dollar-for-dollar basis any remaining carry-forward held by such Participating Manufacturer with respect to such adjustment or offset). The Independent Auditor shall then add interest at the Prime Rate (calculated from the Payment Due Date in question) to the additional payment (as reduced pursuant to the preceding sentence), except that where the additional payment owed by a Participating Manufacturer is the result of an underpayment by such Participating Manufacturer caused by such Participating Manufacturer's withholding of information as described in subsection (d)(5)(B), the applicable interest rate shall be that described in subsection IX(h). The Independent Auditor shall promptly give notice of the additional payment owed by the Participating Manufacturer in question (as reduced and/or increased as described above) to all Notice Parties, showing the new information and all calculations. Upon receipt of such notice, any Participating Manufacturer or Settling State may dispute the Independent Auditor's calculations in the manner described in subsection (d)(3), and the Independent Auditor shall promptly notify each Notice Party of any subsequent revisions to its calculations. Not more than 15 days after receipt of such notice (or, if the Independent Auditor revises its calculations, not more than 15 days after receipt of the revisions), any Participating Manufacturer and any Settling State may dispute the Independent Auditor's calculations in the manner prescribed in subsection (d)(6). Failure to dispute the Independent Auditor's calculations in this manner shall constitute agreement with the Independent Auditor's calculations, subject to the limitations set forth in subsection (d)(6). Payment of the undisputed portion of an additional payment shall be made to the Escrow Agent not more than 20 days after receipt of the notice described in this subsection (A) (or, if the Independent Auditor revises its calculations, not more than 20 days after receipt of the revisions). Failure to pay such portion shall render the Participating Manufacturer liable for interest thereon as provided in subsection IX(h). Payment of the disputed portion shall be governed by subsection (d)(8).

(B) To the extent a dispute as to a prior payment is resolved with finality against a Participating Manufacturer: (i) in the case where the disputed amount has been paid into the Disputed Payments Account pursuant to subsection (d)(8), the Independent Auditor shall instruct the Escrow Agent to transfer such amount to the applicable payee Account(s); (ii) in the case where the disputed amount has not been paid into the Disputed Payments Account and the dispute was identified prior to the Payment Due Date in question by delivery of a statement pursuant to subsection (d)(6) identifying such dispute, the Independent Auditor shall calculate interest on the disputed amount from the Payment Due Date in question (the applicable interest rate to be that provided in subsection IX(h)) and the allocation of such amount and interest among the applicable payees, and shall provide notice of the amount owed (and the identity of the payor and payees) to all Notice Parties; and (iii) in all other cases, the procedure described in subsection (ii) shall apply, except that the applicable interest rate shall be the Prime Rate.

(2) Overpayments.

(A) If a dispute as to a prior payment is resolved with finality in favor of a Participating Manufacturer where the disputed amount has been paid into the Disputed Payments Account pursuant to subsection (d)(8), the Independent Auditor shall instruct the Escrow Agent to transfer such amount to such Participating Manufacturer.

(B) If information becomes available to the Independent Auditor not later than four years after a Payment Due Date showing that a Participating Manufacturer made an overpayment on such date, or if a dispute as to a prior payment is resolved with finality in favor of a Participating Manufacturer where the disputed amount has been paid but not into the Disputed Payments Account, such Participating Manufacturer shall be entitled to a continuing dollar-for-dollar offset as follows:

(i) offsets under this subsection (B) shall be applied only against eligible payments to be made by such Participating Manufacturer after the entitlement to the offset arises. The eligible payments shall be: in the case of offsets arising from payments under subsection IX(b) or IX(c)(1), subsequent payments under any of such subsections; in the case of offsets arising from payments under subsection IX(c)(2), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under subsection IX(c)(1); in the case of offsets arising from payments under subsection IX(e), subsequent payments under such subsection or subsection IX(c); in the case of offsets arising from payments under subsection VI(c), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under any of subsection IX(c)(1), IX(c)(2) or IX(e); in the case of offsets arising from payments under subsection VIII(b), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under either subsection IX(c)(1) or IX(c)(2); in the case of offsets arising from payments under subsection VIII(c), subsequent payments under either subsection IX(c)(1) or IX(c)(2); and, in the case of offsets arising from payments under subsection IX(i), subsequent payments under such subsection (consistent with the provisions of this subsection (B)(i)).

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

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

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

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

XII. SETTLING STATES' RELEASE, DISCHARGE AND COVENANT

(a) Release.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

XIII. CONSENT DECREES AND DISMISSAL OF CLAIMS

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

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

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

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

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

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

XIV. PARTICIPATING MANUFACTURERS' DISMISSAL OF RELATED LAWSUITS

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

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

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

XV. VOLUNTARY ACT OF THE PARTIES

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

XVI. CONSTRUCTION

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

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

XVII. RECOVERY OF COSTS AND ATTORNEYS' FEES

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

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

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

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

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

XVIII. MISCELLANEOUS

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

(b) Limited Most-Favored Nation Provision.

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

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

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

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

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

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

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

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

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

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

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

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

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

(j) Amendment and Waiver. This Agreement may be amended by a written instrument executed by all Participating Manufacturers affected by the amendment and by all Settling States affected by the amendment. The terms of any such amendment shall not be enforceable in any Settling State that is not a signatory to such amendment. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving party or parties. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, nor shall such waiver be deemed to be or construed as a waiver by any other party.

(k) Notices. All notices or other communications to any party to this Agreement shall be in writing (including, but not limited to, facsimile, telex, telecopy or similar writing) and shall be given at the addresses specified in Exhibit P (as it may be amended to reflect any additional Participating Manufacturer that becomes a party to this Agreement after the MSA Execution Date). Any Settling State or Participating Manufacturer may change or add the name and address of the persons designated to receive notice on its behalf by notice given (effective upon the giving of such notice) as provided in this subsection.

(l) Cooperation. Each Settling State and each Participating Manufacturer agrees to use its best efforts and to cooperate with each other to cause this Agreement and the Consent Decrees to become effective, to obtain all necessary approvals, consents and authorizations, if any, and to execute all documents and to take such other action as may be appropriate in connection herewith. Consistent with the foregoing, each Settling State and each Participating Manufacturer agrees that it will not directly or indirectly assist or encourage any challenge to this Agreement or any Consent Decree by any other person, and will support the integrity and enforcement of the terms of this Agreement and the Consent Decrees. Each Settling State shall use its best efforts to cause State-Specific Finality to occur as to such Settling State.

(m) Designees to Discuss Disputes. Within 14 days after the MSA Execution Date, each Settling State's Attorney General and each Participating Manufacturer shall provide written notice of its designation of a senior representative to discuss with the other signatories to this Agreement any disputes and/or other issues that may arise with respect to this Agreement. Each Settling State's Attorney General shall provide such notice of the name, address and telephone number of the person it has so designated to each Participating Manufacturer and to NAAG. Each Participating Manufacturer shall provide such notice of the name, address and telephone number of the person it has so designated to each Settling State's Attorney General, to NAAG and to each other Participating Manufacturer.

(n) Governing Law. This Agreement (other than the Escrow Agreement) shall be governed by the laws of the relevant Settling State, without regard to the conflict of law rules of such Settling State. The Escrow Agreement shall be governed by the laws of the State in which the Escrow Court is located, without regard to the conflict of law rules of such State.

(o) Severability.

(1) Sections VI, VII, IX, X, XI, XII, XIII, XIV, XVI, XVIII(b), (c), (d), (e), (f), (g), (h), (o), (p), (r), (s), (u), (w), (z), (bb), (dd), and Exhibits A, B, and E hereof ("Nonseverable Provisions") are not severable, except to the extent that severance of section VI is permitted by Settling States pursuant to subsection VI(i) hereof. The remaining terms of this Agreement are severable, as set forth herein.

(2) If a court materially modifies, renders unenforceable, or finds to be unlawful any of the Nonseverable Provisions, the NAAG executive committee shall select a team of Attorneys General (the "Negotiating Team") to attempt to negotiate an equivalent or comparable substitute term or other appropriate credit or adjustment (a "Substitute Term") with the Original Participating Manufacturers. In the event that the court referred to in the preceding sentence is located in a Settling State, the Negotiating Team shall include the Attorney General of such Settling State. The Original Participating Manufacturers shall have no obligation to agree to any Substitute Term. If any Original Participating Manufacturer does not agree to a Substitute Term, this Agreement shall be terminated in all Settling States affected by the court's ruling. The Negotiating Team shall submit any proposed Substitute Term negotiated by the Negotiating Team and agreed to by all of the Original Participating Manufacturers to the Attorneys General of all of the affected Settling States for their approval. If any affected Settling State does not approve the proposed Substitute Term, this Agreement in such Settling State shall be terminated.

(3) If a court materially modifies, renders unenforceable, or finds to be unlawful any term of this Agreement other than a Nonseverable Provision:

(A) The remaining terms of this Agreement shall remain in full force and effect.

(B) Each Settling State whose rights or obligations under this Agreement are affected by the court's decision in question (the "Affected Settling State") and the Participating Manufacturers agree to negotiate in good faith a Substitute Term. Any agreement on a Substitute Term reached between the Participating Manufacturers and the Affected Settling State shall not modify or amend the terms of this Agreement with regard to any other Settling State.

(C) If the Affected Settling State and the Participating Manufacturers are unable to agree on a Substitute Term, then they will submit the issue to non-binding mediation. If mediation fails to produce agreement to a Substitute Term, then that term shall be severed and the remainder of this Agreement shall remain in full force and effect.

(4) If a court materially modifies, renders unenforceable, or finds to be unlawful any portion of any provision of this Agreement, the remaining portions of such provision shall be unenforceable with respect to the affected Settling State unless a Substitute Term is arrived at pursuant to subsection (o)(2) or (o)(3) hereof, whichever is applicable.

(p) Intended Beneficiaries. No portion of this Agreement shall provide any rights to, or be enforceable by, any person or entity that is not a Settling State or a Released Party. No Settling State may assign or otherwise convey any right to enforce any provision of this Agreement.

(q) Counterparts. This Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered as valid signatures as of the date affixed, although the original signature pages shall thereafter be appended.

(r) Applicability. The obligations and duties of each Participating Manufacturer set forth herein are applicable only to actions taken (or omitted to be taken) within the States. This subsection (r) shall not be construed as extending the territorial scope of any obligation or duty set forth herein whose scope is otherwise limited by the terms hereof.

(s) Preservation of Privilege. Nothing contained in this Agreement or any Consent Decree, and no act required to be performed pursuant to this Agreement or any Consent Decree, is intended to constitute, cause or effect any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint defense privilege, and each Settling State and each Participating Manufacturer agrees that it shall not make or cause to be made in any forum any assertion to the contrary.

(t) Non-Release. Except as otherwise specifically provided in this Agreement, nothing in this Agreement shall limit, prejudice or otherwise interfere with the rights of any Settling State or any Participating Manufacturer to pursue any and all rights and remedies it may have against any Non-Participating Manufacturer or other non-Released Party.

(u) Termination.

(1) Unless otherwise agreed to by each of the Original Participating Manufacturers and the Settling State in question, in the event that (A) State-Specific Finality in a Settling State does not occur in such Settling State on or before December 31, 2001; or (B) this Agreement or the Consent Decree has been disapproved by the Court (or, in the event of an appeal from or review of a decision of the Court to approve this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review), and the time to Appeal from such disapproval has expired, or, in the event of an Appeal from such disapproval, the Appeal has been dismissed or the disapproval has been affirmed by the court of last resort to which such Appeal has been taken and such dismissal or disapproval has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court); or (C) this Agreement is terminated in a Settling State for whatever reason (including, but not limited to, pursuant to subsection XVIII(o) of this Agreement), then this Agreement and all of its terms (except for the non-admissibility provisions hereof, which shall continue in full force and effect) shall be canceled and terminated with respect to such Settling State, and it and all orders issued by the courts in such Settling State pursuant hereto shall become null and void and of no effect.

(2) If this Agreement is terminated with respect to a Settling State for whatever reason, then (A) the applicable statute of limitation or any similar time requirement shall be tolled from the date such Settling State signed this Agreement until the later of the time permitted by applicable law or for one year from the date of such termination, with the effect that the parties shall be in the same position with respect to the statute of limitation as they were at the time such Settling State filed its action, and (B) the parties shall jointly move the Court for an order reinstating the actions and claims dismissed pursuant to sections XIII and XIV hereof, with the effect that the parties shall be in the same position with respect to those actions and claims as they were at the time the action or claim was stayed or dismissed.

(v) Freedom of Information Requests. Upon the occurrence of State-Specific Finality in a Settling State, each Participating Manufacturer will withdraw in writing any and all requests for information, administrative applications, and proceedings brought or caused to be brought by such Participating Manufacturer pursuant to such Settling State's freedom of information law relating to the subject matter of the lawsuits identified in Exhibit D.

(w) Bankruptcy. The following provisions shall apply if a Participating Manufacturer both enters Bankruptcy and at any time thereafter is not timely performing its financial obligations as required under this Agreement:

(1) In the event that both a number of Settling States equal to at least 75% of the total number of Settling States and Settling States having aggregate Allocable Shares equal to at least 75% of the total aggregate Allocable Shares assigned to all Settling States deem (by written notice to the Participating Manufacturers other than the bankrupt Participating Manufacturer) that the financial obligations of this Agreement have been terminated and rendered null and void as to such bankrupt Participating Manufacturer (except as provided in subsection (A) below) due to a material breach by such Participating Manufacturer, whereupon, with respect to all Settling States:

(A) all agreements, all concessions, all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall be null and void as to such Participating Manufacturer. Provided, however, that (i) all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall remain in full force and effect as to all persons or entities (other than the bankrupt Participating Manufacturer itself or any person or entity that, as a result of the Bankruptcy, obtains domestic tobacco assets of such

Participating Manufacturer (unless such person or entity is itself a Participating Manufacturer)) who (but for the first sentence of this subsection (A)) would otherwise be Released Parties by virtue of their relationship with the bankrupt Participating Manufacturer; and (ii) in the event a Settling State asserts any Released Claim against a bankrupt Participating Manufacturer after the termination of this Agreement with respect to such Participating Manufacturer as described in this subsection (1) and receives a judgment, settlement or distribution arising from such Released Claim, then the amount of any payments such Settling State has previously received from such Participating Manufacturer under this Agreement shall be applied against the amount of any such judgment, settlement or distribution (provided that in no event shall such Settling State be required to refund any payments previously received from such Participating Manufacturer pursuant to this Agreement);

(B) the Settling States shall have the right to assert any and all claims against such Participating Manufacturer in the Bankruptcy or otherwise without regard to any limits otherwise provided in this Agreement (subject to any and all defenses against such claims);

(C) the Settling States may exercise all rights provided under the federal Bankruptcy Code (or other applicable bankruptcy law) with respect to their Claims against such Participating Manufacturer, including the right to initiate and complete police and regulatory actions against such Participating Manufacturer pursuant to the exceptions to the automatic stay set forth in section 362(b) of the Bankruptcy Code (provided, however, that such Participating Manufacturer may contest whether the Settling State's action constitutes a police and regulatory action); and

(D) to the extent that any Settling State is pursuing a police and regulatory action against such Participating Manufacturer as described in subsection (1)(C), such Participating Manufacturer shall not request or support a request that the Bankruptcy court utilize the authority provided under section 105 of the Bankruptcy Code to impose a discretionary stay on the Settling State's action. The Participating Manufacturers further agree that they will not request, seek or support relief from the terms of this Agreement in any proceeding before any court of law (including the federal bankruptcy courts) or an administrative agency or through legislative action, including (without limitation) by way of joinder in or consent to or acquiescence in any such pleading or instrument filed by another.

(2) Whether or not the Settling States exercise the option set forth in subsection (1) (and whether or not such option, if exercised, is valid and enforceable):

(A) In the event that the bankrupt Participating Manufacturer is an Original Participating Manufacturer, such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer for all purposes under this Agreement except (i) such Participating Manufacturer shall be treated as a Non-Participating Manufacturer (and not as an Original Participating Manufacturer or Participating Manufacturer) for all purposes with respect to subsections IX(d)(1), IX(d)(2) and IX(d)(3) (including, but not limited to, that the Market Share of such Participating Manufacturer shall not be included in Base Aggregate Participating Manufacturer Market Share or Actual Aggregate Participating Manufacturer Market Share, and that such Participating Manufacturer's volume shall not be included for any purpose under subsection IX(d)(1)(D)); (ii) such Participating Manufacturer's Market Share shall not be included as that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(e) has been achieved (provided that such Participating Manufacturer shall be treated as an Original Participating Manufacturer for all other purposes with respect to such subsection); (iii) for purposes of subsection (B)(iii) of Exhibit E, such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer, but its operating income shall be recalculated by the Independent Auditor to reflect what such income would have been had such Participating Manufacturer made the payments that would have been due under this Agreement but for the Bankruptcy; (iv) for purposes of subsection XVIII(c), such Participating Manufacturer shall not be treated as an Original Participating Manufacturer or as a Participating Manufacturer to the extent that after entry into Bankruptcy it becomes the acquiror or transferee of Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection); and (v) as to any action that by the express terms of this Agreement requires the unanimous agreement of all Original Participating Manufacturers.

(B) In the event that the bankrupt Participating Manufacturer is a Subsequent Participating Manufacturer, such Participating Manufacturer shall continue to be treated as a Subsequent Participating Manufacturer for all purposes under this Agreement except (i) such Participating Manufacturer shall be treated as a Non-Participating Manufacturer (and not as a Subsequent Participating Manufacturer or Participating Manufacturer) for all purposes with respect to subsections IX(d)(1), (d)(2) and (d)(4) (including, but not limited to, that the Market Share of such Participating Manufacturer shall not be included in Base Aggregate Participating Manufacturer Market Share or Actual Aggregate Participating Manufacturer Market Share, and that such Participating Manufacturer's volume shall not be included for any purpose under subsection IX(d)(1)(D)); (ii) such Participating Manufacturer's Market Share shall not be included as that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(e) has been achieved (provided that such Participating Manufacturer shall be treated as a Subsequent Participating Manufacturer for all other purposes with respect to such subsection); and (iii) for purposes of subsection XVIII(c), such Participating Manufacturer shall not be treated as a Subsequent Participating Manufacturer or as a Participating Manufacturer to the extent that after entry into Bankruptcy it becomes the acquiror or transferee of Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall

continue to be treated as a Subsequent Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection).

(C) Revision of this Agreement pursuant to subsection XVIII(b)(2) shall not be required by virtue of any resolution on an involuntary basis in the Bankruptcy of Claims against the bankrupt Participating Manufacturer.

(x) Notice of Material Transfers. Each Participating Manufacturer shall provide notice to each Settling State at least 20 days before consummating a sale, transfer of title or other disposition, in one transaction or series of related transactions, of assets having a fair market value equal to five percent or more (determined in accordance with United States generally accepted accounting principles) of the consolidated assets of such Participating Manufacturer.

(y) Entire Agreement. This Agreement (together with any agreements expressly contemplated hereby and any other contemporaneous written agreements) embodies the entire agreement and understanding between and among the Settling States and the Participating Manufacturers relating to the subject matter hereof and supersedes (l) all prior agreements and understandings relating to such subject matter, whether written or oral, and (2) all purportedly contemporaneous oral agreements and understandings relating to such subject matter.

(z) Business Days. Any obligation hereunder that, under the terms of this Agreement, is to be performed on a day that is not a Business Day shall be performed on the first Business Day thereafter.

(aa) Subsequent Signatories. With respect to a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, the timing of obligations under this Agreement (other than payment obligations, which shall be governed by subsection II(jj)) shall be negotiated to provide for the institution of such obligations on a schedule not more favorable to such subsequent signatory than that applicable to the Original Participating Manufacturers.

(bb) Decimal Places. Any figure or percentage referred to in this Agreement shall be carried to seven decimal places.

(cc) Regulatory Authority. Nothing in section III of this Agreement is intended to affect the legislative or regulatory authority of any local or State government.

(dd) Successors. In the event that a Participating Manufacturer ceases selling a brand of Tobacco Products in the States that such Participating Manufacturer owned in the States prior to July 1, 1998, and an Affiliate of such Participating Manufacturer thereafter and after the MSA Execution Date intentionally sells such brand in the States, such Affiliate shall be considered to be the successor of such Participating Manufacturer with respect to such brand. Performance by any such successor of the obligations under this Agreement with respect to the sales of such brand shall be subject to court-ordered specific performance.

(ee) Export Packaging. Each Participating Manufacturer shall place a visible indication on each pack of Cigarettes it manufactures for sale outside of the fifty United States and the District of Columbia that distinguishes such pack from packs of Cigarettes it manufactures for sale in the fifty United States and the District of Columbia.

(ff) Actions Within Geographic Boundaries of Settling States. To the extent that any provision of this Agreement expressly prohibits, restricts, or requires any action to be taken "within" any Settling State or the Settling States, the relevant prohibition, restriction, or requirement applies within the geographic boundaries of the applicable Settling State or Settling States, including, but not limited to, Indian country or Indian trust land within such geographic boundaries.

(gg) Notice to Affiliates. Each Participating Manufacturer shall give notice of this Agreement to each of its Affiliates.

IN WITNESS WHEREOF, each Settling State and each Participating Manufacturer, through their fully authorized representatives, have agreed to this Agreement.

[Signatures Intentionally Omitted]

EXHIBIT A
STATE ALLOCATION PERCENTAGES

State	Percentage
Alabama	1.6161308%
Alaska	0.3414187%
Arizona	1.4738845%
Arkansas	0.8280661%
California	12.7639554%
Colorado	1.3708614%
Connecticut	1.8565373%
Delaware	0.3954695%
D.C.	0.6071183%
Florida	0.0000000%
Georgia	2.4544575%
Hawaii	0.6018650%
Idaho	0.3632632%
Illinois	4.6542472%
Indiana	2.0398033%
Iowa	0.8696670%
Kansas	0.8336712%
Kentucky	1.7611586%
Louisiana	2.2553531%
Maine	0.7693505%
Maryland	2.2604570%
Massachusetts	4.0389790%
Michigan	4.3519476%
Minnesota	0.0000000%
Mississippi	0.0000000%
Missouri	2.2746011%
Montana	0.4247591%
Nebraska	0.5949833%
Nevada	0.6099351%
New Hampshire	0.6659340%
New Jersey	3.8669963%
New Mexico	0.5963897%
New York	12.7620310%
North Carolina	2.3322850%
North Dakota	0.3660138%
Ohio	5.0375098%
Oklahoma	1.0361370%
Oregon	1.1476582%
Pennsylvania	5.7468588%
Rhode Island	0.7189054%
South Carolina	1.1763519%
South Dakota	0.3489458%
Tennessee	2.4408945%
Texas	0.0000000%
Utah	0.4448869%
Vermont	0.4111851%
Virginia	2.0447451%
Washington	2.0532582%
West Virginia	0.8864604%
Wisconsin	2.0720390%
Wyoming	0.2483449%
American Samoa	0.0152170%
N. Mariana Isld.	0.0084376%
Guam	0.0219371%
U.S. Virgin Isld.	0.0173593%
Puerto Rico	1.1212774%
Total	100.0000000%

EXHIBIT B
FORM OF ESCROW AGREEMENT

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

WITNESSETH:

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

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

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1. *Appointment of Escrow Agent.*

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

SECTION 2. *Definitions.*

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

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

SECTION 3. *Escrow and Accounts.*

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

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

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

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

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

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

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

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

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

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

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

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

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

Each signatory to this Escrow Agreement shall provide the Escrow Agent with a correct taxpayer identification number on a substitute Form W-9 or if it does not have such a number, a statement evidencing its status as an entity exempt from back-up withholding, within 30 days of the date hereof (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). The escrow established pursuant to this Escrow Agreement is intended to be treated as a Qualified Settlement Fund for federal tax purposes pursuant to Treas. Reg. § 1.468B-l. The Escrow Agent shall comply with all applicable tax filing, payment and reporting requirements, including, without limitation, those imposed under Treas. Reg. § 1.468B, and if requested to do so shall join in the making of the relation-back election under such regulation.

SECTION 7. *Duties and Liabilities of Escrow Agent.*

The Escrow Agent shall have no duty or obligation hereunder other than to take such specific actions as are required of it from time to time under the provisions of this Escrow Agreement, and it shall incur no liability hereunder or in connection herewith for anything whatsoever other than any liability resulting from its own gross negligence or willful misconduct. The Escrow Agent shall not be bound in any way by any agreement or contract between the Participating Manufacturers and the Settling States (whether or not the Escrow Agent has knowledge thereof) other than this Escrow Agreement, and the only duties and responsibilities of the Escrow Agent shall be the duties and obligations specifically set forth in this Escrow Agreement.

SECTION 8. *Indemnification of Escrow Agent.*

The Participating Manufacturers shall indemnify, hold harmless and defend the Escrow Agent from and against any and all losses, claims, liabilities and reasonable expenses, including the reasonable fees of its counsel, which it may suffer or incur in connection with the performance of its duties and obligations under this Escrow Agreement, except for those losses, claims, liabilities and expenses resulting solely and directly from its own gross negligence or willful misconduct.

SECTION 9. *Resignation of Escrow Agent.*

The Escrow Agent may resign at any time by giving written notice thereof to the other parties hereto, but such resignation shall not become effective until a successor Escrow Agent, selected by the Original Participating Manufacturers and the Settling States, shall have been appointed and shall have accepted such appointment in writing. If an instrument of acceptance by a successor Escrow Agent shall not have been delivered to the resigning Escrow Agent within 90 days after the giving of such notice of resignation, the resigning Escrow Agent may, at the expense of the Participating Manufacturers (to

be shared according to their pro rata Market Shares), petition the Escrow Court for the appointment of a successor Escrow Agent.

SECTION 10. *Escrow Agent Fees and Expenses.*

The Participating Manufacturers shall pay to the Escrow Agent its fees as set forth in Appendix A hereto as amended from time to time by agreement of the Original Participating Manufacturers and the Escrow Agent. The Participating Manufacturers shall pay to the Escrow Agent its reasonable fees and expenses, including all reasonable expenses, charges, counsel fees, and other disbursements incurred by it or by its attorneys, agents and employees in the performance of its duties and obligations under this Escrow Agreement. Such fees and expenses shall be shared by the Participating Manufacturers according to their pro rata Market Shares.

SECTION 11. *Notices.*

All notices, written instructions or other communications to any party or other person hereunder shall be given in the same manner as, shall be given to the same person as, and shall be effective at the same time as provided in subsection XVIII(k) of the Agreement.

SECTION 12. *Setoff; Reimbursement.*

The Escrow Agent acknowledges that it shall not be entitled to set off against any funds in, or payable from, any Account to satisfy any liability of any Participating Manufacturer. Each Participating Manufacturer that pays more than its pro rata Market Share of any payment that is made by the Participating Manufacturers to the Escrow Agent pursuant to Section 8, 9 or 10 hereof shall be entitled to reimbursement of such excess from the other Participating Manufacturers according to their pro rata Market Shares of such excess.

SECTION 13. *Intended Beneficiaries; Successors.*

No persons or entities other than the Settling States, the Participating Manufacturers and the Escrow Agent are intended beneficiaries of this Escrow Agreement, and only the Settling States, the Participating Manufacturers and the Escrow Agent shall be entitled to enforce the terms of this Escrow Agreement. Pursuant to the Agreement, the Settling States have designated NAAG and the Foundation as recipients of certain payments; for all purposes of this Escrow Agreement, the Settling States shall be the beneficiaries of such payments entitled to enforce payment thereof. The provisions of this Escrow Agreement shall be binding upon and inure to the benefit of the parties hereto and, in the case of the Escrow Agent and Participating Manufacturers, their respective successors. Each reference herein to the Escrow Agent or to a Participating Manufacturer shall be construed as a reference to its successor, where applicable.

SECTION 14. *Governing Law.*

This Escrow Agreement shall be construed in accordance with and governed by the laws of the State in which the Escrow Court is located, without regard to the conflicts of law rules of such state.

SECTION 15. *Jurisdiction and Venue.*

The parties hereto irrevocably and unconditionally submit to the continuing exclusive jurisdiction of the Escrow Court for purposes of any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, this Escrow Agreement, and the parties hereto agree not to commence any such suit, action or proceeding except in the Escrow Court. The parties hereto hereby irrevocably and unconditionally waive any objection to the laying of venue of any such suit, action or proceeding in the Escrow Court and hereby further irrevocably waive and agree not to plead or claim in the Escrow Court that any such suit, action or proceeding has been brought in an inconvenient forum.

SECTION 16. *Amendments.*

This Escrow Agreement may be amended only by written instrument executed by all of the parties hereto that would be affected by the amendment. The waiver of any rights conferred hereunder shall be effective only if made in a written instrument executed by the waiving party. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this Escrow Agreement, nor shall such waiver be deemed to be or construed as a waiver by any other party.

SECTION 17. *Counterparts.*

This Agreement may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. Delivery by facsimile of a signed counterpart shall be deemed delivery for purposes of acknowledging acceptance hereof; however, an original executed Escrow Agreement must promptly thereafter be delivered to each party.

SECTION 18. *Captions.*

The captions herein are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 19. *Conditions to Effectiveness.*

This Escrow Agreement shall become effective when each party hereto shall have signed a counterpart hereof. The parties hereto agree to use their best efforts to seek an order of the Escrow Court approving, and retaining continuing jurisdiction over, the Escrow Agreement as soon as possible, and agree that such order shall relate back to, and be deemed effective as of, the date this Escrow Agreement became effective.

SECTION 20. *Address for Payments*.

Whenever funds are under the terms of this Escrow Agreement required to be disbursed to a Settling State, a Participating Manufacturer, NAAG or the Foundation, the Escrow Agent shall disburse such funds by wire transfer to the account specified by such payee by written notice delivered to all Notice Parties in accordance with Section 11 hereof at least five Business Days prior to the date of payment. Whenever funds are under the terms of this Escrow Agreement required to be disbursed to any other person or entity, the Escrow Agent shall disburse such funds to such account as shall have been specified in writing by the Independent Auditor for such payment at least five Business Days prior to the date of payment.

SECTION 21. *Reporting*.

The Escrow Agent shall provide such information and reporting with respect to the escrow as the Independent Auditor may from time to time request.

IN WITNESS WHEREOF, the parties have executed this Escrow Agreement as of the day and year first hereinabove written.

[Signature Blocks]

Appendix A

Schedule Of Fees And Expenses

EXHIBIT C
FORMULA FOR CALCULATING
INFLATION ADJUSTMENTS

(1) Any amount that, in any given year, is to be adjusted for inflation pursuant to this Exhibit (the "Base Amount") shall be adjusted upward by adding to such Base Amount the Inflation Adjustment.

(2) The Inflation Adjustment shall be calculated by multiplying the Base Amount by the Inflation Adjustment Percentage applicable in that year.

(3) The Inflation Adjustment Percentage applicable to payments due in the year 2000 shall be equal to the greater of 3% or the CPI%. For example, if the Consumer Price Index for December 1999 (as released in January 2000) is 2% higher than the Consumer Price Index for December 1998 (as released in January 1999), then the CPI% with respect to a payment due in 2000 would be 2%. The Inflation Adjustment Percentage applicable in the year 2000 would thus be 3%.

(4) The Inflation Adjustment Percentage applicable to payments due in any year after 2000 shall be calculated by applying each year the greater of 3% or the CPI% on the Inflation Adjustment Percentage applicable to payments due in the prior year. Continuing the example in subsection (3) above, if the CPI% with respect to a payment due in 2001 is 6%, then the Inflation Adjustment Percentage applicable in 2001 would be 9.1800000% (an additional 6% applied on the 3% Inflation Adjustment Percentage applicable in 2000), and if the CPI% with respect to a payment due in 2002 is 4%, then the Inflation Adjustment Percentage applicable in 2002 would be 13.5472000% (an additional 4% applied on the 9.1800000% Inflation Adjustment Percentage applicable in 2001).

(5) "Consumer Price Index" means the Consumer Price Index for All Urban Consumers as published by the Bureau of Labor Statistics of the U.S. Department of Labor (or other similar measures agreed to by the Settling States and the Participating Manufacturers).

(6) The "CPI%" means the actual total percent change in the Consumer Price Index during the calendar year immediately preceding the year in which the payment in question is due.

(7) Additional Examples.

(A) Calculating the Inflation Adjustment Percentages:

Payment Year	Hypothetical CPI%	Percentage to be applied on the Inflation Adjustment Percentage for the prior year (i.e., the greater of 3% or the CPI%)	Inflation Adjustment Percentage
2000	2.4%	3.0%	3.0000000%
2001	2.1%	3.0%	6.0900000%
2002	3.5%	3.5%	9.8031500%
2003	3.5%	3.5%	13.6462603%
2004	4.0%	4.0%	18.1921107%
2005	2.2%	3.0%	21.7378740%
2006	1.6%	3.0%	25.3900102%

(B) Applying the Inflation Adjustment:

Using the hypothetical Inflation Adjustment Percentages set forth in section (7)(A):

-- the subsection IX(c)(1) base payment amount for 2002 of $6,500,000,000 as adjusted for inflation would equal $7,137,204,750;

-- the subsection IX(c)(1) base payment amount for 2004 of $8,000,000,000 as adjusted for inflation would equal $9,455,368,856;

-- the subsection IX(c)(1) base payment amount for 2006 of $8,000,000,000 as adjusted for inflation would equal $10,031,200,816.

EXHIBIT D
LIST OF LAWSUITS

1. Alabama
Blaylock et al. v. American Tobacco Co. et al.,
Circuit Court, Montgomery County, No. CV-96-1508-PR

2. Alaska
State of Alaska v. Philip Morris, Inc., et al., Superior Court, First Judicial District of Juneau, No. IJU-97915 CI (Alaska)

3. Arizona
State of Arizona v. American Tobacco Co., Inc., et al., Superior Court, Maricopa County, No. CV-96-14769 (Ariz.)

4. Arkansas
State of Arkansas v. The American Tobacco Co., Inc., et al., Chancery Court, 6th Division, Pulaski County, No. IJ 97-2982 (Ark.)

5. California
People of the State of California et al. v. Philip Morris, Inc., et al., Superior Court, Sacramento County, No. 97-AS-30301

6. Colorado
State of Colorado et al., v. R.J. Reynolds Tobacco Co., et al., District Court, City and County of Denver, No. 97CV3432 (Colo.)

7. Connecticut
State of Connecticut v. Philip Morris, et al., Superior Court, Judicial District of Waterbury No. X02 CV96-0148414S (Conn.)

8. Georgia
State of Georgia et al. v. Philip Morris, Inc., et al., Superior Court, Fulton County, No. CA E-61692 (Ga.)

9. Hawaii
State of Hawaii v. Brown & Williamson Tobacco Corp., et al., Circuit Court, First Circuit, No. 97-0441-01 (Haw.)

10. Idaho
State of Idaho v. Philip Morris, Inc., et al., Fourth Judicial District, Ada County, No. CVOC 9703239D (Idaho)

11. Illinois
People of the State of Illinois v. Philip Morris et al., Circuit Court of Cook County, No. 96-L13146 (Ill.)

12. Indiana
State of Indiana v. Philip Morris, Inc., et al., Marion County Superior Court, No. 49D 07-9702-CT-000236 (Ind.)

13. Iowa
State of Iowa v. R.J. Reynolds Tobacco Company et al., Iowa District Court, Fifth Judicial District, Polk County, No. CL71048 (Iowa)

14. Kansas
State of Kansas v. R.J. Reynolds Tobacco Company, et al., District Court of Shawnee County, Division 2, No. 96-CV-919 (Kan.)

15. Louisiana
Ieyoub v. The American Tobacco Company, et al., 14th Judicial District Court, Calcasieu Parish, No. 96-1209 (La.)

16. Maine
State of Maine v. Philip Morris, Inc., et al., Superior Court, Kennebec County, No. CV 97-134 (Me.)

17. Maryland
Maryland v. Philip Morris Incorporated, et al., Baltimore City Circuit Court, No. 96-122017-CL211487 (Md.)

18. Massachusetts
Commonwealth of Massachusetts v. Philip Morris Inc., et al., Middlesex Superior Court, No. 95-7378 (Mass.)

19. Michigan
Kelley v. Philip Morris Incorporated, et al., Ingham County Circuit Court, 30th Judicial Circuit, No. 96-84281-CZ (Mich.)

20. Missouri
State of Missouri v. American Tobacco Co., Inc. et al., Circuit Court, City of St. Louis, No. 972-1465 (Mo.)

21. Montana
State of Montana v. Philip Morris, Inc., et al., First Judicial Court, Lewis and Clark County, No. CDV 9700306-14 (Mont.)

22. Nebraska
State of Nebraska v. R.J. Reynolds Tobacco Co., et al., District Court, Lancaster County, No. 573277 (Neb.)

23. Nevada
Nevada v. Philip Morris, Incorporated, et al., Second Judicial Court, Washoe County, No. CV97-03279 (Nev.)

24. New Hampshire
New Hampshire v. R.J. Reynolds, Tobacco Co., et al., New Hampshire Superior Court, Merrimack County, No. 97-E-165 (N.H.)

25. New Jersey
State of New Jersey v. R.J. Reynolds Tobacco Company, et al., Superior Court, Chancery Division, Middlesex County, No. C-254-96 (N.J.)

26. New Mexico
State of New Mexico, v. The American Tobacco Co., et al., First Judicial District Court, County of Santa Fe, No. SF-1235 c (N.M.)

27. New York State
State of New York et al. v. Philip Morris, Inc., et al., Supreme Court of the State of New York, County of New York, No. 400361/97 (N.Y.)

28. Ohio
State of Ohio v. Philip Morris, Inc., et al., Court of Common Pleas, Franklin County, No. 97CVH055114 (Ohio)

29. Oklahoma
State of Oklahoma, et al. v. R.J. Reynolds Tobacco Company, et al., District Court, Cleveland County, No. CJ-96-1499-L (Okla.)

30. Oregon
State of Oregon v. The American Tobacco Co., et al., Circuit Court, Multnomah County, No. 9706-04457 (Or.)

31. Pennsylvania
Commonwealth of Pennsylvania v. Philip Morris, Inc., et al., Court of Common Pleas, Philadelphia County, April Term 1997, No. 2443

32. Puerto Rico
Rossello, et al. v. Brown & Williamson Tobacco Corporation, et al., U.S. District Court, Puerto Rico, No. 97-1910JAF

33. Rhode Island
State of Rhode Island v. American Tobacco Co., et al., Rhode Island Superior Court, Providence, No. 97-3058 (R.I.)

34. South Carolina
State of South Carolina v. Brown & Williamson Tobacco Corporation, et al., Court of Common Pleas, Fifth Judicial Circuit, Richland County, No. 97-CP-40-1686 (S.C.)

35. South Dakota
State of South Dakota, et al. v. Philip Morris, Inc., et al., Circuit Court, Hughes County, Sixth Judicial Circuit, No. 98-65 (S.D.)

36. Utah
State of Utah v. R.J. Reynolds Tobacco Company, et al., U.S. District Court, Central Division, No. 96 CV 0829W (Utah)

37. Vermont
State of Vermont v. Philip Morris, Inc., et al., Chittenden Superior Court, Chittenden County, No. 744-97 (Vt.) and 5816-98 (Vt.)

38. Washington
State of Washington v. American Tobacco Co. Inc., et al., Superior Court of Washington, King County, No. 96-2-1505608SEA (Wash.)

39. West Virginia
McGraw, et al. v. The American Tobacco Company, et al., Kanawha County Circuit Court, No. 94-1707 (W. Va.)

40. Wisconsin
State of Wisconsin v. Philip Morris Inc., et al., Circuit Court, Branch 11, Dane County, No. 97-CV-328 (Wis.)

Additional States

For each Settling State not listed above, the lawsuit or other legal action filed by the Attorney General or Governor of such Settling State against *Participating* Manufacturers in the Court in such Settling State prior to 30 days after the MSA Execution Date asserting Released Claims.

EXHIBIT E
FORMULA FOR CALCULATING
VOLUME ADJUSTMENTS

Any amount that by the terms of the Master Settlement Agreement is to be adjusted pursuant to this Exhibit E (the "Applicable Base Payment") shall be adjusted in the following manner:

(A) In the event the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico by the Original Participating Manufacturers in the Applicable Year (as defined hereinbelow) (the "Actual Volume") is greater than 475,656,000,000 Cigarettes (the "Base Volume"), the Applicable Base Payment shall be multiplied by the ratio of the Actual Volume to the Base Volume.

(B) In the event the Actual Volume is less than the Base Volume,

i. The Applicable Base Payment shall be reduced by subtracting from it the amount equal to such Applicable Base Payment multiplied both by 0.98 and by the result of (i) 1(one) minus (ii) the ratio of the Actual Volume to the Base Volume.

ii. Solely for purposes of calculating volume adjustments to the payments required under subsection IX(c)(1), if a reduction of the Base Payment due under such subsection results from the application of subparagraph (B)(i) of this Exhibit E, but the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes for the Applicable Year in the fifty United States, the District of Columbia, and Puerto Rico (the "Actual Operating Income") is greater than $7,195,340,000 (the "Base Operating Income") (such Base Operating Income being adjusted upward in accordance with the formula for inflation adjustments set forth in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996) then the amount by which such Base Payment is reduced by the application of subsection (B)(i) shall be reduced (but not below zero) by the amount calculated by multiplying (i) a percentage equal to the aggregate Allocable Shares of the Settling States in which State-Specific Finality has occurred by (ii) 25% of such increase in such operating income. For purposes of this Exhibit E, "operating income from sales of Cigarettes" shall mean operating income from sales of Cigarettes in the fifty United States, the District of Columbia, and Puerto Rico: (a) before goodwill amortization, trademark amortization, restructuring charges and restructuring related charges, minority interest, net interest expense, non-operating income and expense, general corporate expenses and income taxes; and (b) excluding extraordinary items, cumulative effect of changes in method of accounting and discontinued operations -- all as such income is reported to the United States Securities and Exchange Commission ("SEC") for the Applicable Year (either independently by the Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of such Participating Manufacturer) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with U.S. generally accepted accounting principles and audited by a nationally recognized accounting firm. For years subsequent to 1998, the determination of the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes shall not exclude any charges or expenses incurred or accrued in connection with this Agreement or any prior settlement of a tobacco and health case and shall otherwise be derived using the same principles as were employed in deriving such Original Participating Manufacturers' aggregate operating income from sales of Cigarettes in 1996.

iii. Any increase in a Base Payment pursuant to subsection (B)(ii) above shall be allocated among the Original Participating Manufacturers in the following manner:

(1) only to those Original Participating Manufacturers whose operating income from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico for the year for which the Base Payment is being adjusted is greater than their respective operating income from such sales of Cigarettes (including operating income from such sales of any of their Affiliates that do not continue to have such sales after the MSA Execution Date) in 1996 (as increased for inflation as provided in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996); and

(2) among the Original Participating Manufacturers described in paragraph (1) above in proportion to the ratio of (x) the increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of the Original Participating Manufacturer in question, to (y) the aggregate increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of those Original Participating Manufacturers described in paragraph (1) above.

(C) "Applicable Year" means the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

(D) For purposes of this Exhibit, shipments shall be measured as provided in subsection II(mm).

EXHIBIT F
POTENTIAL LEGISLATION NOT TO BE OPPOSED

1. Limitations on Youth access to vending machines.
2. Inclusion of cigars within the definition of tobacco products.
3. Enhancement of enforcement efforts to identify and prosecute violations of laws prohibiting retail sales to Youth.
4. Encouraging or supporting use of technology to increase effectiveness of age-of-purchase laws, such as, without limitation, the use of programmable scanners, scanners to read drivers' licenses, or use of other age/ID data banks.
5. Limitations on promotional programs for non-tobacco goods using tobacco products as prizes or give-aways.
6. Enforcement of access restrictions through penalties on Youth for possession or use.
7. Limitations on tobacco product advertising in or on school facilities, or wearing of tobacco logo merchandise in or on school property.
8. Limitations on non-tobacco products which are designed to look like tobacco products, such as bubble gum cigars, candy cigarettes, etc.

EXHIBIT G
OBLIGATIONS OF THE TOBACCO INSTITUTE
UNDER THE MASTER SETTLEMENT AGREEMENT

(a) Upon court approval of a plan of dissolution The Tobacco Institute ("TI") will:

(1) Employees. Promptly notify and arrange for the termination of the employment of all employees; provided, however, that TI may continue to engage any employee who is (A) essential to the wind-down function as set forth in section (g) herein; (B) reasonably needed for the sole purpose of directing and supporting TI's defense of ongoing litigation; or (C) reasonably needed for the sole purpose of performing the Tobacco Institute Testing Laboratory's (the "TITL") industry-wide cigarette testing pursuant to the Federal Trade Commission (the "FTC") method or any other testing prescribed by state or federal law as set forth in section (h) herein.

(2) Employee Benefits. Fund all employee benefit and pension programs; provided, however, that unless ERISA or other federal or state law prohibits it, such funding will be accomplished through periodic contributions by the Original Participating Manufacturers, according to their Relative Market Shares, into a trust or a like mechanism, which trust or like mechanism will be established within 90 days of court approval of the plan of dissolution. An opinion letter will be appended to the dissolution plan to certify that the trust plan is not inconsistent with ERISA or employee benefit pension contracts.

(3) Leases. Terminate all leaseholds at the earliest possible date pursuant to the leases; provided, however, that TI may retain or lease anew such space (or lease other space) as needed for its wind-down activities, for TITL testing as described herein, and for subsequent litigation defense activities. Immediately upon execution of this Agreement, TI will provide notice to each of its landlords of its desire to terminate its lease with such landlord, and will request that the landlord take all steps to re-lease the premises at the earliest possible date consistent with TI's performance of its obligations hereunder. TI will vacate such leasehold premises as soon as they are re-leased or on the last day of wind-down, whichever occurs first.

(b) Assets/Debts. Within 60 days after court approval of a plan of dissolution, TI will provide to the Attorney General of New York and append to the dissolution plan a description of all of its assets, its debts, tax claims against it, claims of state and federal governments against it, creditor claims against it, pending litigation in which it is a party and notices of claims against it.

(c) Documents. Subject to the privacy protections provided by New York Public Officers Law §§ 91-99, TI will provide a copy of or otherwise make available to the State of New York all documents in its possession, excluding those that TI continues to claim to be subject to any attorney-client privilege, attorney work product protection, common interest/joint defense privilege or any other applicable privilege (collectively, "privilege") after the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County) (the "Oklahoma action"):

(1) TI will deliver to the Attorney General of the State of New York a copy of the privilege log served by it in the Oklahoma action. Upon a written request by the Attorney General, TI will deliver an updated version of its privilege log, if any such updated version exists.

(2) The disclosure of any document or documents claimed to be privileged will be governed by section IV of this Agreement.

(3) At the conclusion of the document production and privilege logging process, TI will provide a sworn affidavit that all documents in its possession have been made available to the Attorney General of New York except for documents claimed to be privileged, and that any privilege logs that already exist have been made available to the Attorney General.

(d) Remaining Assets. On mutual agreement between TI and the Attorney General of New York, a not-for-profit health or child welfare organization will be named as the beneficiary of any TI assets that remain after lawful transfers of assets and satisfaction of TI's employee benefit obligations and any other debts, liabilities or claims.

(e) Defense of Litigation. Pursuant to Section 1006 of the New York Not-for-Profit Corporations Law, TI will have the right to continue to defend its litigation interests with respect to any claims against it that are pending or threatened now or that are brought or threatened in the future. TI will retain sole discretion over all litigation decisions, including, without limitation, decisions with respect to asserting any privileges or defenses, having privileged communications and creating privileged documents, filing pleadings, responding to discovery requests, making motions, filing affidavits and briefs, conducting party and non-party discovery, retaining expert witnesses and consultants, preparing for and defending itself at trial, settling any claims asserted against it, intervening or otherwise participating in litigation to protect interests that it deems significant to its defense, and otherwise directing or conducting its defense. Pursuant to existing joint defense agreements, TI may continue to assist its current or former members in defense of any litigation brought or threatened against them. TI also may enter into any new joint defense agreement or agreements that it deems significant to its defense of pending or threatened claims. TI may continue to engage such employees as reasonably needed for the sole purpose of directing and supporting its defense of ongoing litigation. As soon as TI has no litigation pending against it, it will dissolve completely and will cease all functions consistent with the requirements of law.

(f) No public statement. Except as necessary in the course of litigation defense as set forth in section (e) above, upon court approval of a plan of dissolution, neither TI nor any of its employees or agents acting in their official capacity on behalf of TI will issue any statements, press releases, or other public statement concerning tobacco.

(g) Wind-down. After court approval of a plan of dissolution, TI will effectuate wind-down of all activities (other than its defense of litigation as described in section (e) above) expeditiously, and in no event later than 180 days after the date of court approval of the plan of dissolution. TI will provide monthly status reports to the Attorney General of New York regarding the progress of wind-down efforts and work remaining to be done with respect to such efforts.

(h) TITL. Notwithstanding any other provision of this Exhibit G or the dissolution plan, TI may perform TITL industry-wide cigarette testing pursuant to the FTC method or any other testing prescribed by state or federal law until such function is transferred to another entity, which transfer will be accomplished as soon as practicable but in no event more than 180 days after court approval of the dissolution plan.

(i) Jurisdiction. After the filing of a Certificate of Dissolution, pursuant to Section 1004 of the New York Not-for-Profit Corporation Law, the Supreme Court for the State of New York will have continuing jurisdiction over the dissolution of TI and the winding-down of TI's activities, including any litigation-related activities described in subsection (e) herein.

(j) No Determination or Admission. The dissolution of TI and any proceedings taken hereunder are not intended to be and shall not in any event be construed as, deemed to be, or represented or caused to be represented by any Settling State as, an admission or concession or evidence of any liability or any wrongdoing whatsoever on the part of TI, any of its current or former members or anyone acting on their behalf. TI specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it by the Attorneys General of the Settling States.

(k) Court Approval. The Attorney General of the State of New York and the Original Participating Manufacturers will prepare a joint plan of dissolution for submission to the Supreme Court of the State of New York, all of the terms of which will be agreed on and consented to by the Attorney General and the Original Participating Manufacturers consistent with this schedule. The Original Participating Manufacturers and their employees, as officers and directors of TI, will take whatever steps are necessary to execute all documents needed to develop such a plan of dissolution and to submit it to the court for approval. If any court makes any material change to any term or provision of the plan of dissolution agreed upon and consented to by the Attorney General and the Original Participating Manufacturers, then:

(1) the Original Participating Manufacturers may, at their election, nevertheless proceed with the dissolution plan as modified by the court; or

(2) if the Original Participating Manufacturers elect not to proceed with the court-modified dissolution plan, the Original Participating Manufacturers will be released from any obligations or undertakings under this Agreement or this schedule with respect to TI; provided, however, that the Original Participating Manufacturers will engage in good faith negotiations with the New York Attorney General to agree upon the term or terms of the dissolution plan that the court may have modified in an effort to agree upon a dissolution plan that may be resubmitted for the court's consideration.

EXHIBIT H
DOCUMENT PRODUCTION

Section 1.

(a) Philip Morris Companies, Inc., et al., v. American Broadcasting Companies, Inc., et al., At Law No. 760CL94X00816-00 (Cir. Ct., City of Richmond)

(b) Harley-Davidson v. Lorillard Tobacco Co., No. 93-947 (S.D.N.Y.)

(c) Lorillard Tobacco Co. v. Harley-Davidson, No. 93-6098 (E.D. Wis.)

(d) Brown & Williamson v. Jacobson and CBS, Inc., No. 82-648 (N.D. Ill.)

(e) The FTC investigations of tobacco industry advertising and promotion as embodied in the following cites:

46 FTC 706
48 FTC 82
46 FTC 735
47 FTC 1393
108 F. Supp. 573
55 FTC 354
56 FTC 96
79 FTC 255
80 FTC 455
Investigation #8023069
Investigation #8323222

Each Original Participating Manufacturer and Tobacco-Related Organization will conduct its own reasonable inquiry to determine what documents or deposition testimony, if any, it produced or provided in the above-listed matters.

Section 2.

(a) State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King)

(b) In re Mike Moore, Attorney General, ex rel, State of Mississippi Tobacco Litigation, No. 94-1429 (Chancery Ct., Jackson, Miss.)

(c) State of Florida v. American Tobacco Co., et al., No. CL 95-1466 AH (Fla. Cir. Ct., 15th Judicial Cir., Palm Beach Co.)

(d) State of Texas v. American Tobacco Co., et al., No. 5-96CV-91 (E.D. Tex.)

(e) Minnesota v. Philip Morris et al., No. C-94-8565 (Minn. Dist. Ct., County of Ramsey)

(f) Broin v. R.J. Reynolds, No. 91-49738 CA (22) (11th Judicial Ct., Dade County, Florida)

EXHIBIT I
INDEX AND SEARCH FEATURES FOR DOCUMENT WEBSITE

(a) Each Original Participating Manufacturer and Tobacco-Related Organization will create and maintain on its website, at its expense, an enhanced, searchable index, as described below, using Alta-Vista or functionally comparable software, for all of the documents currently on its website and all documents being placed on its website pursuant to section IV of this Agreement.

(b) The searchable indices of documents on these websites will include:

(1) all of the information contained in the 4(b) indices produced to the State Attorneys General (excluding fields specific only to the Minnesota action other than "request number");

(2) the following additional fields of information (or their substantial equivalent) to the extent such information already exists in an electronic format that can be incorporated into such an index:

Document ID	Master ID
Other Number	Document Date
Primary Type	Other Type
Person Attending	Person Noted
Person Author	Person Recipient
Person Copied	Person Mentioned
Organization Author	Organization Recipient
Organization Copied	Organization Mentioned
Organization Attending	Organization Noted
Physical Attachment 1	Physical Attachment 2
Characteristics	File Name
Site	Area
Verbatim Title	Old Brand
Primary Brand	Mentioned Brand
Page Count	

(c) Each Original Participating Manufacturer and Tobacco-Related Organization will add, if not already available, a user-friendly document retrieval feature on the Website consisting of a "view all pages" function with enhanced image viewer capability that will enable users to choose to view and/or print either "all pages" for a specific document or "page-by-page".

(d) Each Original Participating Manufacturer and Tobacco-Related Organizations will provide at its own expense to NAAG a copy set in electronic form of its website document images and its accompanying subsection IV(h) index in ASCII-delimited form for all of the documents currently on its website and all of the documents described in subsection IV(d) of this Agreement. The Original Participating Manufacturers and Tobacco-Related Organizations will not object to any subsequent distribution and/or reproduction of these copy sets.

EXHIBIT J
TOBACCO ENFORCEMENT FUND PROTOCOL

The States' Antitrust/Consumer Protection Tobacco Enforcement Fund ("Fund") is established by the Attorneys General of the Settling States, acting through NAAG, pursuant to section VIII(c) of the Agreement. The following shall be the primary and mandatory protocol for the administration of the Fund.

Section A
Fund Purpose

Section 1

The monies to be paid pursuant to section VIII(c) of the Agreement shall be placed by NAAG in a new and separate interest bearing account, denominated the States' Antitrust/ Consumer Protection Tobacco Enforcement Fund, which shall not then or thereafter be commingled with any other funds or accounts. However, nothing herein shall prevent deposits into the account so long as monies so deposited are then lawfully committed for the purpose of the Fund as set forth herein.

Section 2

A committee of three Attorneys General ("Special Committee") shall be established to determine disbursements from the account, using the process described herein. The three shall be the Attorney General of the State of Washington, the Chair of NAAG's antitrust committee, and the Chair of NAAG's consumer protection committee. In the event that an Attorney General shall hold either two or three of the above stated positions, that Attorney General may serve only in a single capacity, and shall be replaced in the remaining positions by first, the President of NAAG, next by the President-Elect of NAAG and if necessary the Vice-President of NAAG.

Section 3

The purpose of the Fund is: (1) to enforce and implement the terms of the Agreement, in particular, by partial payment of the monetary costs of the Independent Auditor as contemplated by the Agreement; and (2) to provide monetary assistance to the various states' attorneys general: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute ("Qualifying Actions"). The Special Committee shall entertain requests only from Settling States for disbursement from the fund associated with a Qualifying Action ("Grant Application").

Section B
Administration Standards Relative to Grant Applications

Section 1

The Special Committee shall not entertain any Grant Application to pay salaries or ordinary expenses of regular employees of any Attorney General's office.

Section 2

The affirmative vote of two or more of the members of the Special Committee shall be required to approve any Grant Application.

Section 3

The decision of the Special Committee shall be final and non-appealable.

Section 4

The Attorney General of the State of Washington shall be chair of the Special Committee and shall annually report to the Attorneys General on the requests for funds from the Fund and the actions of the Special Committee upon the requests.

Section 5

When a Grant Application to the Fund is made by an Attorney General who is then a member of the Special Committee, such member will be temporarily replaced on the Committee, but only for the determination of such Grant Application. The remaining members of the Special Committee shall designate an Attorney General to replace the Attorney General so disqualified, in order to consider the application.

Section 6

The Fund shall be maintained in a federally insured depository institution located in Washington, D.C. Funds may be invested in federal government-backed vehicles. The Fund shall be regularly reported on NAAG financial statements and subject to annual audit.

Section 7

Withdrawals from and checks drawn on the Fund will require at least two of three authorized signatures. The three persons so authorized shall be the executive director, the deputy director, and controller of NAAG.

Section 8

The Special Committee shall meet in person or telephonically as necessary to determine whether a grant is sought for assistance with a Qualifying Action and whether and to what extent the Grant Application is accepted. The chair of the

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

Section 9

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

Section 10

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

Section 11

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

Section 12

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

Section 13

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

Section C
Grant Application Procedures

Section 1

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

Section 2

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

Section 3

Grant Applications must include the following:

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

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

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

(D) The amount requested.

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

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

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

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

Section 4

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

Section 5

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

Section D
Other Disbursements from the Fund

Section 1

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

Section E
Administrative Costs

Section 1

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

EXHIBIT K
MARKET CAPITALIZATION PERCENTAGES

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

EXHIBIT L
MODEL CONSENT DECREE

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

- x

CAUSE NO. XXXXXX

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

CONSENT DECREE AND FINAL JUDGMENT

- x

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

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

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

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

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

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

I. JURISDICTION AND VENUE

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

II. DEFINITIONS

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

III. APPLICABILITY

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

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

IV. VOLUNTARY ACT OF THE PARTIES

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

V. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

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

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

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

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

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

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

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

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

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

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

VI. MISCELLANEOUS PROVISIONS

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

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

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

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

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

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

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

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

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

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

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

VII. FINAL DISPOSITION

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

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

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this _____ day of _____, 1998.

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

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

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

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

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

5. Philip Morris, et al. v. William H. Sorrell, et al., No. 1:98-ev-132, United States District Court for the District of Vermont

EXHIBIT N
LITIGATING POLITICAL SUBDIVISIONS

1. City of New York, et al. v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of New York, Index No. 406225/96
2. County of Erie v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of Erie, Index No. I 1997/359
3. County of Los Angeles v. R.J. Reynolds Tobacco Co. et al., San Diego Superior Court, No. 707651
4. The People v. Philip Morris, Inc. et al., San Francisco Superior Court, No. 980864
5. County of Cook v. Philip Morris, Inc. et al., Circuit Court of Cook County, Ill., No. 97-L-4550

EXHIBIT O
MODEL STATE FEE PAYMENT AGREEMENT

This STATE Fee Payment Agreement (the "STATE Fee Payment Agreement") is entered into as of _____, _____ between and among the Original Participating Manufacturers and STATE Outside Counsel (as defined herein), to provide for payment of attorneys' fees pursuant to Section XVII of the Master Settlement Agreement (the "Agreement").

WITNESSETH:

WHEREAS, the State of STATE and the Original Participating Manufacturers have entered into the Agreement to settle and resolve with finality all Released Claims against the Released Parties, including the Original Participating Manufacturers, as set forth in the Agreement; and

WHEREAS, Section XVII of the Agreement provides that the Original Participating Manufacturers shall pay reasonable attorneys' fees to those private outside counsel identified in Exhibit S to the Agreement, pursuant to the terms hereof;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the mutual agreement of the State of STATE and the Original Participating Manufacturers to the terms of the Agreement and of the mutual agreement of STATE Outside Counsel and the Original Participating Manufacturers to the terms of this STATE Fee Payment Agreement, and such other consideration described herein, the Original Participating Manufacturers and STATE Outside Counsel agree as follows:

SECTION 1. *Definitions*.

All definitions contained in the Agreement are incorporated by reference herein, except as to terms specifically defined herein.

(a) "*Action*" means the lawsuit identified in Exhibit D, M or N to the Agreement that has been brought by or against the State of STATE [or Litigating Political Subdivision].

(b) "*Allocated Amount*" means the amount of any Applicable Quarterly Payment allocated to any Private Counsel (including STATE Outside Counsel) pursuant to section 17 hereof.

(c) "*Allocable Liquidated Share*" means, in the event that the sum of all Payable Liquidated Fees of Private Counsel as of any date specified in section 8 hereof exceeds the Applicable Liquidation Amount for any payment described therein, a percentage share of the Applicable Liquidation Amount equal to the proportion of (i) the amount of the Payable Liquidated Fee of STATE Outside Counsel to (ii) the sum of Payable Liquidated Fees of all Private Counsel.

(d) "*Applicable Liquidation Amount*" means, for purposes of the payments described in section 8 hereof —

(i) for the payment described in subsection (a) thereof, $125 million;

(ii) for the payment described in subsection (b) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsection (a) thereof;

(iii) for the payment described in subsection (c) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a) and (b) thereof;

(iv) for the payment described in subsection (d) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a), (b) and (c) thereof;

(v) for the payment described in subsection (e) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a), (b), (c) and (d) thereof;

(vi) for each of the first, second and third quarterly payments for any calendar year described in subsection (f) thereof, $62.5 million; and

(vii) for each of the fourth calendar quarterly payments for any calendar year described in subsection (f) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel with respect to the preceding calendar quarters of the calendar year.

(e) "*Application*" means a written application for a Fee Award submitted to the Panel, as well as all supporting materials (which may include video recordings of interviews).

(f) "*Approved Cost Statement*" means both (i) a Cost Statement that has been accepted by the Original Participating Manufacturers; and (ii) in the event that a Cost Statement submitted by STATE Outside Counsel is disputed, the determination by arbitration pursuant to subsection (b) of section 19 hereof as to the amount of the reasonable costs and expenses of STATE Outside Counsel.

(g) "*Cost Statement*" means a signed and attested statement of reasonable costs and expenses of Outside Counsel for any action identified on Exhibit D, M or N to the Agreement that has been brought by or against a Settling State or Litigating Political Subdivision.

(h) "*Designated Representative*" means the person designated in writing, by each person or entity identified in Exhibit S to the Agreement [by the Attorney General of the State of STATE or as later certified in writing by the governmental prosecuting authority of the Litigating Political Subdivision], to act as their agent in receiving payments from the Original Participating Manufacturers for the benefit of STATE Outside Counsel pursuant to sections 8, 16 and 19 hereof, as applicable.

(i) "*Director*" means the Director of the Private Adjudication Center of the Duke University School of Law or such other person or entity as may be chosen by agreement of the Original Participating Manufacturers and the Committee described in the second sentence of paragraph (b)(ii) of section 11 hereof.

(j) "*Eligible Counsel*" means Private Counsel eligible to be allocated a part of a Quarterly Fee Amount pursuant to section 17 hereof.

(k) "*Federal Legislation*" means federal legislation that imposes an enforceable obligation on Participating Defendants to pay attorneys' fees with respect to Private Counsel.

(l) "*Fee Award*" means any award of attorneys' fees by the Panel in connection with a Tobacco Case.

(m) "*Liquidated Fee*" means an attorneys' fee for Outside Counsel for any action identified on Exhibit D, M or N to the Agreement that has been brought by or against a Settling State or Litigating Political Subdivision, in an amount agreed upon by the Original Participating Manufacturers and such Outside Counsel.

(n) "*Outside Counsel*" means all those Private Counsel identified in Exhibit S to the Agreement.

(o) "*Panel*" means the three-member arbitration panel described in section 11 hereof.

(p) "*Party*" means (i) STATE Outside Counsel and (ii) an Original Participating Manufacturer.

(q) "*Payable Cost Statement*" means the unpaid amount of a Cost Statement as to which all conditions precedent to payment have been satisfied.

(r) "*Payable Liquidated Fee*" means the unpaid amount of a Liquidated Fee as to which all conditions precedent to payment have been satisfied.

(s) "*Previously Settled States*" means the States of Mississippi, Florida and Texas.

(t) "*Private Counsel*" means all private counsel for all plaintiffs in a Tobacco Case (including STATE Outside Counsel).

(u) "*Quarterly Fee Amount*" means, for purposes of the quarterly payments described in sections 16, 17 and 18 hereof —

(i) for each of the first, second and third calendar quarters of any calendar year beginning with the first calendar quarter of 1999 and ending with the third calendar quarter of 2008, $125 million;

(ii) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 1999 and ending with the fourth calendar quarter of 2003, the sum of (A) $125 million and (B) the difference, if any, between (*1*) $375 million and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any;

(iii) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 2004 and ending with the fourth calendar quarter of 2008, the sum of (A) $125 million; (B) the difference between (*1*) $375 million; and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any; and (C) the difference, if any, between (*1*) $250 million and (*2*) the product of (*a*) .2 (two tenths) and (*b*) the sum of all amounts paid in satisfaction of all Liquidated Fees of Outside Counsel pursuant to section 8 hereof, if any;

(iv) for each of the first, second and third calendar quarters of any calendar year beginning with the first calendar quarter of 2009, $125 million; and

(v) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 2009, the sum of (A) $125 million and (B) the difference, if any, between (*1*) $375 million and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any.

(v) *"Related Persons"* means each Original Participating Manufacturer's past, present and future Affiliates, divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing).

(w) "*State of STATE*" means the [applicable Settling State or the Litigating Political Subdivision], any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and subdivisions.

(x) "*STATE Outside Counsel*" means all persons or entities identified in Exhibit S to the Agreement by the Attorney General of State of STATE [or as later certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] as having been retained by and having represented the STATE in connection with the Action, acting collectively by unanimous decision of all such persons or entities.

(y) "*Tobacco Case*" means any tobacco and health case (other than a non-class action personal injury case brought directly by or on behalf of a single natural person or the survivor of such person or for wrongful death, or any non-class action consolidation of two or more such cases).

(z) *"Unpaid Fee"* means the unpaid portion of a Fee Award.

SECTION 2. *Agreement to Pay Fees.*

The Original Participating Manufacturers will pay reasonable attorneys' fees to STATE Outside Counsel for their representation of the State of STATE in connection with the Action, as provided herein and subject to the *Code of Professional Responsibility* of the American Bar Association. Nothing herein shall be construed to require the Original Participating Manufacturers to pay any attorneys' fees other than (i) a Liquidated Fee or a Fee Award and (ii) a Cost Statement, as provided herein, nor shall anything herein require the Original Participating Manufacturers to pay any Liquidated Fee, Fee Award or Cost Statement in connection with any litigation other than the Action.

SECTION 3. *Exclusive Obligation of the Original Participating Manufacturers.*

The provisions set forth herein constitute the entire obligation of the Original Participating Manufacturers with respect to payment of attorneys' fees of STATE Outside Counsel (including costs and expenses) in connection with the Action and the exclusive means by which STATE Outside Counsel or any other person or entity may seek payment of fees by the Original Participating Manufacturers or Related Persons in connection with the Action. The Original Participating Manufacturers shall have no obligation pursuant to Section XVII of the Agreement to pay attorneys' fees in connection with the Action to any counsel other than STATE Outside Counsel, and they shall have no other obligation to pay attorneys' fees to or otherwise to compensate STATE Outside Counsel, any other counsel or representative of the State of STATE or the State of STATE itself with respect to attorneys' fees in connection with the Action.

SECTION 4. *Release.*

(a) Each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] hereby irrevocably releases the Original Participating Manufacturers and all Related Persons from any and all claims that such person or entity ever had, now has or hereafter can, shall or may have in any way related to the Action (including but not limited to any negotiations related to the settlement of the Action). Such release shall not be construed as a release of any person or entity as to any of the obligations undertaken herein in connection with a breach thereof.

(b) In the event that STATE Outside Counsel and the Original Participating Manufacturers agree upon a Liquidated Fee pursuant to section 7 hereof, it shall be a precondition to any payment by the Original Participating Manufacturers to the Designated Representative pursuant to section 8 hereof that each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] shall have irrevocably released all entities represented by STATE Outside Counsel in the Action, as well as all persons acting by or on behalf of such entities (including the Attorney General [or the office of the governmental prosecuting authority] and each other person or entity identified on Exhibit S to the Agreement by the Attorney General [or the office of the governmental prosecuting authority]) from any and all claims that such person or entity ever had, now has or hereafter can, shall or may have in any way related to the Action (including but not limited to any negotiations related to the settlement of the Action). Such release shall not be construed as a release of any person or entity as to any of the obligations undertaken herein in connection with a breach thereof.

SECTION 5. *No Effect on STATE Outside Counsel's Fee Contract.*

The rights and obligations, if any, of the respective parties to any contract between the State of STATE and STATE Outside Counsel shall be unaffected by this STATE Fee Payment Agreement except (a) insofar as STATE Outside Counsel grant the release described in subsection (b) of section 4 hereof; and (b) to the extent that STATE Outside Counsel receive any payments in satisfaction of a Fee Award pursuant to section 16 hereof, any amounts so received shall be credited, on a dollar-for-dollar basis, against any amount payable to STATE Outside Counsel by the State of STATE [or the Litigating Political Subdivision] under any such contract.

SECTION 6. *Liquidated Fees.*

(a) In the event that the Original Participating Manufacturers and STATE Outside Counsel agree upon the amount of a Liquidated Fee, the Original Participating Manufacturers shall pay such Liquidated Fee, pursuant to the terms hereof.

(b) The Original Participating Manufacturers' payment of any Liquidated Fee pursuant to this STATE Fee Payment Agreement shall be subject to (i) satisfaction of the conditions precedent stated in section 4 and paragraph (c)(ii) of section 7 hereof; and (ii) the payment schedule and the annual and quarterly aggregate national caps specified in sections 8 and 9 hereof, which shall apply to all payments made with respect to Liquidated Fees of all Outside Counsel.

SECTION 7. *Negotiation of Liquidated Fees.*

(a) If STATE Outside Counsel seek to be paid a Liquidated Fee, the Designated Representative shall so notify the Original Participating Manufacturers. The Original Participating Manufacturers may at any time make an offer of a Liquidated Fee to the Designated Representative in an amount set by the unanimous agreement, and at the sole discretion, of the Original Participating Manufacturers and, in any event, shall collectively make such an offer to the Designated Representative no more than 60 Business Days after receipt of notice by the Designated Representative that STATE Outside

Counsel seek to be paid a Liquidated Fee. The Original Participating Manufacturers shall not be obligated to make an offer of a Liquidated Fee in any particular amount. Within ten Business Days after receiving such an offer, STATE Outside Counsel shall either accept the offer, reject the offer or make a counteroffer.

(b) The national aggregate of all Liquidated Fees to be agreed to by the Original Participating Manufacturers in connection with the settlement of those actions indicated on Exhibits D, M and N to the Agreement shall not exceed one billion two hundred fifty million dollars ($1,250,000,000).

(c) If the Original Participating Manufacturers and STATE Outside Counsel agree in writing upon a Liquidated Fee:

(i) STATE Outside Counsel shall not be eligible for a Fee Award;

(ii) such Liquidated Fee shall not become a Payable Liquidated Fee until such time as (A) State-Specific Finality has occurred in the State of STATE; (B) each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority of the Litigating Political Subdivision] has granted the release described in subsection (b) of section 4 hereof; and (C) notice of the events described in subparagraphs (A) and (B) of this paragraph has been provided to the Original Participating Manufacturers.

(iii) payment of such Liquidated Fee pursuant to sections 8 and 9 hereof (together with payment of costs and expenses pursuant to section 19 hereof), shall be STATE Outside Counsel's total and sole compensation by the Original Participating Manufacturers in connection with the Action.

(d) If the Original Participating Manufacturers and STATE Outside Counsel do not agree in writing upon a Liquidated Fee, STATE Outside Counsel may submit an Application to the Panel for a Fee Award to be paid as provided in sections 16, 17 and 18 hereof.

SECTION 8. *Payment of Liquidated Fee*.

In the event that the Original Participating Manufacturers and STATE Outside Counsel agree in writing upon a Liquidated Fee, and until such time as the Designated Representative has received payments in full satisfaction of such Liquidated Fee —

(a) On February 1, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before January 15, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel as of January 15, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(b) On August 1, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee on or after January 15, 1999 and before July 15, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees on or after January 15, 1999 and before July 15, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(c) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee on or after July 15, 1999 and before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees on or after July 15, 1999 and before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(d) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, or (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that become Payable Liquidated Fees before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(e) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel or (ii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(f) On the last day of each calendar quarter, beginning with the first calendar quarter of 2000 and ending with the fourth calendar quarter of 2003, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee at least 15 Business Days prior to the last day of each such calendar quarter, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel or (ii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel as of the date 15 Business Days prior to the date of the payment in question exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

SECTION 9. *Limitations on Payments of Liquidated Fees*.

Notwithstanding any other provision hereof, all payments by the Original Participating Manufacturers with respect to Liquidated Fees shall be subject to the following:

(a) Under no circumstances shall the Original Participating Manufacturers be required to make any payment that would result in aggregate national payments of Liquidated Fees:

(i) during 1999, totaling more than $250 million;

(ii) with respect to any calendar quarter beginning with the first calendar quarter of 2000 and ending with the fourth calendar quarter of 2003, totaling more than $62.5 million, except to the extent that a payment with respect to any prior calendar quarter of any calendar year did not total $62.5 million; or

(iii) with respect to any calendar quarter after the fourth calendar quarter of 2003, totaling more than zero.

(b) The Original Participating Manufacturers' obligations with respect to the Liquidated Fee of STATE Outside Counsel, if any, shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, such Liquidated Fee shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

SECTION 10. *Fee Awards*.

(a) In the event that the Original Participating Manufacturers and STATE Outside Counsel do not agree in writing upon a Liquidated Fee as described in section 7 hereof, the Original Participating Manufacturers shall pay, pursuant to the terms hereof, the Fee Award awarded by the Panel to STATE Outside Counsel.

(b) The Original Participating Manufacturers' payment of any Fee Award pursuant to this STATE Fee Payment Agreement shall be subject to the payment schedule and the annual and quarterly aggregate national caps specified in sections 17 and 18 hereof, which shall apply to:

(i) all payments of Fee Awards in connection with an agreement to pay fees as part of the settlement of any Tobacco Case on terms that provide for payment by the Original Participating Manufacturers or other defendants acting in agreement with the Original Participating Manufacturers (collectively, "Participating Defendants") of fees with respect to any Private Counsel, subject to an annual cap on payment of all such fees; and

(ii) all payments of attorneys' fees (other than fees for attorneys of Participating Defendants) pursuant to Fee Awards for activities in connection with any Tobacco Case resolved by operation of Federal Legislation.

SECTION 11. *Composition of the Panel*.

(a) The first and the second members of the Panel shall both be permanent members of the Panel and, as such, will participate in the determination of all Fee Awards. The third Panel member shall not be a permanent Panel member, but instead shall be a state-specific member selected to determine Fee Awards on behalf of Private Counsel retained in connection with litigation within a single state. Accordingly, the third, state-specific member of the Panel for purposes of determining Fee Awards with respect to litigation in the State of STATE shall not participate in any determination as to any Fee Award with respect to litigation in any other state (unless selected to participate in such determinations by such persons as may be authorized to make such selections under other agreements).

(b) The members of the Panel shall be selected as follows:

(i) The first member shall be the natural person selected by Participating Defendants.

(ii) The second member shall be the person jointly selected by the agreement of Participating Defendants and a majority of the committee described in the fee payment agreements entered in connection with the settlements of the Tobacco Cases brought by the Previously Settled States. In the event that the person so selected is unable or unwilling to continue to serve, a replacement for such member shall be selected by agreement of the Original Participating Manufacturers and a majority of the members of a committee composed of the following members: Joseph F. Rice, Richard F. Scruggs, Steven W. Berman, Walter Umphrey, one additional representative, to be selected in the sole discretion of NAAG, and two representatives of Private Counsel in Tobacco Cases, to be selected at the sole discretion of the Original Participating Manufacturers.

(iii) The third, state-specific member for purposes of determining Fee Awards with respect to litigation in the State of STATE shall be a natural person selected by STATE Outside Counsel, who shall notify the Director and the Original Participating Manufacturers of the name of the person selected.

SECTION 12. *Application of STATE Outside Counsel*.

(a) STATE Outside Counsel shall make a collective Application for a single Fee Award, which shall be submitted to the Director. Within five Business Days after receipt of the Application by STATE Outside Counsel, the Director shall serve the Application upon the Original Participating Manufacturers and the STATE. The Original Participating Manufacturers shall submit all materials in response to the Application to the Director by the later of (i) 60 Business Days after service of the Application upon the Original Participating Manufacturers by the Director, (ii) five Business Days after the date of State-Specific Finality in the State of STATE or (iii) five Business Days after the date on which notice of the name of the third, state-specific panel member described in paragraph (b)(iii) of section 11 hereof has been provided to the Director and the Original Participating Manufacturers.

(b) The Original Participating Manufacturers may submit to the Director any materials that they wish and, notwithstanding any restrictions or representations made in any other agreements, the Original Participating Manufacturers shall be in no way constrained from contesting the amount of the Fee Award requested by STATE Outside Counsel. The Director, the Panel, the State of STATE, the Original Participating Manufacturers and STATE Outside Counsel shall preserve the confidentiality of any attorney work-product materials or other similar confidential information that may be submitted.

(c) The Director shall forward the Application of STATE Outside Counsel, as well as all written materials relating to such Application that have been submitted by the Original Participating Manufacturers pursuant to subsection (b) of this section, to the Panel within five Business Days after the later of (i) the expiration of the period for the Original Participating Manufacturers to submit such materials or (ii) the earlier of (A) the date on which the Panel issues a Fee Award with respect to any Application of other Private Counsel previously forwarded to the Panel by the Director or (B) 30 Business Days after the forwarding to the Panel of the Application of other Private Counsel most recently forwarded to the Panel by the Director. The Director shall notify the Parties upon forwarding the Application (and all written materials relating thereto) to the Panel.

(d) In the event that either Party seeks a hearing before the Panel, such Party may submit a request to the Director in writing within five Business Days after the forwarding of the Application of STATE Outside Counsel to the Panel by the Director, and the Director shall promptly forward the request to the Panel. If the Panel grants the request, it shall promptly set a date for hearing, such date to fall within 30 Business Days after the date of the Panel's receipt of the Application.

SECTION 13. *Panel Proceedings*.

The proceedings of the Panel shall be conducted subject to the terms of this Agreement and of the Protocol of Panel Procedures attached as an Appendix hereto.

SECTION 14. *Award of Fees to STATE Outside Counsel*.

The members of the Panel will consider all relevant information submitted to them in reaching a decision as to a Fee Award that fairly provides for full reasonable compensation of STATE Outside Counsel. In considering the amount of the Fee Award, the Panel shall not consider any Liquidated Fee agreed to by any other Outside Counsel, any offer of or negotiations relating to any proposed liquidated fee for STATE Outside Counsel or any Fee Award that already has been or yet may be awarded in connection with any other Tobacco Case. The Panel shall not be limited to an hourly-rate or lodestar analysis in determining the amount of the Fee Award of STATE Outside Counsel, but shall take into account the totality of the circumstances. The Panel's decisions as to the Fee Award of STATE Outside Counsel shall be in writing and shall report the amount of the fee awarded (with or without explanation or opinion, at the Panel's discretion). The Panel shall determine the amount of the Fee Award to be paid to STATE Outside Counsel within the later of 30 calendar days after receiving the Application (and all related materials) from the Director or 15 Business Days after the last date of any hearing held pursuant to subsection (d) of section 12 hereof. The Panel's decision as to the Fee Award of STATE Outside Counsel shall be final, binding and non-appealable.

SECTION 15. *Costs of Arbitration*.

All costs and expenses of the arbitration proceedings held by the Panel, including costs, expenses and compensation of the Director and of the Panel members (but not including any costs, expenses or compensation of counsel making applications to the Panel), shall be borne by the Original Participating Manufacturers in proportion to their Relative Market Shares.

SECTION 16. *Payment of Fee Award of STATE Outside Counsel*.

On or before the tenth Business Day after the last day of each calendar quarter beginning with the first calendar quarter of 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the Allocated Amount for STATE Outside Counsel for the calendar quarter with respect to which such quarterly payment is being made (the "Applicable Quarter").

SECTION 17. *Allocated Amounts of Fee Awards*.

The Allocated Amount for each Private Counsel with respect to any payment to be made for any particular Applicable Quarter shall be determined as follows:

(a) The Quarterly Fee Amount shall be allocated equally among each of the three months of the Applicable Quarter. The amount for each such month shall be allocated among those Private Counsel retained in connection with Tobacco Cases settled before or during such month (each such Private Counsel being an "Eligible Counsel" with respect to such monthly amount), each of which shall be allocated a portion of each such monthly amount up to (or, in the event that the sum of all Eligible Counsel's respective Unpaid Fees exceeds such monthly amount, in proportion to) the amount of such Eligible Counsel's Unpaid Fees. The monthly amount for each month of the calendar quarter shall be allocated among those Eligible Counsel having Unpaid Fees, without regard to whether there may be Eligible Counsel that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter. The allocation of subsequent Quarterly Fee Amounts for the calendar year, if any, shall be adjusted, as necessary, to account for any Eligible Counsel that are granted Fee Awards in a subsequent quarter of such calendar year, as provided in paragraph (b)(ii) of this section.

(b) In the event that the amount for a given month is less than the sum of the Unpaid Fees of all Eligible Counsel:

(i) in the case of the first quarterly allocation for any calendar year, such monthly amount shall be allocated among all Eligible Counsel for such month in proportion to the amounts of their respective Unpaid Fees.

(ii) in the case of a quarterly allocation after the first quarterly allocation, the Quarterly Fee Amount shall be allocated among only those Private Counsel, if any, that were Eligible Counsel with respect to any monthly amount for any prior quarter of the calendar year but were not allocated a proportionate share of such monthly amount (either because such Private Counsel's applications for Fee Awards were still under consideration as of the last day of the calendar quarter containing the month in question or for any other reason), until each such Eligible Counsel has been allocated a proportionate share of all such prior monthly payments for the calendar year (each such share of each such Eligible Counsel being a "Payable Proportionate Share"). In the event that the sum of all Payable Proportionate Shares exceeds the Quarterly Fee Amount, the Quarterly Fee Amount shall be allocated among such Eligible Counsel on a monthly basis in proportion to the amounts of their respective Unpaid Fees (without regard to whether there may be other Eligible Counsel with respect to such prior monthly amounts that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter). In the event that the sum of all Payable Proportionate Shares is less than the Quarterly Fee Amount, the amount by which the Quarterly Fee Amount exceeds the sum of all such Payable Proportionate Shares shall be allocated among each month of the calendar quarter, each such monthly amount to be allocated among those Eligible Counsel having Unpaid Fees in proportion to the amounts of their respective Unpaid Fees (without regard to whether there may be Eligible Counsel that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter).

(c) Adjustments pursuant to subsection (b)(ii) of this section 17 shall be made separately for each calendar year. No amounts paid in any calendar year shall be subject to refund, nor shall any payment in any given calendar year affect the allocation of payments to be made in any subsequent calendar year.

SECTION 18. *Credits to and Limitations on Payment of Fee Awards*.

Notwithstanding any other provision hereof, all payments by the Original Participating Manufacturers with respect to Fee Awards shall be subject to the following:

(a) Under no circumstances shall the Original Participating Manufacturers be required to make payments that would result in aggregate national payments and credits by Participating Defendants with respect to all Fee Awards of Private Counsel:

(i) during any year beginning with 1999, totaling more than the sum of the Quarterly Fee Amounts for each calendar quarter of the calendar year, excluding certain payments with respect to any Private Counsel for 1998 that are paid in 1999; and

(ii) during any calendar quarter beginning with the first calendar quarter of 1999, totaling more than the Quarterly Fee Amount for such quarter, excluding certain payments with respect to any Private Counsel for 1998 that are paid in 1999.

(b) The Original Participating Manufacturers' obligations with respect to the Fee Award of STATE Outside Counsel, if any, shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, such Fee Award shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

SECTION 19. *Reimbursement of Outside Counsel's Costs*.

(a) The Original Participating Manufacturers shall reimburse STATE Outside Counsel for reasonable costs and expenses incurred in connection with the Action, provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers ordinarily reimburse their own counsel or agents. Payment of any Approved Cost Statement pursuant to this STATE Fee Payment Agreement shall be subject to (i) the condition precedent of approval of the Agreement by the Court for the State of STATE and (ii) the payment schedule and the aggregate national caps specified in subsection (c) of this section, which shall apply to all payments made with respect to Cost Statements of all Outside Counsel.

(b) In the event that STATE Outside Counsel seek to be reimbursed for reasonable costs and expenses incurred in connection with the Action, the Designated Representative shall submit a Cost Statement to the Original Participating Manufacturers. Within 30 Business Days after receipt of any such Cost Statement, the Original Participating Manufacturers shall either accept the Cost Statement or dispute the Cost Statement, in which event the Cost Statement shall be subject to a full audit by examiners to be appointed by the Original Participating Manufacturers (in their sole discretion). Any such audit will be completed within 120 Business Days after the date the Cost Statement is received by the Original Participating Manufacturers. Upon completion of such audit, if the Original Participating Manufacturers and STATE Outside Counsel cannot agree as to the appropriate amount of STATE Outside Counsel's reasonable costs and expenses, the Cost Statement and the examiner's audit report shall be submitted to the Director for arbitration before the Panel or, in the event that STATE Outside Counsel and the Original Participating Manufacturers have agreed upon a Liquidated Fee pursuant to section 7 hereof, before a separate three-member panel of independent arbitrators, to be selected in a manner to be agreed to by STATE Outside Counsel and the Original Participating Manufacturers, which shall determine the amount of STATE Outside Counsel's reasonable costs and expenses for the Action. In determining such reasonable costs and expenses, the members of the arbitration panel shall be governed by the Protocol of Panel Procedures attached as an Appendix hereto. The amount of

STATE Outside Counsel's reasonable costs and expenses determined pursuant to arbitration as provided in the preceding sentence shall be final, binding and non-appealable.

(c) Any Approved Cost Statement of STATE Outside Counsel shall not become a Payable Cost Statement until approval of the Agreement by the Court for the State of STATE. Within five Business Days after receipt of notification thereof by the Designated Representative, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the Payable Cost Statement of STATE Outside Counsel, subject to the following:

(i) All Payable Cost Statements of Outside Counsel shall be paid in the order in which such Payable Cost Statements became Payable Cost Statements.

(ii) Under no circumstances shall the Original Participating Manufacturers be required to make payments that would result in aggregate national payments by Participating Defendants of all Payable Cost Statements of Private Counsel in connection with all of the actions identified in Exhibits D, M and N to the Agreement, totaling more than $75 million for any given year.

(iii) Any Payable Cost Statement of Outside Counsel not paid during the year in which it became a Payable Cost Statement as a result of paragraph (ii) of this subsection shall become payable in subsequent years, subject to paragraphs (i) and (ii), until paid in full.

(d) The Original Participating Manufacturers' obligations with respect to reasonable costs and expenses incurred by STATE Outside Counsel in connection with the Action shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, any Approved Cost Statement determined pursuant to subsection (b) of this section (including any Approved Cost Statement determined pursuant to arbitration before the Panel or the separate three-member panel of independent arbitrators described therein) shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other incumbrance.

SECTION 20. *Distribution of Payments among STATE Outside Counsel*.

(a) All payments made to the Designated Representative pursuant to this STATE Fee Payment Agreement shall be for the benefit of each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], each of which shall receive from the Designated Representative a percentage of each such payment in accordance with the fee sharing agreement, if any, among STATE Outside Counsel (or any written amendment thereto).

(b) The Original Participating Manufacturers shall have no obligation, responsibility or liability with respect to the allocation among those persons or entities identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], or with respect to any claim of misallocation, of any amounts paid to the Designated Representative pursuant to this STATE Fee Payment Agreement.

SECTION 21. *Calculations of Amounts*.

All calculations that may be required hereunder shall be performed by the Original Participating Manufacturers, with notice of the results thereof to be given promptly to the Designated Representative. Any disputes as to the correctness of calculations made by the Original Participating Manufacturers shall be resolved pursuant to the procedures described in Section XI(c) of the Agreement for resolving disputes as to calculations by the Independent Auditor.

SECTION 22. *Payment Responsibility*.

(a) Each Original Participating Manufacturer shall be severally liable for its share of all payments pursuant to this STATE Fee Payment Agreement. Under no circumstances shall any payment due hereunder or any portion thereof become the joint obligation of the Original Participating Manufacturers or the obligation of any person other than the Original Participating Manufacturer from which such payment is originally due, nor shall any Original Participating Manufacturer be required to pay a portion of any such payment greater than its Relative Market Share.

(b) Due to the particular corporate structures of R. J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("Brown & Williamson") with respect to their non-domestic tobacco operations, Reynolds and Brown & Williamson shall each be severally liable for its respective share of each payment due pursuant to this STATE Fee Payment Agreement up to (and its liability hereunder shall not exceed) the full extent of its assets used in, and earnings and revenues derived from, its manufacture and sale in the United States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of its other assets or earnings to satisfy such obligations.

SECTION 23. *Termination*.

In the event that the Agreement is terminated with respect to the State of STATE pursuant to Section XVIII(u) of the Agreement (or for any other reason) the Designated Representative and each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision] shall immediately refund to the Original Participating Manufacturers all amounts received under this STATE Fee Payment Agreement.

SECTION 24. *Intended Beneficiaries*.

No provision hereof creates any rights on the part of, or is enforceable by, any person or entity that is not a Party or a person covered by either of the releases described in section 4 hereof, except that sections 5 and 20 hereof create rights on the part of, and shall be enforceable by, the State of STATE. Nor shall any provision hereof bind any non-signatory or determine, limit or prejudice the rights of any such person or entity.

SECTION 25. *Representations of Parties*.

The Parties hereto hereby represent that this STATE Fee Payment Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of the Parties hereto.

SECTION 26. *No Admission*.

This STATE Fee Payment Agreement is not intended to be and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of any liability or wrongdoing whatsoever on the part of any signatory hereto or any person covered by either of the releases provided under section 4 hereof. The Original Participating Manufacturers specifically disclaim and deny any liability or wrongdoing whatsoever with respect to the claims released under section 4 hereof and enter into this STATE Fee Payment Agreement for the sole purposes of memorializing the Original Participating Manufacturers' rights and obligations with respect to payment of attorneys' fees pursuant to the Agreement and avoiding the further expense, inconvenience, burden and uncertainty of potential litigation.

SECTION 27. *Non-admissibility*.

This STATE Fee Payment Agreement having been undertaken by the Parties hereto in good faith and for settlement purposes only, neither this STATE Fee Payment Agreement nor any evidence of negotiations relating hereto shall be offered or received in evidence in any action or proceeding other than an action or proceeding arising under this STATE Fee Payment Agreement.

SECTION 28. *Amendment and Waiver*.

This STATE Fee Payment Agreement may be amended only by a written instrument executed by the Parties. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving Party. The waiver by any Party of any breach hereof shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this STATE Fee Payment Agreement.

SECTION 29. *Notices*.

All notices or other communications to any party hereto shall be in writing (including but not limited to telex, facsimile or similar writing) and shall be given to the notice parties listed on Schedule A hereto at the addresses therein indicated. Any Party hereto may change the name and address of the person designated to receive notice on behalf of such Party by notice given as provided in this section including an updated list conformed to Schedule A hereto.

SECTION 30. *Governing Law*.

This STATE Fee Payment Agreement shall be governed by the laws of the State of STATE without regard to the conflict of law rules of such State.

SECTION 31. *Construction*.

None of the Parties hereto shall be considered to be the drafter hereof or of any provision hereof for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter hereof.

SECTION 32. *Captions*.

The captions of the sections hereof are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 33. *Execution of STATE Fee Payment Agreement*.

This STATE Fee Payment Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered valid signatures as of the date hereof, although the original signature pages shall thereafter be appended to this STATE Fee Payment Agreement.

SECTION 34. *Entire Agreement of Parties*.

This STATE Fee Payment Agreement contains an entire, complete and integrated statement of each and every term and provision agreed to by and among the Parties with respect to payment of attorneys' fees by the Original Participating Manufacturers in connection with the Action and is not subject to any condition or covenant, express or implied, not provided for herein.

IN WITNESS WHEREOF, the Parties hereto, through their fully authorized representatives, have agreed to this STATE Fee Payment Agreement as of this __th day of _____, 1998.

[SIGNATURE BLOCK]

APPENDIX
to MODEL FEE PAYMENT AGREEMENT

PROTOCOL OF PANEL PROCEEDINGS

This Protocol of procedures has been agreed to between the respective parties to the STATE Fee Payment Agreement, and shall govern the arbitration proceedings provided for therein.

SECTION 1. *Definitions*.

All definitions contained in the STATE Fee Payment Agreement are incorporated by reference herein.

SECTION 2. *Chairman*.

The person selected to serve as the permanent, neutral member of the Panel as described in paragraph (b)(ii) of section 11 of the STATE Fee Payment Agreement shall serve as the Chairman of the Panel.

SECTION 3. *Arbitration Pursuant to Agreement*.

The members of the Panel shall determine those matters committed to the decision of the Panel under the STATE Fee Payment Agreement, which shall govern as to all matters discussed therein.

SECTION 4. *ABA Code of Ethics*.

Each of the members of the Panel shall be governed by the *Code of Ethics for Arbitrators in Commercial Disputes* prepared by the American Arbitration Association and the American Bar Association (the "*Code of Ethics*") in conducting the arbitration proceedings pursuant to the STATE Fee Payment Agreement, subject to the terms of the STATE Fee Payment Agreement and this Protocol. Each of the party-appointed members of the Panel shall be governed by Canon VII of the *Code of Ethics*. No person may engage in any *ex parte* communications with the permanent, neutral member of the Panel selected pursuant to paragraph (b)(ii) of section 11, in keeping with Canons I, II and III of the *Code of Ethics*.

SECTION 5. *Additional Rules and Procedures*.

The Panel may adopt such rules and procedures as it deems necessary and appropriate for the discharge of its duties under the STATE Fee Payment Agreement and this Protocol, subject to the terms of the STATE Fee Payment Agreement and this Protocol.

SECTION 6. *Majority Rule*.

In the event that the members of the Panel are not unanimous in their views as to any matter to be determined by them pursuant to the STATE Fee Payment Agreement or this Protocol, the determination shall be decided by a vote of a majority of the three members of the Panel.

SECTION 7. *Application for Fee Award and Other Materials*.

(a) The Application of STATE Outside Counsel and any materials submitted to the Director relating thereto (collectively, "submissions") shall be forwarded by the Director to each of the members of the Panel in the manner and on the dates specified in the STATE Fee Payment Agreement.

(b) All materials submitted to the Director by either Party (or any other person) shall be served upon all Parties. All submissions required to be served on any Party shall be deemed to have been served as of the date on which such materials have been sent by either (i) hand delivery or (ii) facsimile and overnight courier for priority next-day delivery.

(c) To the extent that the Panel believes that information not submitted to the Panel may be relevant for purposes of determining those matters committed to the decision of the Panel under the terms of the STATE Fee Payment Agreement, the Panel shall request such information from the Parties.

SECTION 8. *Hearing*.

Any hearing held pursuant to section 12 of the STATE Fee Payment Agreement shall not take place other than in the presence of all three members of the Panel upon notice and an opportunity for the respective representatives of the Parties to attend.

SECTION 9. *Miscellaneous*.

(a) Each member of the Panel shall be compensated for his services by the Original Participating Manufacturers on a basis to be agreed to between such member and the Original Participating Manufacturers.

(b) The members of the Panel shall refer all media inquiries regarding the arbitration proceeding to the respective Parties to the STATE Fee Payment Agreement and shall refrain from any comment as to the arbitration proceedings to be conducted pursuant to the STATE Fee Payment Agreement during the pendency of such arbitration proceedings, in keeping with Canon IV(B) of the *Code of Ethics*.

EXHIBIT P
NOTICES

[Intentionally Omitted]

EXHIBIT Q
1996 AND 1997 DATA

(1) 1996 Operating Income

Original Participating Manufacturer	Operating Income
Brown & Williamson Tobacco Corp.	$801,640,000
Lorillard Tobacco Co.	$719,100,000
Philip Morris Inc.	$4,206,600,000
R.J. Reynolds Tobacco Co.	$1,468,000,000
Total (Base Operating Income)	$7,195,340,000

(2) 1997 volume (as measured by shipments of Cigarettes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,911,000,000
Lorillard Tobacco Co.	42,288,000,000
Philip Morris Inc.	236,203,000,000
R.J. Reynolds Tobacco Co.	118,254,000,000
Total (Base Volume)	475,656,000,000

(3) 1997 volume (as measured by excise taxes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,758,000,000
Lorillard Tobacco Co.	42,315,000,000
Philip Morris Inc.	236,326,000,000
R.J. Reynolds Tobacco Co.	119,099,000,000

* The volume includes 2,847,595 pounds of "roll your own" tobacco converted into the number of Cigarettes using 0.0325 ounces per Cigarette conversion factor.

EXHIBIT R
EXCLUSION OF CERTAIN BRAND NAMES

Brown & Williamson Tobacco Corporation
GPC
State Express 555
Riviera

Philip Morris Incorporated
Players
B&H
Belmont
Mark Ten
Viscount
Accord
L&M
Lark
Rothman's
Best Buy
Bronson
F&L
Genco
GPA
Gridlock
Money
No Frills
Generals
Premium Buy
Shenandoah
Top Choice

Lorillard Tobacco Company
None

R.J. Reynolds Tobacco Company
Best Choice
Cardinal
Director's Choice
Jacks
Rainbow
Scotch Buy
Slim Price
Smoker Friendly
Valu Time
Worth

EXHIBIT S
DESIGNATION OF OUTSIDE COUNSEL

[Intentionally Omitted]

EXHIBIT T
MODEL STATUTE

Section __. Findings and Purpose. [1]

(a) Cigarette smoking presents serious public health concerns to the State and to the citizens of the State. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the State. Under certain health-care programs, the State may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the State pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

(d) It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts.

(e) On _____, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the State. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the State (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

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

Section __. Definitions.

(a) "Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

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

(c) "Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

(d) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

(e) "Master Settlement Agreement" means the settlement agreement (and related documents) entered into on _____, 1998 by the State and leading United States tobacco product manufacturers.

(f) "Qualified escrow fund" means an escrow arrangement with a federally or State chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least $1,000,000,000 where such arrangement requires that such financial institution hold the escrowed funds' principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing or directing the use of the funds' principal except as consistent with section ___(b)-(c) of this Act.

(g) "Released claims" means Released Claims as that term is defined in the Master Settlement Agreement.

(h) "Releasing parties" means Releasing Parties as that term is defined in the Master Settlement Agreement.

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

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

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

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

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

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

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

Section __. Requirements.

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

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

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

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

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

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

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

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

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

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

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

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

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

[2] [All per unit numbers subject to verification]

[3] [The phrase "after the date of enactment of this Act" would need to be included only in the calendar year in which the Act is enacted.]

manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall --

(A) be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 5 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100 percent of the original amount improperly withheld from escrow;

(B) in the case of a knowing violation, be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 15 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300 percent of the original amount improperly withheld from escrow; and

(C) in the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed 2 years.

Each failure to make an annual deposit required under this section shall constitute a separate violation.[4]

[4] [A State may elect to include a requirement that the violator also pay the State's costs and attorney's fees incurred during a successful prosecution under this paragraph (3).]

EXHIBIT U
STRATEGIC CONTRIBUTION FUND PROTOCOL

The payments made by the Participating Manufacturers pursuant to section IX(c)(2) of the Agreement ("Strategic Contribution Fund") shall be allocated among the Settling States pursuant to the process set forth in this Exhibit U.

Section 1

A panel committee of three former Attorneys General or former Article III judges ("Allocation Committee") shall be established to determine allocations of the Strategic Contribution Fund, using the process described herein. Two of the three members of the Allocation Committee shall be selected by the NAAG executive committee. Those two members shall choose the third Allocation Committee member. The Allocation Committee shall be geographically and politically diverse.

Section 2

Within 60 days after the MSA Execution Date, each Settling State will submit an itemized request for funds from the Strategic Contribution Fund, based on the criteria set forth in Section 4 of this Exhibit U.

Section 3

The Allocation Committee will determine the appropriate allocation for each Settling State based on the criteria set forth in Section 4 below. The Allocation Committee shall make its determination based upon written documentation.

Section 4

The criteria to be considered by the Allocation Committee in its allocation decision include each Settling State's contribution to the litigation or resolution of state tobacco litigation, including, but not limited to, litigation and/or settlement with tobacco product manufacturers, including Liggett and Myers and its affiliated entities.

Section 5

Within 45 days after receiving the itemized requests for funds from the Settling States, the Allocation Committee will prepare a preliminary decision allocating the Strategic Contribution Fund payments among the Settling States who submitted itemized requests for funds. All Allocation Committee decisions must be by majority vote. Each Settling State will have 30 days to submit comments on or objections to the draft decision. The Allocation Committee will issue a final decision allocating the Strategic Contribution Fund payments within 45 days.

Section 6

The decision of the Allocation Committee shall be final and non-appealable.

Section 7

The expenses of the Allocation Committee, in an amount not to exceed $100,000, will be paid from disbursements from the Subsection VIII(c) Account.

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APPENDIX C

PROPOSED FORMS OF OPINIONS OF THE ATTORNEY GENERAL AND CO-BOND COUNSEL

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[FORM OF OPINION OF THE ATTORNEY GENERAL
OF THE STATE OF MICHIGAN]

Michigan Tobacco Settlement
Finance Authority
Lansing, Michigan

In my capacity as Attorney General of the State of Michigan, I have caused to be examined a closing transcript of proceedings and other documents, including, in particular, the following documents relating to the issuance by the Michigan Tobacco Settlement Finance Authority (the "Authority") of bonds designated MICHIGAN TOBACCO SETTLEMENT FINANCE AUTHORITY TOBACCO SETTLEMENT ASSET-BACKED BONDS, SERIES 2008A CURRENT INTEREST TURBO TERM BONDS, in the aggregate principal amount of $114,860,000 (the "Series A Bonds"), MICHIGAN TOBACCO SETTLEMENT AUTHORITY SETTLEMENT ASSET-BACKED BONDS, SERIES 2008B TAXABLE CAPITAL APPRECIATION TURBO TERM BONDS, in the aggregate principal amount of $29,874,650.00 (the "Series B Bonds"), and MICHIGAN TOBACCO SETTLEMENT FINANCE AUTHORITY TOBACCO SETTLEMENT ASSET-BACKED BONDS, SERIES 2008C CAPITAL APPRECIATION TURBO TERM BONDS, in the initial aggregate principal amount of $57,673,814.40 (the "Series C Bonds," and together with the Series A Bonds and the Series B Bonds, the "Bonds"):

(1) the Michigan Tobacco Settlement Finance Authority Act, 2005 PA 226, as amended (the "Act"), which created the Authority and empowers it to issue bonds;

(2) a certified copy of the resolution adopted by the State Administrative Board on May 6, 2008 (the "State Resolution") approving the sale by the State Budget Director, on behalf of the State of Michigan (the "State") to the Authority of a portion of the State's tobacco receipts (the "Sold Tobacco Receipts");

(3) a certified copy of the resolution adopted by the Authority on May 28, 2008 authorizing the issuance of the Bonds (the "Bond Resolution");

(4) an executed counterpart of the trust indenture dated as of May 1, 2006, as supplemented by the Series 2008 Supplement, dated as of June 1, 2008 (collectively, the "Indenture"), entered into between the Authority and The Bank of New York Mellon Trust Company, National Association, as successor in interest to J.P. Morgan Trust Company, National Association, as trustee (the "Trustee"); and

(5) one each of the Series 2008A Bonds, the Series 2008B Bonds, and the Series C Bonds, as executed, or specimen thereof.

The Bonds will be issued pursuant to the Act to provide funds to (i) refund certain of the Authority's Series 2006 Taxable Tobacco Settlement Asset-Backed Bonds, (ii) make a payment in the amount of $60,000,000 to the State for deposit in its general fund, and (iii) provide for the payment of capitalized interest through December 1, 2008 and the costs of issuance of the Bonds. The Bonds are subject to redemption prior to maturity as provided in the Indenture.

Based upon the foregoing, I am of the opinion that, under existing law as presently interpreted:

1. The State Resolution has been duly adopted by the State Administrative Board and is in full force and effect in the form adopted.

2. The Authority is a public body corporate and politic of the State duly organized and validly existing under the Constitution and the laws of the State, including particularly the Act.

3. The Authority has the power under the laws of the State to adopt the Bond Resolution. The Bond Resolution has been duly adopted by the Authority and is in full force and effect in the form adopted.

4. The Authority has the power under the laws of the State to enter into the Indenture. The Indenture has been duly authorized, executed, and delivered by the Authority and constitutes the valid and binding agreement of the Authority enforceable in accordance with its terms.

5. The Bonds have been duly authorized, executed, and delivered by the Authority and, when duly authenticated, will constitute valid and binding special revenue obligations of the Authority enforceable in accordance with their terms and the terms of the Indenture.

6. The Bonds are special revenue obligations of the Authority. The Bonds, including the interest on them, are not general obligations of the Authority and do not constitute obligations, debts, or liabilities of the State and do not constitute a charge against the general credit of the Authority or a charge against the credit or taxing power of the State. The Authority has no taxing power.

7. Interest on the Series A Bonds and interest on the Series C Bonds (i) is excluded from gross income for federal income tax purposes and (ii) is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. However, for the purpose of computing the alternative minimum tax imposed on corporations (as defined for federal tax purposes), interest on the Bonds is taken into account in determining adjusted current earnings. This opinion is subject to the condition that the Authority and the State comply with all requirements of the Internal Revenue Code of 1986, as amended, that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon be, or continue to be, excluded from gross income for federal income tax purposes. The Authority has

covenanted to comply with each such requirement to the extent permitted by law. The State has covenanted for itself and on behalf of the Authority to comply with each such requirement. Failure to comply with certain of those requirements may cause the inclusion of interest on the Bonds in gross income for federal income tax purposes retroactive to the date of issuance of the Bonds. I express no opinion regarding other federal tax consequences arising with respect to the Bonds.

8. Interest on the Series A Bonds and interest on the Series C Bonds is excluded from taxable income for purposes of the State personal income tax.

9. Interest on the Series B Bonds is included in gross income for federal and state income tax purposes.

Enforceability of the Bonds and the Indenture may be subject to bankruptcy, insolvency, reorganization, moratorium, and other laws affecting creditors' rights that have been or in the future will be enacted to the extent constitutionally applicable and their enforcement may be subject to the exercise of judicial discretion including the application of general principles of equity.

Sincerely yours,

Mike Cox
Attorney General

Terrence P. Grady
Assistant Attorney General

Timothy F. Konieczny
Assistant Attorney General

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DICKINSON WRIGHT PLLC
DYKEMA GOSSETT PLLC

July __, 2008

Michigan Tobacco Settlement Finance Authority
Austin Building
430 West Allegan Street
Lansing, Michigan 48922

Ladies and Gentlemen:

We have acted as co-bond counsel to the Michigan Tobacco Settlement Finance Authority (the "Authority") in connection with the issuance by the Authority of its Tobacco Settlement Asset-Backed Bonds, Series 2008A (the "Series 2008A Bonds") Tobacco Settlement Asset-Backed Bonds, Series 2008B (the "Series 2008B Bonds") and Tobacco Settlement Asset-Backed Bonds, Series 2008C (the "Series 2008C Bonds") and together with the Series 2008A Bonds, and the 2008B Bonds, the "Bonds").

The Authority is a public body corporate and politic, created by and existing pursuant to Act No. 226, Public Acts of Michigan, 2005, as amended (the "Act"). The Bonds are authorized to be issued by the Act and the resolution of the Authority adopted on May 28, 2008 (the "Resolution").

The Bonds are being issued pursuant to a Trust Indenture, dated as of May 1, 2006, between the Authority and The Bank of New York Trust Company, N.A., as successor in interest to J.P. Morgan Trust Company, National Association, as Trustee (the "Trust Indenture"), as supplemented by a Series 2008 Supplement, Authorizing the Issuance of $202,408,464.40 Tobacco Settlement Asset-Backed Bonds, Series 2008 of the Michigan Tobacco Settlement Finance Authority, dated as of June 1, 2008 (the "Series 2008 Supplement", collectively with the Trust Indenture, the "Indenture"). The Bonds are being issued to provide funding for the Authority to make a payment to the State of Michigan (the "State") for deposit in the State's general fund, to refund the Authority's outstanding Indexed Floating Rate Turbo Term Bonds, Series 2006B, to refund through the purchase in the open market and retirement of the Authority's Capital Appreciation Turbo Term Bonds, Series 2006C and to pay capitalized interest on and costs of issuance related to the Bonds. The Bonds are subject to redemption prior to maturity as provided in the Indenture. Terms used herein and not otherwise defined have the meanings ascribed thereto in the Indenture. We assume the parties will perform their respective covenants in the Indenture in all material respects.

We have made such investigation of law and examined such information, records, and documents, including the Tax Certificate dated July 7, 2008 signed by the Authority and the Tax Regulatory Agreement dated July 7, 2008 signed by the State, as we deemed appropriate to render the opinions set forth below. In rendering such opinions we have assumed 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 or photostatic copies. As to matters of fact material to any of our opinions, we have relied, without independent investigation, on representations and certifications of officials of the Authority and other public officials contained in the transcript of the record of proceedings relating to the issuance, sale and delivery of the Bonds, or otherwise furnished to us. We have also examined one Series 2008A Bond, one Series 2008B Bond and one Series 2008C Bond only or a specimen thereof.

Based upon the foregoing, under existing law, we are of the opinion that:

1. The Authority is duly created and validly existing as a public body corporate and politic with the power to adopt the Resolution, enter into the Indenture, and issue the Bonds.

2. The Resolution was validly adopted by the Authority.

3. The Indenture was duly authorized, executed and delivered by the Authority, and is a valid and binding agreement of the Authority, enforceable in accordance with its terms. The Indenture creates the valid pledge of the Collateral that it purports to create.

4. The Bonds have been duly authorized, executed and delivered and are valid and binding special revenue obligations of the Authority, payable as to the principal or accreted value thereof and the accrued interest thereon solely from the Collateral. The Bonds are enforceable in accordance with their terms. The Bonds are secured by the pledge of the Collateral set forth in the Indenture and otherwise have the benefits of the Indenture. The Bonds are not general obligations of the Authority. Neither the State nor any political subdivision thereof is obligated to pay the principal or accreted value of or interest on the Bonds, and neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the principal or accreted value of or interest on the Bonds. The Authority has no taxing power.

5. The Authority is authorized to issue Additional Bonds, as provided in the Indenture.

6. The interest on the Series 2008A Bonds and the Series 2008C Bonds (a) is excluded from gross income for federal income tax purposes and (b) is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, it should be noted that certain corporations must take into account interest on the Series 2008A Bonds and the Series 2008C Bonds in determining adjusted current earnings for the purpose of computing such alternative minimum tax. The opinion set forth in clause (a) above is subject to the condition that the Authority and the State comply with all requirements of the Internal Revenue Code of 1986, as amended, that must be satisfied subsequent to the issuance of the Series 2008A Bonds and the Series 2008C Bonds in order that interest thereon be (or continue to be) excluded from gross income for federal income tax purposes. Failure to comply with such requirements could cause the interest on the Series 2008A

Bonds and the Series 2008C Bonds to be so included in gross income retroactive to the date of issuance of the Series 2008A Bonds and the Series 2008C Bonds. The Authority and the State have covenanted to comply with all such requirements to the extent permitted by law. We express no opinion regarding other federal tax consequences arising with respect to the Series 2008A Bonds and the Series 2008C Bonds and the interest thereon.

7. The interest on the Series 2008A Bonds and the Series 2008C Bonds is excluded from taxable income for purposes of the State of Michigan personal income tax.

8. The interest on the Series 2008B Bonds is included in gross income for federal income tax purposes and the Series 2008B Bonds and the interest thereon are not exempt from taxation by the State of Michigan or any political subdivision thereof.

The enforceability of the Bonds and the Indenture are subject to bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and similar laws of general application affecting the rights and remedies of creditors and to general principles of equity, including those related to equitable subordination, now existing or hereafter enacted to the extent constitutionally applicable, and their enforcement may be subject to the exercise of judicial discretion in appropriate cases.

Respectfully submitted,

Dickinson Wright PLLC Dykema Gossett PLLC

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APPENDIX D

DEFINITIONS AND SUMMARY OF THE INDENTURE

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APPENDIX D

SUMMARIES OF CERTAIN PROVISIONS OF THE TRUST INDENTURE AND THE SERIES 2008 SUPPLEMENT

Certain Definitions

In addition to the other terms defined in this Offering Circular, when used in the summaries of certain provisions of the Trust Indenture and the Series 2008 Supplement, the following terms have the meanings ascribed to them below:

"Accounts" means the Pledged Accounts and any Pledged Accounts established by Series Supplement, which if providing for Junior Payments shall be outside the Bond Fund; all of which shall be segregated trust accounts established and held by the Trustee; but shall not include the Operating Account and the Unencumbered TSR Account, which accounts shall be established and held by the Authority and are not Collateral.

"Accreted Value" when used in reference to the Trust Indenture, means, with respect to any Capital Appreciation Bond, an amount equal to the initial principal amount of such Bond, plus interest thereon from its date, compounded on each Distribution Date, commencing on the first Distribution Date after its issuance (through and including the Maturity Date or earlier redemption date of such Bond, or in the case of a Convertible Capital Appreciation Bond, through and excluding the applicable Conversion Date or earlier redemption date of such Bond) at the "original issue yield" for such Bond, as set forth in the related Series Supplement or in an exhibit thereto; provided, however, that the Authority shall calculate or cause to be calculated the Accreted Value on any date other than a Distribution Date set forth in the related Series Supplement or in an exhibit thereto by straight line interpolation of the Accreted Values as of the immediately preceding and succeeding Distribution Dates. In performing such calculation, the Authority shall be entitled to engage and rely upon a firm of accountants, consultants or financial advisors with appropriate knowledge and experience. The Trustee may conclusively rely upon such calculations. The term "original issue yield" means, with respect to any particular Bond, the yield to the applicable Maturity Date of such Bond from the initial date of delivery thereof calculated on the basis of semiannual compounding on each Distribution Date.

"Accreted Value" when used in reference to the Series 2008 Supplement, means for any Series 2008B Bond (i) as of any Valuation Date, the amount set forth in the applicable Schedule thereto and (ii) as of any date other than a Valuation Date, the sum of (a) the Accreted Value on the preceding Valuation Date and (b) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date and the denominator of which is the number of days from such preceding Valuation Date to the next succeeding Valuation Date, calculated based on the assumption that Accreted Value accrues during any semiannual period in equal daily amounts on the basis of a year of twelve thirty-day months, and (2) the difference between the Accreted Values for such Valuation Dates.

"Accretion Period" when used in reference to the Trust Indenture, means (i) with respect to any particular Convertible Capital Appreciation Bond, the period from the Delivery Date thereof through, but not including, the Conversion Date, after which interest shall accrue and be payable semiannually, with the first such payment date being, except as set forth in such Series Supplement, the applicable Distribution Date immediately succeeding the Conversion Date and (ii) with respect to any particular Capital Appreciation Bond, the period from the Delivery Date thereof to the maturity date thereof.

"Accretion Period" when used in reference to the Series 2008 Supplement, means for any Series 2008B Bond, the period commencing on the delivery date of such Series 2008B Bonds to and including the maturity date therefor.

"Act" means the Michigan Tobacco Settlement Finance Authority Act, 2005 PA 226, MCL 129.261 et seq., as the same may be amended from time to time.

"Additional Bonds" means any Bond issued pursuant to the Trust Indenture that is not a Refunding Bond.

"Aggregate Principal Obligation" means, with respect to the calculation thereof, as of the date of such calculation, the sum of (i) the Principal amount of Current Interest Bonds Outstanding under the Trust Indenture that are included in such calculation and (ii) the Accreted Value of Capital Appreciation Bonds and Convertible Capital Appreciation Bonds Outstanding under the Trust Indenture that are included in such calculation.

"Agreement" or **"Sale Agreement"** means the Amended and Restated Purchase and Sale Agreement, dated as of June 1, 2008, by and between the Authority and the State, as further amended, supplemented and in effect from time to time.

"Ancillary Facility" means any revolving credit agreement, agreement establishing a line of credit or letter of credit, reimbursement agreement, Interest Rate Exchange or Similar Agreement, currency exchange agreement, interest rate floor or cap, options, puts or calls to hedge payment, currency, rate, spread or similar exposure, or similar agreements, investment agreements, float agreements, forward agreements or other investment arrangements, insurance contract, surety bond, commitment to purchase or sell securities, purchase or sale agreements or commitments or other contracts or agreements and other security agreements approved by the Authority, including, without limitation any arrangements referred to in the Act; provided, however, that prior to the effective date of any such Ancillary Facility and the commencement of any Priority Payments thereon, the Authority shall give 15 days' prior notice to S&P.

"Authority" means the Michigan Tobacco Settlement Finance Authority created under the Act as a public body corporate and politic of the State of Michigan, separate and distinct from the State, exercising public and essential governmental functions.

"Authorized Denominations", except as may otherwise be provided in a Supplemental Indenture, means (a) with respect to a Current Interest Bond, $5,000 or any integral multiple thereof; (b) with respect to a Convertible Capital Appreciation Bond, (i) the amount which will accrete to $5,000 or any integral multiple thereof at the Conversion Date; (ii) after the Conversion Date, $5,000 or any integral multiple thereof; and (c) with respect to a Capital

Appreciation Bond, the amount which will accrete to $5,000 or any integral multiple thereof at the maturity date thereof (such accretion being calculated in the manner described in the definition of Accreted Value).

"Authorized Officer" means: (i) in the case of the Authority, the State Treasurer, any Deputy State Treasurer designated as such by the State Treasurer, and any other person authorized to act in such capacity hereunder by a resolution adopted by the Authority with appropriate Written Notice to the Trustee, and (ii) in the case of the Trustee, any officer assigned to the Corporate Trust Office, including any managing director, director, vice president, assistant vice president, associate, assistant secretary or any other officer of the Trustee customarily performing functions similar to those performed by any of the above designated officers and having direct responsibility for the administration of the Trust Indenture, and also, with respect to a particular matter, any other officer, to whom such matter is referred because of such officer's knowledge of and familiarity with the particular subject.

"Beneficiaries" means Bondholders and, to the extent specified herein, the Benefited Parties to Ancillary Facilities.

"Benefited Parties" means persons, firms, or corporations that enter into Ancillary Facilities with the Authority.

"Bond Fund" means the fund so designated and established pursuant to the Trust Indenture, which includes the Debt Service Account, the Partial Lump Sum Payment Account, the Liquidity Reserve Account and the Turbo Redemption Account, but excludes any accounts established by a Series Supplement to provide for Junior Payments.

"Bond Obligation" means, as of any given date of calculation, (i) with respect to any Outstanding Current Interest Bond, the principal amount of such Current Interest Bond, and (ii) with respect to any Outstanding Capital Appreciation Bond or Convertible Capital Appreciation Bond prior to the Conversion Date, the Accreted Value thereof as of such date.

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

"Bondholders", **"Holders"** and similar terms mean the registered owners of the Bonds, as shown on the books of the Authority, and the owners of Coupon Bonds. Unless and until the Bonds have been issued to Bondholders other than DTC, all references to "Bondholders" or "Holders" of the Bonds are qualified by reference to the Trust Indenture.

"Bonds" means all obligations issued pursuant to the Trust Indenture.

"Business Day" means any day other than (i) a Saturday or a Sunday or (ii) a day on which banking institutions in Lansing, Michigan or New York, New York, are required or authorized by law to be closed.

"Capital Appreciation Bond" means a Bond the interest on which shall be compounded periodically, shall be payable only at maturity or redemption or prepayment prior to maturity, and shall be determined by subtracting from the Accreted Value thereof the original principal

amount thereof. Capital Appreciation Bonds do not include Convertible Capital Appreciation Bonds on or after the applicable Conversion Date, but do include Convertible Capital Appreciation Bonds prior to the applicable Conversion Date.

"Capitalized Interest Subaccount" means the subaccount of the Debt Service Account held by the Trustee pursuant to the Trust Indenture.

"Cash Equivalent" means a letter of credit, insurance policy, surety, guarantee or other security arrangement that is an Eligible Investment under paragraph (j) (as provided in a Supplemental Indenture) provided by an institution to represent the deposit in the Liquidity Reserve Account of all or a portion of the Liquidity Reserve Requirement.

"Closing Date" means (i) with respect to the issuance of the Series 2008 Bonds, June 17, 2008, and (ii) with respect to the issuance of the any Series of Additional Bonds or Refunding Bonds, the date of delivery of such Series of Bonds.

"Code" means the Internal Revenue Code of 1986, as amended.

"**Collateral**" shall have the meaning ascribed thereto under the caption "*Security and Pledge*" below.

"Collection Account" means the account so designated and established pursuant to the Trust Indenture.

"Collections" means the Pledged TSRs and investment earnings on amounts on deposit in or credited to the Pledged Accounts.

"Consent Decree" means the Consent Decree and Final Judgment of the Ingham County Circuit Court, dated December 7, 1998, relating to the MSA, as the same has been and may be corrected, amended or modified in the action entitled Kelley Ex Rel Michigan v Philip Morris, Inc. et al, Ingham County Circuit Court Docket No. 96-84281CZ.

"Conversion Date" means the date set forth in the applicable Series Supplement on and after which a Convertible Capital Appreciation Bond is deemed a Current Interest Bond and after which the Holders shall be entitled to receive current payments of interest on each Distribution Date.

"Convertible Capital Appreciation Bond" means a Bond the interest on which (x) prior to the Conversion Date, shall be (i) compounded periodically, (ii) payable only upon redemption or prepayment, and (iii) determined by subtracting from the Accreted Value thereof, the original principal amount thereof and (y) on and after the Conversion Date, shall accrue and be payable periodically commencing on the next succeeding Distribution Date following the Conversion Date. On and after the Conversion Date, Convertible Capital Appreciation Bonds shall be Current Interest Bonds. Convertible Capital Appreciation Bonds do not include Capital Appreciation Bonds.

"Corporate Trust Office" means the office of the Trustee at which the corporate trust business of the Trustee related hereto shall, at any particular time, be principally administered,

which office is, at the date of the Trust Indenture, located at 719 Griswold Street, Suite 930, Detroit, Michigan 48226.

"Costs of Issuance" means the costs, expenses and fees directly related to the authorization and issuance of Bonds and entering into of Ancillary Facilities as follows: all costs, fees and expenses of procuring insurance, other credit enhancements, and other financing arrangements to fulfill the purposes of the Authority under the Act, including such arrangements, instruments, contracts and agreements as municipal bond insurance, liquidity facilities, interest rate agreements and letters of credit, financial advisory services, Bond underwriting services, auditors' or accountants' services, printing costs, costs of reproducing documents, filing and recording fees, escrow fees, initial fees and expenses of the Trustee, legal fees and charges, professional consultants' fees, costs of credit ratings, fees and charges for execution, transportation and safekeeping of Bonds, governmental charges, and other costs or expenses and fees of issuance of any kind directly related to the authorization and the issuance of the Bonds by the Authority or, in accordance with the Agreement, by the State. Costs of issuance shall include any financing cost set forth in the Act, except for capitalized interest.

"Costs of Issuance Fund" means the fund so designated and established pursuant to the Trust Indenture.

"Counsel" means Dickinson Wright PLLC and Dykema Gossett PLLC, or another nationally recognized bond counsel or such other counsel as may be selected by the Authority for a specific purpose hereunder.

"Coupon Bonds" means Bonds registered to bearer, with interest coupons.

"Current Interest Bond" means a Bond the interest on which is payable currently on each Distribution Date (including an Indexed Floating Rate Bond, and as the context requires, a Convertible Capital Appreciation Bond on and after the applicable Conversion Date).

"Debt Service" means (i) interest, redemption premium and Bond Obligation due on Outstanding Senior Bonds and (ii) Parity Payments.

"Debt Service Account" means the Account within the Bond Fund so designated and established pursuant to the Trust Indenture.

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

"Default Rate" means that rate of interest that a Convertible Capital Appreciation Bond or a Capital Appreciation Bond will accrete on and during the occurrence of a Payment Default as set forth in the Series Supplement authorizing the issuance of such Bonds.

"Defeasance Collateral" means money and any of the following, provided such investments are legal under the laws of the State:

(a) direct obligations of the United States government, which are not redeemable at the option of the issuer thereof;

(b) (i) obligations, the timely payment of the principal and interest on which are unconditionally guaranteed by the United States government; (ii) certificates of deposit of banks or trust companies secured by obligations of the United States of America of a market value equal at all times to the amount of the deposit; (iii) notes, bonds, debentures, mortgages and other evidences of indebtednesses, issued or guaranteed at the time of the investment by the United States Postal Service, Fannie Mae, FHLMC, the Student Loan Marketing Association, the Federal Farm Credit System, or any other United States government sponsored agency; (iv) notes, bonds, debentures, mortgages and other evidences of indebtedness, issued or guaranteed at the time of investment by the Asian Development Bank, Bank Nederlandse Gemeenten, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank and International Bank for Reconstruction and Development; or (v) bonds or other obligations of any state of the United States of America or of any agency instrumentality or local governmental unit of any such state (x) which are not callable at the option of the obligor or otherwise prior to maturity or as to which irrevocable notice has been given by the obligor to call such bonds or obligations on the date specified in the notice, and (y) timely payment of which is fully secured by a fund consisting only of cash or obligations of the character described in clause (i), (ii), (iii) or (iv) which fund may be applied only to the payment when due of such bonds or other obligations; provided that the above-listed investments are not redeemable at the option of the issuer thereof and which shall be rated at the time of the investment in the highest long term category by each Rating Agency;

(c) any depository receipt issued by an Eligible Bank as custodian with respect to any Defeasance Collateral which is specified in clause (a) above and held by such Eligible Bank for the account of the holder of such depositary receipt, or with respect to any specific payment of principal of or interest on any such Defeasance Collateral which is so specified and held, provided that (except as required by law) such custodian is not authorized to make any deduction from the amount payable to the holder of such depositary receipt from any amount received by the custodian in respect of the Defeasance Collateral or the specific payment of principal or interest evidenced by such depositary receipt;

(d) any certificate of deposit specified in the definition of "Eligible Investments" below, including certificates of deposit issued by the Trustee or by the Paying Agent or by an affiliate of the Trustee or a Paying Agent, secured by obligations specified in clause (a) above at a market value equal at all times to the amount of the deposit, which shall be rated at the time of the investment in the highest long-term rating category by each Rating Agency; or

(e) investment arrangements that are rated or with providers whose senior unsecured debt obligations are rated in the highest long term and short term category by each Rating Agency.

"Defeasance Redemption Schedule" means for each Defeased Turbo Term Bond of the same Maturity Date and Series upon Written Notice from the Authority, and written direction to invest in Defeasance Collateral, the Trustee shall establish a defeasance escrow which: (a) redeems on the earliest possible date the pro rata Defeasance Redemptions which were originally projected to occur prior to the date of the defeasance, if any; and (b) thereafter, redeems the pro rata Defeasance Redemptions according to their schedule.

"**Defeased Turbo Term Bonds**" means Turbo Term Bonds for which a defeasance escrow has been established pursuant to the Trust Indenture.

"Delivery Date" means the date on which a Series of Bonds is delivered to the original purchasers thereof.

"Deposit Date" means the date of actual receipt by the Trustee of any Collections.

"**Distribution Date**" means each June 1 and December 1, or if such date is not a Business Day, the following Business Day, each additional Distribution Date selected by the Authority or the Trustee following a Payment Default, and each Distribution Date, to the extent so characterized in a Supplemental Indenture.

"DTC" means The Depository Trust Company, a limited-purpose trust company organized under the laws of the State of New York, and includes any nominee of DTC in whose name any Bonds are then registered.

"Eligible Bank" means any (i) bank or trust company organized under the laws of any state of the United States of America (including the Trustee and any of its affiliates), (ii) national banking association, (iii) savings bank or savings and loan association chartered or organized under the laws of any state of the United States of America, or (iv) federal branch or agency established pursuant to the International Banking Act of 1978 or any successor provisions of law, or domestic branch or agency of a foreign bank which branch or agency is duly licensed or authorized to do business under the laws of any state or territory of the United States of America.

"Eligible Investments" means, with respect to the Accounts:

(a) Defeasance Collateral;

(b) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, FHLMC, Fannie Mae, FHLB, the Federal Farm Credit System or the Tennessee Valley Authority;

(c) demand, trust and time deposits, money market deposit account or certificates of deposit of, or bankers' acceptances issued by, any bank (including the Trustee and any of its affiliates) or trust company, savings and loan association, or savings bank, payable on demand or on a specified date no more than three months after the date of issuance thereof, if such deposits or instruments are rated "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch;

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

(e) commercial or finance company paper (including both noninterest-bearing discount obligations and interest bearing obligations payable on demand or on a specific date not more than 270 days after the date of issuance thereof) that is rated at least "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch, if rated by Fitch;

(f) repurchase obligations with respect to any security described in paragraphs (b)(i), (ii) or (iii) of the definition of Defeasance Collateral above entered into with a financial institution, corporation, registered broker/dealer, domestic commercial bank, primary dealer, depository institution, or trust company (acting as principal) rated "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch (if payable on demand or on a specified date no more than three months after the date of issuance thereof), or rated by each Rating Agency maintaining a rating thereon in one of its three highest long term rating categories, provided that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Trustee will have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (3) the agreement has a term of 30 days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is at least 102%;

(g) securities bearing interest or sold at a discount (payable on demand or on a specified date no more than three months after the date of issuance thereof) that are issued by any corporation incorporated under the laws of the United States of America or any state thereof and rated "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch at the time such investment or contractual commitment providing for such investment; provided that securities issued by any such corporation will not be Eligible Investments to the extent that investment therein would cause the then-outstanding principal amount of securities issued by such corporation that are then held to exceed 20% of the aggregate principal amount of all Eligible Investments then held;

(h) units of taxable or tax-exempt money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated by each Rating Agency in one of its three highest rating categories, including if so rated any such fund which the Trustee or an affiliate of the Trustee serves as an investment advisor, administrator, shareholder, servicing agent and/or custodian or sub-custodian, notwithstanding that (x) the Trustee or an affiliate of the Trustee charges and collects fees and expenses (not exceeding current income) from such funds for services rendered, (y) the Trustee charges and collects fees and expenses for services rendered pursuant to the Trust Indenture, and (z) services performed for such funds and pursuant to the Trust Indenture may converge at any time (the Authority specifically authorizes the Trustee or an affiliate of the Trustee to charge and collect all fees and expenses from such funds for services rendered to such funds, in addition to any fees and expenses the Trustee may charge and collect for services rendered pursuant to the Trust Indenture);

(i) investment agreements or guaranteed investment contracts rated, or with any financial institution or corporation whose senior long-term debt obligations are rated, or guaranteed by a financial institution whose senior long-term debt obligations are rated, at the time such agreement or contract is entered into, by each Rating Agency maintaining a rating thereon in one of its three highest rating categories, if the Authority has an option to terminate such agreement in the event that such rating is downgraded below the rating on the Bonds, or if

not so rated, then collateralized by securities described in paragraphs (b)(i), (ii) or (iii) of the definition of Defeasance Collateral above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated in one of the three highest rating categories by each Rating Agency; provided that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Trustee will have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (3) the agreement has a term of 30 days or less, or the Trustee or third party custodian will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is at least 102%;

(j) a surety, guaranty, liquidity agreement, agreement to purchase securities of the Authority or other similar agreement provided in lieu of or in substitution for amounts in the Liquidity Reserve Account by an entity with a rating in the three highest rating categories by each Rating Agency; provided that any cost related to such an investment shall be paid either from funds released from the Liquidity Reserve Account or other available funds and 15 days prior notice is given to S&P; and

(k) other obligations or securities that are non-callable and that are acceptable to each Rating Agency;

provided that no Eligible Investments may (i) evidence the right to receive only interest with respect to prepayable obligations underlying such instrument, or (ii) be purchased at a price greater than par if such instrument may be prepaid or called at a price less than its purchase price prior to its stated maturity.

Any investment in Eligible Investments described above may be made in the form of an entry made on the records of the issuer of such Eligible Investments.

"Event of Default" means an event as described under the caption "*Events of Default*" below.

"Fannie Mae" means the Federal National Mortgage Association.

"FHLB" means any Federal Home Loan Bank.

"FHLMC" means the Federal Home Loan Mortgage Corporation.

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

"Fiscal Year" means the twelve (12) month period commencing October 1 of each year and ending on September 30 of the succeeding year, or such other twelve (12) month period as the Authority or the State may determine from time to time to be the Authority's Fiscal Year. In

the event of a change in the Authority's Fiscal Year, the Authority shall deliver an Officer's Certificate to the Trustee stating such change.

"Fitch" means Fitch Inc.; references to Fitch are effective so long as Fitch is a Rating Agency.

"Fixed Rate Bonds" means the Current Interest Bonds which are not Indexed Floating Rate Bonds.

"Fully Paid" means a Bond which:

(i) has been canceled by the Trustee or delivered to the Trustee for cancellation, including but not limited to under certain circumstances described in the Trust Indenture; or

(ii) shall have matured or been called for redemption and, on such Maturity Date or redemption date, money for the payment of the Bond Obligation, redemption premium, if any, and interest on such Bond is held by the Trustee in trust for the benefit of the person entitled thereto; or

(iii) is alleged to have been lost, stolen, destroyed, partially destroyed, or defaced and has been replaced as provided in the Trust Indenture; or

(iv) has been defeased as provided in the Trust Indenture (whether as part of a defeasance of all or less than all of the Bonds).

"Funds" means the Bond Fund and the Cost of Issuance Fund and funds established by a Series Supplement.

"Interest Rate Exchange Agreement" or **"Interest Rate Exchange or Similar Agreement"** means a written contract with a counterparty to provide for an exchange of payments based upon fixed or variable interest rates, or both fixed and variable interest rates. Any such agreement may include the option to enter into or cancel the agreement or to reverse or extend the agreement.

"Junior Payments" means (i) principal payable under term-out provisions of Ancillary Facilities, (ii) other amounts due under Ancillary Facilities and not payable as Priority Payments or Debt Service and (iii) Junior Payments so identified in or by reference to the Trust Indenture.

"Liquidity Reserve Account" means the Account within the Bond Fund so designated and established pursuant to the Trust Indenture.

"Liquidity Reserve Requirement" means (x) $38,801,532.39 and (y) from and after the date on which there are no Outstanding Senior Bonds which are Current Interest Bonds or Convertible Capital Appreciation Bonds, zero, which amount may be amended upon the issuance of Additional Bonds or Refunding Bonds.

"Lump Sum Payment" means a final payment from a PM that results in, or is due to, a release of that PM from all of its future payment obligations under the MSA. Any Lump Sum

Payment shall be applied as Collections as provided in the Trust Indenture. The term "Lump Sum Payment" does not include any payments that are Partial Lump Sum Payments, Total Lump Sum Payments or any non-scheduled prepayments other than a Lump Sum Payment.

"Majority in Interest" means, as of any particular date of calculation, the Holders of a majority of the Aggregate Principal Obligation eligible to act on a matter.

"Master Settlement Agreement" or **"MSA"** means the master settlement agreement and related documents (including the Escrow Agreement) entered into on November 23, 1998, by the State and leading United States tobacco product manufacturers, and incorporated with the Consent Decree.

"**Maturity Date**" means with respect to any Bond, the final date on which all remaining Principal is due and payable.

"Maximum Rate" when used in reference to the Trust Indenture, means, as applicable, (i) the highest rate payable on a Bond to Holders other than parties to Ancillary Facilities, as specified by Series Supplement or (ii) the rate specified by Series Supplement as the Maximum Rate on an Interest Rate Exchange Agreement.

"Moody's" means Moody's Investors Service; references to Moody's are effective so long as Moody's is a Rating Agency.

"Offering Circular" means the final offering circular, dated June 26, 2008, relating to the Series 2008 Bonds.

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

"Operating Cap" means (i) $200,000 in the Fiscal Year ending September 30, 2006, inflated in each following Fiscal Year by the greater of 3% or the percentage increase in the CPI for all urban consumers as published by the Bureau of Labor Statistics for the prior year, plus (ii) in each Fiscal Year, Tax Obligations and Priority Payments, if any, specified in an Officer's Certificate.

"Operating Account" means the Account held by the Authority pursuant to the Trust Indenture.

"Operating Expenses" means the reasonable operating expenses of the Authority, including without limitation, the cost of preparation of accounting and other reports, costs of maintenance of the ratings on the Bonds, insurance premiums, and costs of Authority meetings or other required activity of the Authority, counsel fees, including the fees of the Attorney General, and fees and expenses incurred for consultants and fiduciaries, all costs and expenses incurred by the State and other amounts which are required to be reimbursed or borne by the Authority pursuant to the Agreement and all other costs authorized by the Act or all other Operating Expenses so identified in the Trust Indenture.

"Outstanding Bonds" means Bonds issued under the Trust Indenture, excluding: (i) Bonds that have been exchanged or replaced, or delivered to the Trustee for credit against the Principal; (ii) Bonds that have been paid or Fully Paid; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Bonds for which (A) there has been irrevocably set aside sufficient Defeasance Collateral timely maturing and bearing interest, to pay or redeem them and (B) any required notice of redemption shall have been duly given in accordance with the Trust Indenture or irrevocable instructions to give notice shall have been given to the Trustee; (v) Bonds the payment of which shall have been provided for pursuant to certain provisions of the Trust Indenture; and (vi) for purposes of any consent or other action to be taken by the Holders of a Majority in Interest or specified percentage of Bonds under the Trust Indenture, Bonds held by or for the account of the Authority, the State or any person controlling, controlled by or under common control with either of them. For the purposes of this definition, "control," when used with respect to any specified person, means the power to direct the management and policies of such person, directly or indirectly, whether by contract, statute, governmental order or otherwise, and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"Parity Payments" means payments under an Interest Rate Exchange Agreement not to exceed the applicable Maximum Rate, but does not include any payments under any other Ancillary Facility.

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

"Partial Lump Sum Payment Account" means that Account within the Bond Fund so designated and established pursuant to the Trust Indenture.

"Paying Agent" means the Trustee and any other Paying Agent designated from time to time.

"Payment Default" means an Event of Default that has occurred as a consequence of the Authority's failure to pay: (i) the Principal of, premium or interest on any Senior Bond when due; or (ii) payments (other than Termination Payments), when due under an Interest Rate Exchange Agreement.

"Periodic Interest Accrual Period" means with respect to any Distribution Date, the period commencing on the prior Distribution Date (or the Closing Date, in the case of the first Distribution Date) and ending on the day preceding such Distribution Date.

"**Pledged Accounts"** means the Collection Account and all accounts and subaccounts, if any, of the Bond Fund.

"Pledged TSRs" means, initially, the right, title and interest to 100% of the Sold Tobacco Receipts, which are payable to the Authority or the Trustee pursuant to the Agreement and are subject to the lien of the Trust Indenture, until modified by an Officer's Certificate of the Authority delivered in connection with the issuance of Additional Bonds or Refunding Bonds, whereupon "Pledged TSRs" will mean the revised percentage set forth in such Officer's Certificate of each dollar of Sold Tobacco Receipts which are payable to the Authority or the Trustee.

"**PM**" means a Participating Manufacturer, as defined in the MSA.

"**Principal**" means the amount of the principal or Accreted Value due on the Maturity Date for any Bonds.

"Priority Payments" means fees payable pursuant to Ancillary Facilities that are identified by the Trust Indenture or by a Series Supplement as Priority Payments, which shall not include payments of or in lieu of interest, Principal, redemption price or purchase price of Bonds.

"Pro Rata" means, for an allocation of available amounts to any payment of interest, Accreted Value, Principal or payments under an Interest Rate Exchange Agreement to be made pursuant to the Trust Indenture, the application of a fraction of such available amounts (a) the numerator of which is equal to the amount due to the respective Holders or any party who has entered into an Interest Rate Exchange Agreement with the Authority, as applicable, to whom such payment is owing, and (b) the denominator of which is equal to the total amount due to all Holders or counterparties to whom such payment is owing, as applicable.

"Projected Final Turbo Redemption Date" means with respect to any particular Series of Series 2008 Bonds, the latest Distribution Date on which a Turbo Redemption of the Bonds of such Series is projected to be made, as set forth in the related schedule hereto.

"Projected Turbo Redemption" means, for a Series of Bonds, each respective Turbo Redemption projected to be made pursuant to the Trust Indenture, as such projections are set forth on the Projected Turbo Schedule.

"Projected Turbo Schedule" means, for a Series of Bonds that includes Turbo Term Bonds, the schedule of projected redemptions of such Turbo Term Bonds set forth in the related Series Supplement or in an exhibit thereto.

"Rating Agency" means each nationally recognized securities rating organization that has issued, at the request of the Authority, a rating in effect for the Senior Bonds, without regard to credit enhancement, if any.

"Rating Confirmation" means written evidence that no rating assigned to a Senior Bond by a Rating Agency will be withdrawn, qualified or reduced solely as a result of an action to be taken under the Trust Indenture.

"Refunding Bonds" means any Bond issued pursuant to the Trust Indenture to pay or provide for the payment of all or a portion of any Outstanding Bond.

"Residual Certificate" means that certificate evidencing Residual Interests, substantially in the form of Appendix A to the Agreement.

"Residual Interests" means initially all of the following:

(i) The Sold Tobacco Receipts and the income of the Authority that are in excess of the Authority's requirements to pay its operating expenses, debt service (including, without limitation, any mandatory redemptions of the Series 2006 Bonds and the Series 2008 Bonds),

sinking fund requirements, reserve fund or escrow fund requirements, and any other contractual obligations to the owners of the Series 2006 Bonds, the Series 2008 Bonds or Benefited Parties, or that may be incurred in connection with the issuance or repayment of the Series 2006 Bonds and the Series 2008 Bonds or the execution or repayment of Ancillary Facilities; and

(ii) Contractual rights provided to the State pursuant to the provisions of Article V of the Agreement.

"S&P" means Standard & Poor's Ratings Services; references to S&P are effective so long as S&P is a Rating Agency.

"Securities Depository" means DTC or another securities depository specified by Series Supplement, or if the incumbent Securities Depository resigns from its functions as depository of the Bonds or the Authority discontinues use of the incumbent Securities Depository, then any other securities depository selected by Officer's Certificate of the Authority.

"Senior Bonds" means the Series 2008 Bonds designated as such and all other Bonds designated as Senior Bonds in the Series Supplement relating thereto.

"Serial Bonds" means the Bonds so specified in a Series Supplement.

"Series" means all Bonds so identified in a Series Supplement, regardless of variations in class, maturity, interest rate or other provisions, and any Bonds thereafter delivered in exchange or replacement therefor.

"Series 2008A Bonds" means the $114,860,000 Tobacco Settlement Asset-Backed Bonds, Series 2008A of the Authority authorized by the Series 2008 Supplement.

"Series 2008B Bonds" means the $29,874,560 Taxable Tobacco Settlement Asset-Backed Bonds, Series 2008B of the Authority authorized by the Series 2008 Supplement.

"Series 2008C Bonds" means the $57,673,814.40 Tobacco Settlement Asset-Backed Bonds, Series 2008C of the Authority authorized by the Series 2008 Supplement.

"Series 2008 Bonds" means collectively, the Series 2008A Bonds and the Series 2008B Bonds.

"Series 2008 Supplement" means the Series 2008 Supplement Authorizing the Issuance of $202,408,464.80 Tobacco Settlement Asset-Backed Bonds, Series 2008.

"Series Supplement" means a resolution or Supplemental Indenture complying with the Trust Indenture authorizing the issuance of Additional Bonds.

"Sinking Fund Installment" means each respective principal payment to be made on Turbo Term Bonds scheduled to be made from Collections to the extent available pursuant to certain provisions of the Trust Indenture, as such schedule may be set forth in a Series Supplement.

"Sold Tobacco Receipts" means the portion of the State's Tobacco Receipts sold and payable to the Authority pursuant to the Purchase and Sale Agreement.

"State" means the State of Michigan.

"State's Tobacco Receipts" means all of the following:

(i) All tobacco settlement revenue that is received by the State that is required to be made, under the terms of the Master Settlement Agreement, by tobacco manufacturers to the State, and that is payable to the State on or after April 1, 2008;

(ii) All lump sum or partial lump sum payments of tobacco settlement revenue, whenever received, that are allocable to a payment that is payable on or after April 1, 2008, under the terms of the Master Settlement Agreement, by tobacco manufacturers to the State; and

(iii) The State's right to receive the tobacco settlement revenue referred to in (i) and (ii) of this definition, under the Master Settlement Agreement.

"State Treasurer" means the State Treasurer of the State.

"Subordinate Bonds" means all Bonds other than Senior Bonds.

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

"**Surplus Collections**" means all Collections that are in excess of the requirements of the Trust Indenture for the funding of Operating Expenses, interest, Principal, Parity Payments, Priority Payments, Tax Obligations, payments due on Ancillary Facilities, Junior Payments and maintenance of the Liquidity Reserve Account.

"Taxable Bonds" means all Bonds so identified in the Series Supplement relating to such Bonds.

"Tax-Exempt Bonds" means all Bonds so identified in the Series Supplement relating to such Bonds.

"Tax Obligations" means, with respect to the issuance of Tax-Exempt Bonds, if any, the rebate requirement and any penalties, fines or other payments required to be made to the United States of America under the arbitrage or rebate provisions of the Code.

"Term Bonds" means the Bonds, including Turbo Term Bonds, so specified in a Series Supplement.

"Termination Payment" means any payment made by the Authority with respect to a loss under or the termination of an Interest Rate Exchange Agreement, investment agreement or forward purchase agreement relating to an Account.

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

"Treasury Yield" means the rate *per annum* equal to the semiannual equivalent yield to maturity of the Comparable Treasury Issue at the Comparable Treasury Price (rounded to 4 digits to the right of the decimal). If a shorter and longer Comparable Treasury Issue is selected, then the Treasury Yield shall be interpolated linearly between the yield of such shorter and longer Comparable Treasury Issues.

"**Trustee**" means The Bank of New York Trust Company, N.A., its successors in interest and any successor trustee under the Trust Indenture.

"Trust Indenture" means the Trust Indenture dated as of May 1, 2006 by and between the Authority and the Trustee, as amended, supplemented and in effect from time to time.

"**Turbo Redemptions**" means the redemption of Bond Obligations from Surplus Collections on deposit in the Turbo Redemption Account pursuant to the Trust Indenture.

"**Turbo Redemption Account**" means the Account in the Bond Fund so designated and established pursuant to the Trust Indenture.

"**Turbo Term Bonds**" means such maturities of Bonds as are designated as Turbo Term Bonds in the applicable Series Supplement.

"Turbo Term Bond Maturity" means the principal payment required to be made upon the final maturity of any Turbo Term Bond, as set forth in a Series Supplement.

"**Unencumbered TSRs**" means initially, the right, title and interest to 0% of the Sold Tobacco Receipts, which are payable to the Authority, if any, pursuant to the Agreement but are not subject to the lien of the Trust Indenture, unless modified by an Officer's Certificate of the Authority delivered in connection with the issuance of Additional Bonds or Refunding Bonds, whereupon "Unencumbered TSRs" will mean the revised percentage as set forth in such Officer's Certificate of each dollar of Sold Tobacco Receipts which are payable to the Authority.

"Valuation Date" means, with respect to a Series 2008B Bond, December 1, 2008 and June 1 and December 1 of each year thereafter to and including the maturity date of such Bond.

"Written Notice", **"written notice"** or **"notice in writing"** means notice in writing which may be delivered by hand or first class mail and also means facsimile transmission.

The Trust Indenture

The following summary describes certain terms of the Trust Indenture pursuant to which the Series 2008 Bonds will be issued. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Trust Indenture and the Bonds. Copies of the Trust Indenture and the Series 2008 Supplement may be obtained upon written request to the Trustee at 719 Griswold Street, Suite 930, Detroit, Michigan 48226. See

"SECURITY FOR THE BONDS" and "THE SERIES 2008 BONDS" for further descriptions of certain terms and provisions of the Bonds.

Members of the Authority and State Officials Not Liable on Bonds. Neither the members or officers of the Authority nor any person executing Bonds or other obligations of the Authority nor any official, employee or agent of the Authority or of the State shall be liable personally thereon or be subject to any personal liability or accountability for any claim against the Authority or for the payment or performance of any obligation of the Authority under the Bonds, Ancillary Facilities, or the Trust Indenture or for any other debt or obligation of the Authority.

The Bonds are special revenue obligations of the Authority and shall be secured solely by, and payable solely and only out of, the moneys, assets or revenues pledged by the Authority under the Trust Indenture. The issuance of Bonds and the execution of any Ancillary Facility pursuant to the Act shall not directly or indirectly, or contingently obligate the State or any political subdivision of the State to pay any amounts to the Authority or to the Beneficiaries, or levy or pledge any form of taxation whatsoever for the Bonds or Ancillary Facilities. The Bonds and any Ancillary Facility are not a debt or liability of the State or any agency or instrumentality of the State, other than the Authority, as set forth in the Act, either legal, moral or otherwise, and nothing contained in the Act or the Trust Indenture shall be construed to authorize the Authority to incur any indebtedness on behalf of, or in any way obligate the State or any political subdivision of the State. The Authority has no taxing power.

Any liability of the Authority, including liability for damages, awards, settlement amounts, legal fees, costs, expenses, interest or any other form of monetary recovery, arising out of any actions or proceedings brought by the Trustee or any Beneficiary pursuant to the provisions of the Trust Indenture or the Agreement or otherwise against the Authority with respect to any covenants, indemnities, obligations, representations, responsibilities, warranties, or events of default under the Trust Indenture or the Agreement or otherwise shall be limited and payable solely and only from the Collections. Under no circumstances shall any person or entity have recourse to or against, or any right to receive payment (including for the purpose of paying or satisfying any judgment, debt, liability or other obligation of the Authority) from: (a) any moneys or assets of the State, including funds in the State's general fund or any special fund or other account of the State, and (b) any Unencumbered TSRs.

Security and Pledge. Pursuant to the Trust Indenture, in order to secure the payment of Bonds, and, to the extent permitted by applicable State law, payments in respect of Ancillary Facilities, including Interest Rate Exchange Agreements, all with the respective priorities specified in the Trust Indenture, the Authority, in accordance with the Act, pledges and assigns, as security, to the Trustee in trust upon the terms of the Trust Indenture (i) the Collections, (ii) all rights to receive the Collections and the proceeds of such rights, (iii) the Pledged Accounts and money and investments on deposit in or credited to the Pledged Accounts, (iv) subject to the terms and provisions of the Trust Indenture and the Agreement, all rights and remedies with respect to any breach by the State of any of its covenants, obligations, representations, and warranties under the Agreement, all interests in the Pledged TSRs of the Authority under the Agreement, to which the State has consented to an assignment, subject to the terms and limitations of the Agreement, and (v) any and all other property of every kind and nature from time to time, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as

and for additional security. The property described in the preceding sentence is referred to as the "Collateral."

The pledge of Collateral made by the Authority shall, in accordance with the Act, be valid and binding at the time the pledge is made. The Collateral so pledged and then or thereafter received by the Authority shall immediately be subject to the lien of such pledge without any physical delivery thereof or further act. The lien of any such pledge shall be valid and binding as against all parties having claims of any kind in tort contract or otherwise against the Authority, irrespective of whether such parties have notice of the lien or pledge, and without filing or recording the pledge.

Except as specifically provided in the Trust Indenture, the assignment and pledge of Collateral does not include: (i) the rights of the Authority pursuant to provisions for consent or other action by the Authority, notice to the Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Bondholders or other Beneficiaries, (ii) any other right or power reserved to the Authority pursuant to the Act or other law; nor does it preclude the Authority's enforcement of its rights under the Trust Indenture and pursuant to the Agreement for the benefit of the Bondholders or, to the extent permitted by applicable State law, other Beneficiaries as provided in the Trust Indenture. Unless otherwise specified in the Series Supplement applicable thereto, the proceeds of any Bonds, other than those deposited in the Liquidity Reserve Account or in the Capitalized Interest Subaccount, do not constitute Collections, are not pledged to the holders of such Bonds and are not subject to the lien of the Trust Indenture. The Unencumbered TSRs, if any, do **not** constitute Collections, are **not** subject to the lien of the Trust Indenture and are otherwise unavailable to satisfy any obligation of the Authority under the Trust Indenture.

The Authority will implement, protect and defend the pledge and assignment of the Collateral by all appropriate legal action, the cost thereof to be an Operating Expense. The pledge and assignment made by the Trust Indenture and the covenants and agreements to be performed by or on behalf of the Authority shall be for the equal and ratable benefit, protection and security of the Holders to secure payment of any and all of the Outstanding Bonds, all of which, regardless of the time or times of their issue or maturity, shall be of equal rank without preference, priority or distinction of such Bonds over any other Bonds except as expressly provided in or permitted by the Trust Indenture.

The right of the Authority to receive the Sold Tobacco Receipts is on a parity with and is not inferior or superior to the right of the State to receive the portion of the State's tobacco receipts not sold to the Authority by the State. If the State's Tobacco Receipts at any time are less than required to be paid under the terms of the MSA or are otherwise deficient, neither the Authority nor the Trustee shall have the right to make a claim to make up all or any portion of a deficiency in Pledged TSRs from the Unencumbered TSRs, if any, and likewise, neither the Authority nor the State nor any other person shall have any right to make a claim to make up all or any portion of a deficiency in the Unencumbered TSRs from the Pledged TSRs.

In connection with the issuance of Additional Bonds or Refunding Bonds issued in accordance with the Trust Indenture, the Authority may reduce the percentage of Sold Tobacco Receipts constituting Pledged TSRs (and correspondingly increase the percentage of Sold

Tobacco Receipts constituting Unencumbered TSRs), by delivering to the Trustee an Officer's Certificate of the Authority setting forth the revised percentage of Sold Tobacco Receipts constituting Pledged TSRs. Unencumbered TSRs shall be deposited in the Unencumbered TSR Account and used by the Authority for any lawful purpose.

Defeasance. When (i) there is held by or for the account of the Trustee Defeasance Collateral in such principal amounts, bearing interest at such fixed rates and with such maturities, including any applicable redemption premiums, as will provide sufficient funds to pay, or to redeem in accordance with the Trust Indenture, all obligations to Holders in whole (to be verified by a nationally recognized firm of independent verification agents), (ii) any required notice of the deposit of Defeasance Collateral and any required notice of redemption shall have been duly given in accordance with the Trust Indenture or irrevocable instructions to give notice shall have been given to the Trustee, (iii) all the rights of Beneficiaries (including parties to Ancillary Facilities) have been provided for and all Operating Expenses have been satisfied in accordance with the Trust Indenture, and (iv) the Trustee shall have received an opinion of Counsel to the effect that such defeasance will not, in and of itself, cause interest on any Tax-Exempt Bond to be included in gross income for federal income tax purposes, then upon Written Notice from the Authority to the Trustee, such Beneficiaries under the Trust Indenture shall cease to be entitled to any benefit or security under the Trust Indenture, except the right to receive payment of the funds held in such defeasance escrow and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien thereof, the Trust Indenture, and the lien and rights created by the Trust Indenture (except in such funds and investments) shall terminate and become null and void, and the Authority and the Trustee shall execute and deliver such instruments as may be necessary to discharge the Trustee's lien and rights (except in such funds and investments) created under the Trust Indenture. Upon such defeasance, the funds and investments required to pay or redeem the Bonds shall be irrevocably set aside for that purpose, subject, however, to provisions of the Trust Indenture, and money held for defeasance shall be invested only as provided above and applied by the Trustee or other Paying Agents, if any, to the retirement of the Bonds. Any funds or other property held by the Trustee and not required for payment or redemption of the Bonds shall be distributed in accordance with the order of the Authority. Upon defeasance of all Outstanding Bonds and Beneficiaries, any funds or property held by the Trustee and not required for payment or redemption of such Bonds and such other obligations to Defeased Beneficiaries in full shall be distributed by the Trustee in accordance with the Trust Indenture. With respect to Indexed Floating Rate Bonds, for purposes of this section, any such Bond will be assumed to bear interest at its Maximum Rate to the date set for redemption.

Defeasance of Turbo Term Bonds. For each Defeased Turbo Term Bond of the same Maturity Date and Series, the Authority must determine a pro rata "Defeasance Redemption Schedule" as described in paragraphs (i) and (ii) below. In establishing the defeasance escrow, the Defeased Turbo Term Bonds may not be redeemed more slowly than the pro rata Defeasance Redemption Schedule.

(i) For a given Turbo Term Bond Maturity of a given Series, the Trustee shall determine the pro rata portion of each Projected Turbo Redemption (shown, with respect to each Series of the Series 2008 Bonds, in an exhibit to the 2008 Series Supplement) that is allocable to the Defeased Turbo Term Bonds and notify the Authority of such

determination. The pro rata portion of each Projected Turbo Redemption shall be calculated as of the date of the defeasance by: (a) deducting the Turbo Redemptions which have already occurred from the earliest Projected Turbo Redemptions to arrive at a schedule of "Projected Turbo Redemptions Adjusted for Prior Payments"; (b) calculating a ratio of the Bond Obligation to be defeased of each Turbo Term Bond Maturity divided by the then Outstanding Bond Obligation of the Turbo Term Bond Maturity; and (c) applying that ratio to the Projected Turbo Redemptions Adjusted for Prior Payments, resulting in a schedule for each Turbo Term Bond Maturity defined as the pro rata Defeasance Redemption Schedule and each such payment is referred to as a pro rata "Defeasance Redemption."

(ii) For each Defeased Turbo Term Bond of the same Maturity Date and Series upon Written Notice from the Authority, and written direction to invest in Defeasance Collateral, the Trustee shall establish a defeasance escrow which: (a) redeems on the earliest possible date the pro rata Defeasance Redemptions which were originally projected to occur prior to the date of the defeasance, if any; and (b) thereafter, redeems the pro rata Defeasance Redemptions according to their schedule.

(iii) In order to establish the Projected Turbo Redemption Schedule in effect for each Turbo Term Bond Maturity of a given Series after each partial defeasance, the Trustee shall determine the schedule of Projected Turbo Redemptions Adjusted for Prior Payments then applicable, notify the Authority of such determination and permanently subtract the pro rata Defeasance Redemption Schedule from such schedule of Projected Turbo Redemptions Adjusted for Prior Payments.

(iv) The provisions contained in the Trust Indenture shall not be construed to limit the optional redemption of Bonds of a Series by the Authority pursuant to the applicable Series Supplement.

Partial Defeasance. Subject to the requirements of the Trust Indenture, the Authority may create a defeasance escrow for the retirement and defeasance of any Bonds subject to and in accordance with the Trust Indenture. Thereafter, the Beneficiaries with respect to such Bonds and Ancillary Facilities shall cease to be entitled to any benefit or security under the Trust Indenture except the right to receive payment of the funds held in such defeasance escrow and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien thereof of the Trust Indenture.

Additional Bonds of the Authority. By Series Supplements complying with the Trust Indenture, the Authority may authorize, issue, sell and deliver the Series 2008 Bonds and one or more Series of Refunding Bonds, Additional Bonds or Subordinate Bonds from time to time in such principal amounts as the Authority shall determine. The Bonds of each Series shall bear such dates, mature at such times, be subject to such terms of payment, bear interest at such rates, be in such form and denomination, carry such registration privileges, be executed in such manner, and be payable in such medium of payment, at such place and subject to such terms of redemption, as the Authority may provide in the Trust Indenture and in the related Series Supplement. The proceeds of each Series of Bonds shall be applied as provided in the related Series Supplement.

Refunding Bonds may be issued to refund Bonds in part (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance) and Additional Bonds may be issued at the discretion of the Authority, but only if upon the issuance of such Refunding Bonds and/or Additional Bonds: (A) the amount on deposit in the Liquidity Reserve Account following the issuance of such Refunding Bonds and/or Additional Bonds will be at least equal to the Liquidity Reserve Requirement; (B) no Event of Default shall have occurred and be continuing after the date of issuance of such Bonds; (C) the expected weighted average life of each Turbo Term Bond that will remain Outstanding after the date of issuance of the Refunding Bonds and/or Additional Bonds as computed on the basis of new projections on the date of sale of the Refunding Bonds and/or Additional Bonds will not exceed (x) the remaining expected weighted average life of each such Turbo Term Bond as computed by the Authority on the basis of new projections assuming that no such Refunding Bonds and/or Additional Bonds are issued, plus (y) one year; and (D) a Rating Confirmation is received for any Bonds that will remain Outstanding after the date of issuance of the Refunding Bonds and/or Additional Bonds which are then rated by a Rating Agency.

Application of Collections.

(a) All Pledged TSRs received by the Trustee shall be promptly deposited by the Trustee into the Collection Account. Unencumbered TSRs, if any, shall be deposited in the Unencumbered TSR Account. All Collections that have been identified by an Officer's Certificate as consisting of Partial Lump Sum Payments received by the Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Partial Lump Sum Payment Account, in accordance with the instructions received by the Trustee pursuant to an Officer's Certificate. All Collections that have been identified by an Officer's Certificate as consisting of Total Lump Sum Payments received by the Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) applied as described in subsection (e) below in accordance with the instructions received by the Trustee pursuant to an Officer's Certificate. Not later than on each Distribution Date, the Trustee shall deposit in the Collection Account and apply as described in the following paragraph, all Collections consisting of investment earnings on amounts on deposit with the Trustee in the Pledged Accounts (excluding amounts in the Partial Lump Sum Payment Account), except that unless otherwise specified in a Series Supplement relating to a Series of Bonds, all amounts in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement determined to exist pursuant to the valuation procedure described in the Trust Indenture shall be transferred to the Debt Service Account (except as otherwise provided in the Trust Indenture).

(b) As soon as is practicable, but in any event no later than the earlier of (x) the fifth Business Day following each Deposit Date, or (y) the Distribution Date following each Deposit Date, the Trustee shall withdraw the funds on deposit in the Collection Account and transfer such amounts as follows:

(i) to the Operating Account, an amount sufficient to cause the amount therein to equal the amount specified by the Officer's Certificate most recently delivered or deemed delivered pursuant to the Trust Indenture in order to pay, for the twelve-month period applicable to such Officer's Certificate, (x) the Operating Expenses and Termination Payments to

the extent that the amount thereof does not exceed the Operating Cap, (y) the Tax Obligations, and (z) Priority Payments;

(ii) to the Debt Service Account, an amount sufficient to cause the amount therein (taking into account any amounts already on deposit in the Capitalized Interest Subaccount or the Debt Service Account) to equal the sum of (x) interest at the stated rate on Outstanding Fixed Rate Bonds, plus (y) interest at the Applicable Periodic Rate on Outstanding Indexed Floating Rate Bonds through the next Distribution Date, and thereafter, at the Assumed Rate to the next succeeding Distribution Date, and all Parity Payments that will come due (i) in the next succeeding Bond Year, if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, or (ii) in the then-current Bond Year, if the Deposit Date is on or after June 1 and on or before November 30 of any Bond Year, plus (z) any such unpaid interest on the Outstanding Current Interest Bonds and all Parity Payments from prior Distribution Dates (including interest at the stated rate or Applicable Periodic Rate on such unpaid interest, to the extent legally permissible); and the amounts to be deposited pursuant to the Trust Indenture shall be calculated assuming that principal on the Outstanding Current Interest Bonds will have been paid as described in clauses (ii), (iii), (iv) and (v) of Section 5.03(c) of the Trust Indenture;

(iii) to the Debt Service Account, an amount sufficient to cause the amount therein to equal the amount specified in paragraph (ii) above plus the sum of (a) if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, the Serial Maturity, Sinking Fund Installment or Term Bond Maturities (including Turbo Term Bond Maturities) due in or scheduled for the next succeeding Bond Year, plus (b) any such Serial Maturities, Sinking Fund Installment or Term Bond Maturities (including Turbo Term Bond Maturities) unpaid from prior Distribution Dates, but the amount of each Sinking Fund Installment shall first be adjusted as described in the Trust Indenture;

(iv) unless a Payment Default has occurred, to the Liquidity Reserve Account an amount sufficient to cause the amount on deposit therein to equal the Liquidity Reserve Requirement; provided that on any Distribution Date on which the amount in the Liquidity Reserve Account (less any amount necessary to be paid in connection with the liquidation of the investment of amounts in the Liquidity Reserve Account, including a Termination Payment) equals or exceeds the Bond Obligation and interest on all Senior Bonds other than Capital Appreciation Bonds, the amount in the Liquidity Reserve Account shall be transferred to the Turbo Redemption Account and applied to the Turbo Redemption of all Senior Bonds other than Capital Appreciation Bonds, and then of all remaining Outstanding Senior Bonds;

(v) to the Operating Account, the amount, if any, necessary to make the amount therein equal to the amount specified by the Officer's Certificate most recently delivered or deemed delivered pursuant to Section 6.03(b) of the Trust Indenture in order to pay, for the twelve-month period applicable to such Officer's Certificate, the Operating Expenses and Termination Payments, if any, in excess of the Operating Cap;

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

(vii) to the Turbo Redemption Account, all amounts remaining in the Collection Account.

(c) Unless a Payment Default has occurred and continues, on each Distribution Date the Trustee shall apply amounts in the various Accounts in the following order of priority:

(i) from the Capitalized Interest Subaccount, the Debt Service Account, the Partial Lump Sum Payment Account, and the Liquidity Reserve Account, in that order, to pay interest at the stated rate on Outstanding Fixed Rate Bonds, interest at the Applicable Periodic Rate on Outstanding Indexed Floating Rate Bonds and all Parity Payments due on such Distribution Date;

(ii) from the Debt Service Account and the Partial Lump Sum Payment Account, in that order, to pay, in the following order, the Serial Bond maturities, if any, Sinking Fund Installments and parity Term Bond maturities (including Turbo Term Bond maturities) due on or scheduled for such Distribution Date, provided that the amount of such Sinking Fund Installment shall first have been adjusted as described in Section 5.06(e) of the Trust Indenture, and the Trustee shall not pay a Sinking Fund Installment or a Term Bond maturity (including Turbo Term Bond maturities) pursuant to the Trust Indenture unless the Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date, such interest to be calculated at the stated rate on Outstanding Fixed Rate Bonds and at the Assumed Rate on Outstanding Indexed Floating Rate Bonds through the next succeeding Distribution Date;

(iii) from the Liquidity Reserve Account first to pay the Serial Bond maturities, if any, and Turbo Term Bond maturities due on or scheduled for such Distribution Date or unpaid from prior Distribution Dates, provided (a) that the amount of such Turbo Term Bond maturities shall first have been adjusted as described in Section 5.06(e) of the Trust Indenture and (b) the Trustee shall not pay a Turbo Term Bond maturity pursuant to the Trust Indenture unless the Liquidity Reserve Account will, after giving effect to such payment, contain sufficient funds to pay interest due on the next succeeding Distribution Date, such interest to be calculated at the stated rate on Outstanding Fixed Rate Bonds and at the Assumed Rate on Outstanding Indexed Floating Rate Bonds through the next succeeding Distribution Date, and then to reimburse the provider of any Eligible Investment referred to in (j) of the definition of "Eligible Investment" for any payment under or draw on such investment for a purpose for which the Liquidity Reserve Account is otherwise available;

(iv) from the Turbo Redemption Account, to redeem Turbo Term Bonds on such Distribution Date in accordance with Section 5.06(d) of the Trust Indenture; and

(v) from the Partial Lump Sum Payment Account, but only as directed in an Officer's Certificate delivered by the Authority and accompanied by Rating Confirmation, to redeem Turbo Term Bonds on such Distribution Date in accordance with Section 5.06(d) of the Trust Indenture.

(d) Upon the occurrence of any Payment Default and on each Distribution Date commencing with the Distribution Date following a Payment Default, the Trustee shall apply all Collections and funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account, and the Turbo Redemption Account to pay pro rata, first, the accrued interest on the Bonds and all Parity Payments (including, in each case, interest at the stated rate or Applicable Periodic Rate on any unpaid interest, to the extent legally permissible)

and, second, the Bond Obligation on all Bonds then Outstanding in their order of priority. For purposes of the clause "first" in this paragraph (d), from and after its Maturity Date, a Capital Appreciation Bond shall accrue interest at a rate per annum equal to the Default Rate therefor set forth in the Series Supplement authorizing the issuance of such Capital Appreciation Bonds.

(e) Upon the receipt of a sum that has been identified by an Officer's Certificate as a Total Lump Sum Payment, the Trustee shall after making provision for the amounts required to be deposited pursuant to the Trust Indenture and giving notice as provided for therein, use all remaining proceeds of such Total Lump Sum Payment to pay pro rata, first, the accrued interest on the Bonds and Parity Payments (including interest at the stated rate or Applicable Periodic Rate on any unpaid interest, to the extent legally permissible) and, second, the Bond Obligation on all Bonds then Outstanding in their order of priority.

(f) After making all deposits and payments set forth above, and provided that there are no Outstanding Bonds and no obligations to make payments under an Ancillary Facility, the Trustee shall deliver any amounts remaining to the holder of the Residual Certificate.

(g) Funds in the Operating Account shall be applied by the Trustee at any time, in accordance with directions in an Officer's Certificate pursuant to Section 6.03(b) of the Trust Indenture, to first pay Operating Expenses, Tax Obligations and Priority Payments, and then to pay Termination Payments.

(h) On or prior to any Deposit Date, the Authority may by an Officer's Certificate treat anticipated receipts on an Interest Rate Exchange Agreement as offsets to interest or Bond Obligation if the counterparty is limited to entities (i) the debt securities of which are rated at least "A1" by Moody's and in one of the three highest long-term debt rating categories by S&P and Fitch (if rated by Fitch) or (ii) the obligations of which under the Interest Rate Exchange Agreement are either so rated or guaranteed or insured by an entity the debt securities or insurance policies of which are so rated or (iii) the debt securities of which are rated in the three highest long-term debt rating category by Moody's, S&P and Fitch (if rated by Fitch) or whose obligations are guaranteed or insured by an entity so rated, in either case the obligations of which under the contract are continuously and fully secured by Eligible Investments meeting criteria provided by the Rating Agencies to the Authority and then in effect.

(i) The Authority may determine at any time to substitute Cash Equivalents for amounts on deposit in the Liquidity Reserve Account, with a Rating Confirmation and if there are Tax-Exempt Bonds Outstanding, an opinion of Counsel to the effect that such action shall not impair the exemption from federal income tax of interest on the Tax-Exempt Bonds, if any, in which event the Trustee shall release to the Authority, free and clear of the lien of the Trust Indenture, the cash amounts and investments replaced by the Cash Equivalents.

(j) The transfer and payments to be made shall be appropriately adjusted by Series Supplement or Officer's Certificate of the Authority delivered to the Trustee to reflect the date of issue of Bonds, any accrued or capitalized interest deposited in the Bond Fund, actual rates of interest, any amount needed or held in the Accounts for Debt Service, and any purchase or redemption of Bonds, so that there will be available on each Distribution Date the amount

necessary to pay Debt Service and so that accrued or capitalized interest will be applied to the installments of interest to which it is applicable.

(k) Notwithstanding anything in the Trust Indenture to the contrary, moneys in the Liquidity Reserve Account shall (i) prior to a Payment Default, be available at the times, in the amounts, and in the manner as described in the Trust Indenture, to pay principal of and interest on Current Interest Bonds and Convertible Capital Appreciation Bonds, but not Capital Appreciation Bonds and (ii) after a Payment Default, be available at the times, in the amounts and in the manner described in the Trust Indenture, to pay the principal of, Accreted Value and interest on all Senior Bonds, including Capital Appreciation Bonds and Convertible Capital Appreciation Bonds.

Bond Fund. A Bond Fund is established with the Trustee and money will be deposited therein as provided in the Trust Indenture. Money shall be deposited in the Bond Fund from the Collection Account as provided in the Trust Indenture. The money in the Bond Fund shall be held in trust and, except as otherwise provided in the Trust Indenture, shall be applied solely to the payment of Debt Service and Turbo Redemptions. The Bond Fund includes the Capitalized Interest Subaccount, the Debt Service Account, the Partial Lump Sum Payment Account, the Liquidity Reserve Account, the Turbo Redemption Account and such other Accounts as may be established in the Bond Fund by Series Supplement or Supplemental Indenture.

Ancillary Facilities, Including Interest Rate Exchange Agreement. The Authority may enter into, amend or terminate, as it determines to be necessary or appropriate, Ancillary Facilities, including Interest Rate Exchange Agreements, and may by Series Supplement provide for the payment of amounts due thereunder as Junior Payments or, to the extent permitted under the Trust Indenture, as Parity Payments or Priority Payments.

Redemption of the Bonds. The Authority may redeem Bonds at its option in accordance with their terms and the terms of the applicable Series Supplement and, subject to provisions in the Trust Indenture shall redeem Bonds in accordance with their terms pursuant to any mandatory redemption requirements established by the Series Supplement. When Bonds are called for redemption, the accrued interest thereon shall be due on the date fixed for redemption. With respect to any optional redemptions pursuant to the Trust Indenture, the Authority shall deposit with the Trustee on or prior to the date fixed for redemption a sufficient sum to pay the Bond Obligation, redemption premium, if any, and accrued interest on, the Bonds to be redeemed on the date fixed for redemption. If notice of redemption has been duly given as provided in the Trust Indenture and money for the payment of the redemption price of the Bonds called for redemption is held by the Trustee, then on the redemption date designated in such notice, Bonds so called for redemption shall become due and payable, and from and after the date so designated, interest on such Bonds shall cease to accrue or such Bond shall cease to accrete in value, as applicable, and the Holder of such Bonds shall have no rights in respect thereof except to receive payment of the redemption price thereof.

If less than all of the Taxable Bonds of any specific maturity are to be redeemed, the Holders of the Bonds of that maturity shall be paid on a pro rata basis.

If less than all of the Tax-Exempt Bonds of a specific Maturity Date are to be redeemed, the Holders of the Tax-Exempt Bonds of such Maturity Date to be redeemed shall be selected in accordance with DTC's standard procedures, or if such Bonds are not then held by DTC or another Securities Depository, on such basis as the Trustee shall deem fair and appropriate, including by lot, and the Trustee may provide for the selection for redemption of portions (equal to any Authorized Denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination.

Investments. Pending its use under the Trust Indenture, money in the Funds and Accounts held by the Trustee shall be invested by the Trustee in Eligible Investments pursuant to written direction of the Authority if there is not then an Event of Default actually known to an Authorized Officer of the Trustee. The Trustee may, if no such written notice is provided, invest money in the Funds and Account, established under the Trust Indenture in subsection (h) of Eligible Investments. Specifically, Eligible Investments shall mature or be redeemable at the option of the Trustee on or before the Business Day preceding each next succeeding Distribution Date, except to the extent that other Eligible Investments timely mature or are so redeemable in an amount sufficient to make the necessary payments on the next succeeding Distribution Date. Investments shall be held by the Trustee in the respective Funds and Accounts and shall be sold or redeemed to the extent necessary to make payments or transfers from each Fund or Account. The Trustee shall not be liable for any losses on investments made unless such losses were caused by the Trustee's negligence, willful misconduct, bad faith or failure to follow instructions of the Authority properly given.

In computing the amount in a Fund or Account, the value of Eligible Investments shall be determined by the Trustee at each Distribution Date or as otherwise requested by the Authority and shall be calculated as follows:

(i) As to investments the bid and asked prices of which are published on a regular basis in The Wall Street Journal (or, if not there, then in The New York Times): the average of the bid and asked prices for such investments so published on or most recently prior to such time of determination;

(ii) As to investments the bid and asked prices of which are not published on a regular basis in The Wall Street Journal or The New York Times: the average bid price at such time of determination for such investments by any two nationally recognized government securities dealers (selected by the Trustee in its absolute discretion) at the time making a market in such investments or the bid price published by a nationally recognized pricing as to investments the bid and asked prices of which are not published on a service;

(iii) As to investments described in subsection (c), (e), (f) or (h) of Eligible Investments: the face amount thereof, plus accrued interest; and

(iv) As to any investment not specified above: the value thereof established by prior agreement between the Authority and the Trustee (with written notice to Moody's of such agreement).

The Trustee may hold undivided interests in Eligible Investments for more than one Fund or Account (for which they are eligible) and may make interfund transfers in kind.

In respect of Defeasance Collateral held for Defeased Bonds, provisions of the Trust Indenture summarized under the caption "*Investments*" shall be effective only to the extent they are consistent with other applicable provisions of the Trust Indenture or any separate escrow agreement.

Contract; Obligations to Bondholders or other Beneficiaries. In consideration of the purchase of any or all of the Bonds and, to the extent permitted by applicable law, execution of Ancillary Facilities, including Interest Rate Exchange Agreements, by those who shall hold the same from time to time, the provisions of the Trust Indenture shall be a part of the contract of the Authority with Bondholders and, to the extent permitted by applicable law, other Beneficiaries. The pledge of the Collateral made in the Trust Indenture and the covenant therein set forth to be performed by the Authority shall be for the equal benefit, protection and security of the Bondholders as such rights are described in the Trust Indenture or, to the extent permitted by applicable law, other Beneficiaries, if any, of the same priority. All of the Bonds or payments on Ancillary Facilities, including Interest Rate Exchange Agreements, of the same priority, regardless of the time or times of their issuance or maturity, shall be of equal rank without preference, priority or distinction of any thereof over any other except as expressly provided pursuant to the Trust Indenture.

The Authority covenants to pay when due all sums payable on the Bonds, but only from the Collections and other moneys constituting Collateral designated in the Trust Indenture, subject only to (i) the Trust Indenture, and (ii) to the extent permitted by the Trust Indenture, (x) agreements with Holders of Bonds pledging particular collateral for the payment thereof and (y) the rights of Beneficiaries under Ancillary Facilities, including Interest Rate Exchange Agreements. The obligation of the Authority to pay the Bond Obligation, interest and redemption premium, if any, to the Holders of Bonds from the Collections and other moneys constituting Collateral, shall be absolute and unconditional, shall be binding and enforceable in all circumstances whatsoever, and shall not be subject to setoff, recoupment or counterclaim.

The Authority represents that it is duly authorized pursuant to the Act to create and issue the Bonds, to enter into the Trust Indenture and to pledge the Collateral as security in accordance with the Act. The Collateral so pledged is and will be free and clear of any pledge, lien, security interest, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Trust Indenture, and all action legally required on the part of the Authority to that end has been duly and validly taken. The Bonds and the provisions of the Trust Indenture are and will be the valid and binding obligations of the Authority in accordance with their terms.

Tax Covenants. In the event the Authority issues Tax-Exempt Bonds, the Authority shall at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Authority on Tax-Exempt Bonds shall be excludable from gross income for federal income tax purposes pursuant to § 103(a) of the Code; and no funds of the Authority shall at any time be used directly or indirectly to acquire securities, obligations or other investment property the acquisition or holding of which would cause any Tax-Exempt

Bond to be an arbitrage bond as defined in the Code. If and to the extent required by the Code, the Authority shall periodically, at such times as may be required to comply with the Code, pay as an Operating Expense the amount, if any, required by the Code to be rebated or paid as a related penalty. Notwithstanding any other provisions of the Trust Indenture, the tax covenant requirements shall survive the defeasance or other payment of the Tax Exempt Bonds.

Accounts and Reports. Pursuant to the Trust Indenture the Authority has covenanted to:

(i) cause to be kept books of account in which complete and accurate entries shall be made of its transactions relating to all Funds and Accounts under the Trust Indenture, which books shall, at all reasonable times and at the expense of the Authority, be subject to the inspection of the Trustee and the Holders of an aggregate of not less than 25% in Aggregate Principal Obligation then Outstanding or their representatives duly authorized in writing;

(ii) annually, within 180 days after the close of the Fiscal Year ending September 30, 2006 and of each Fiscal Year thereafter, deliver to the Trustee and each Rating Agency, a copy of its financial statements for such Fiscal Year, as audited by an independent certified public accountant or accountants;

(iii) keep in effect at all times by Officer's Certificate an accurate and current schedule of all Debt Service to be payable during the life of then Outstanding Bonds, Ancillary Facilities, including Interest Rate Exchange Agreements; certifying for the purpose such estimates as may be necessary; and

(iv) for each Distribution Date, direct the Trustee to provide to each Rating Agency a written statement indicating:

(A) the Outstanding Bonds of each Series;

(B) the amount of Bond Obligation to be paid to the Holders of the Bonds of each Series on such Distribution Date;

(C) the amount of interest to be paid to the Holders of the Bonds of each Series on such Distribution Date;

(D) the Turbo Redemptions to be made for each Series as of that Distribution Date;

(E) the amount on deposit in each Fund and Account as of that Distribution Date;

(F) the Liquidity Reserve Requirement as of that Distribution Date;

(G) whether or not a Lump Sum Payment, Partial Lump Sum Payment or Total Lump Sum Payment has been received; and

(H) the amount of Priority Payments, Parity Payments and Junior Payments paid or to be paid to Beneficiaries under each Ancillary Facility, including an Interest Rate Exchange Agreement, on such Distribution Date.

Ratings. Unless otherwise specified by Series Supplement, the Authority shall pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect on each Series of Senior Bonds the number of ratings from nationally recognized rating organizations, if any (but in no event more than two) originally assigned to each such Series.

Affirmative Covenants. The Authority has made the following affirmative covenants under the Trust Indenture:

Protection of Collateral. The Authority shall from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (i) maintain or preserve the lien and pledge and assignment (and the priority thereof) of the Trust Indenture; (ii) perfect, publish notice of or protect the validity of any pledge and assignment made or to be made by the Trust Indenture; (iii) preserve and defend title to the Collateral pledged under the Trust Indenture and the rights of the Trustee and the Bondholders in such Collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of the Trust Indenture or the Act; (iv) enforce the Agreement; (v) pay any and all taxes lawfully levied or assessed upon all or any part of the Collateral pledged under the Trust Indenture; or (vi) carry out more effectively the purposes of the Trust Indenture.

Performance of Obligations. The Authority (i) shall diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the Collateral pledged under the Trust Indenture and (ii) shall not take any action and will use its best efforts not to permit any action to be taken by others that would release the State from any of its covenants or obligations under the Agreement, or the Authority from any of its obligations under the Trust Indenture or the Agreement, or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the Trust Indenture or the Agreement, except, in each case, as expressly provided in the Act, the Trust Indenture or the Agreement.

Notice of Events of Default. The Authority will give the Trustee and the Rating Agencies prompt written notice of each Default or Event of Default under the Trust Indenture.

Negative Covenants. The Authority will make the following negative covenants under the Trust Indenture:

Maintenance of Existence. The Authority shall not take any action that shall impair its existence and rights as a public body corporate and politic and an instrumentality of the State, separate and distinct from the State, exercising public and essential governmental functions, under the laws of the State.

Sale of Assets. Except as expressly permitted by the Trust Indenture, the Authority shall not sell, transfer, exchange or otherwise dispose of any of its Collateral.

No Setoff. The Authority shall not claim any credit on, or make any deduction from the Principal or premium, if any, or interest due in respect of, the Bonds or assert any claim against

any present or former Bondholder by reason of the payment of taxes levied or assessed upon any part of the Collateral.

Liquidation. The Authority shall not take any action with the intention of terminating its existence or dissolving or liquidating in whole or in part.

Limitation of Liens. The Authority shall not (i) permit the validity or effectiveness of the Trust Indenture or the Agreement to be impaired, or permit the lien of the Trust Indenture to be amended, hypothecated, subordinated, terminated or discharged, or permit the Authority to be released from any covenants or obligations with respect to the Bonds under the Trust Indenture except as may be expressly permitted thereby, (ii) except as otherwise permitted under the Trust Indenture, permit, on a parity basis, any lien, charge, excise, claim, security interest, mortgage or other encumbrance (other than the lien of the Trust Indenture) to be created on or extend to or otherwise arise upon or burden the Collateral or any part thereof or any interest therein or the proceeds thereof or (iii) permit the lien of the Trust Indenture not to constitute a valid pledge in the Collateral.

Limitations on Consolidation, Merger, Sale of Assets, etc. Except as otherwise provided in the Trust Indenture, the Authority shall not affirmatively take action to consolidate or merge with or into any other person, or be succeeded by another entity, unless:

(i) the person surviving such consolidation or merger or succession (if other than the Authority) is organized or established and existing under the laws of the United States, the State or any state and expressly assumes the due and punctual payment of the Bond Obligation of and premium, if any, and interest on all Bonds and the performance or observance of every agreement and covenant of the Authority in the Trust Indenture;

(ii) immediately after giving effect to such transaction, no Default has occurred and is continuing under the Trust Indenture;

(iii) the Authority has received a Rating Confirmation;

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

(v) any action as is necessary to maintain the lien and pledge and assignment by the Trust Indenture has been taken; and

(vi) the Authority has delivered to the Trustee an Officer's Certificate and an opinion of Counsel to the effect that such transaction complies with the Trust Indenture and that all conditions precedent to such transaction have been complied with.

Restricted Payments. The Authority shall not direct the Trustee to make payments to or distributions from the Collection Account except in accordance with the Trust Indenture.

Limitation of Rights and Remedies. The parties acknowledge and agree that all of the covenants, agreements, representations, warranties and obligations of the Authority made under or pursuant to Article VI of the Trust Indenture are subject in all respects to the provisions of Section 1.03 of the Trust Indenture and Sections 3.02, 6.04, 6.08 and 6.10 of the Agreement.

Limitation of Rights and Remedies. All of the provisions and sections of Article VII of the Trust Indenture are subject in all respects to the provisions of Section 1.03 of the Trust Indenture and Sections 3.02, 6.04, 6.08 and 6.10 of the Agreement. Article VII recites certain representations, acknowledgments, consents, warranties, covenants and other obligations made by the State in the Agreement with the Authority. Under the Agreement, the State has covenanted and agreed with the Authority, that the Authority can include in the Trust Indenture, pledges made by the State in Section 11 of the Act, including that the State will: (i) irrevocably direct the escrow agent to transfer all Pledged TSRs directly to the Trustee as assignee of the Authority, (ii) enforce the Authority's right to receive the TSRs to the full extent permitted by the terms of the MSA (it being understood that the State may satisfy its obligation under the Agreement by taking such enforcement action through individual or joint or cooperative efforts with other states and their Attorneys General in a manner that it determines as most appropriate), (iii) not amend the MSA in any manner that would materially impair the rights of the Beneficiaries, (iv) not limit or alter the rights of the Authority to fulfill the terms of its agreements with Beneficiaries, (v) not in any impair the rights and remedies of Beneficiaries or the security for the Bonds or Ancillary Facilities, provided nothing in the Act shall be construed to preclude the State's regulation of smoking and the taxation and regulation of the sale of cigarettes or other tobacco products, (vi) not fail to enforce the Qualifying Statute, and (vii) not amend, supersede, or repeal the Qualifying Statute in any way that would materially adversely affect the amount of any payment to or materially impair the rights of the Authority or the Beneficiaries, until the Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of Bondholders, are fully paid and discharged pursuant to the terms of the Trust Indenture. In the Agreement, the State has expressly covenanted to diligently enforce the provisions of the Qualifying Statute. Pursuant to the Trust Indenture, the Authority has pledged and assigned to the Trustee the Authority's rights and remedies with respect to any breach by the State of its covenants, obligations, representations, and warranties under the Agreement. See, *Security and Pledge* herein. In addition, the Authority has agreed in the Trust Indenture to take action necessary to protect the Collateral including enforcement of the Agreement. See, *Affirmative Covenants – Protection of Collateral* herein and subsection (f) under *Events of Default* herein. Nothing in Article VII or the Trust Indenture is intended or shall be construed to make the State a party to the Trust Indenture or to otherwise create any contractual promise, liability or obligation of the State under the Trust Indenture; provided, however, that this shall not preclude the Trustee from pursuing: (a) any rights arising under Section 11(3) of the Act, or (b) certain rights and remedies of the Authority arising under the Agreement against the State that have been assigned by the Authority to the Trustee under the Trust Indenture, subject to the limitations and provisions of the Agreement and the Trust Indenture.

Acknowledgement by the State in the Sales Agreement. The Agreement provides that the State acknowledges and consents to any assignment and pledge by the Authority to the Trustee pursuant to the Trust Indenture for the benefit of the Bondholders and Benefited Parties of any or

all right, title and interest of the Authority in, to and under the Pledged TSRs or the assignment of any or all of the Authority's rights and obligations under the Agreement to the Trustee.

Resignation or Removal of the Trustee. The Trustee may resign at any time on not less than 30 days' written notice to the Authority, the Holders and each of the Rating Agencies then rating the Bonds. The Trustee will promptly certify to the Authority that it has sent written notice to all Holders and such certificate will be conclusive evidence that such notice was mailed as required by the Trust Indenture. Upon receiving such notice of resignation, the Authority shall take action to appoint a successor and, upon the acceptance by the successor of such appointment, release the resigning Trustee from its obligations under the Trust Indenture by written instrument, a copy of which instrument shall be delivered to each of the Holders, the resigning Trustee and the successor Trustee. The Trustee may be removed by the Authority or by a Majority in Interest of Outstanding Senior Bonds, upon written notice to the Trustee, if rated below investment grade by Moody's and each successor Trustee will have an investment grade rating from Moody's. The Trustee may also be removed by written notice from the Authority if no Default is then continuing or from a Majority in Interest of the Outstanding Senior Bonds to the Trustee and the Authority. No such resignation or removal shall take effect until a successor has been appointed and has accepted the duties of Trustee.

Successor Fiduciaries. Any corporation or association which succeeds to the municipal corporate trust business of a Fiduciary as a whole or substantially as a whole, whether by sale, merger, consolidation or otherwise, shall thereby become vested with all the property, rights, powers and duties thereof under the Trust Indenture, without any further act or conveyance and without the execution or filing of any paper with any party thereto except where an instrument of transfer or assignment is required by law to effect such succession, anything in the Trust Indenture to the contrary notwithstanding.

In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary shall with due care terminate its activities under the Trust Indenture and a successor may, or in the case of the Trustee shall, be appointed by the Authority. The Authority shall notify the Holders and the Rating Agencies of the appointment of a successor Trustee in writing within 20 days from the appointment. The Authority will promptly certify to the successor Trustee that it has given such notice to all Holders and such certificate will be conclusive evidence that such notice was given as required by the Trust Indenture. If no appointment of a successor Trustee is made within 45 days after the giving of written notice in accordance with the provisions of the Trust Indenture summarized under the caption "*Resignation or Removal of the Trustee*" or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Trustee or any Holder may apply to any court of competent jurisdiction for the appointment of such a successor, and such court may thereupon, after such notice, if any, as such court may deem proper, appoint such successor. Any successor Trustee appointed under the Trust Indenture shall be a trust company or a bank having the powers of a trust company, located in the State, having a capital and surplus of not less than $50,000,000. Any such successor Trustee shall notify the Authority of its acceptance of the appointment and, upon giving such notice, shall become Trustee, vested with all the property, rights, powers and duties of the Trustee under the Trust Indenture, without any further act or

conveyance. Such successor Trustee shall execute, deliver, record and file such instruments as are required to confirm or perfect its succession under the Trust Indenture and any predecessor Trustee shall from time to time execute, deliver, record and file such instruments as the incumbent Trustee may reasonably require to confirm or perfect any succession under the Trust Indenture.

Fiduciaries for Subordinate Bonds. The Authority may by Series Supplement provide for the appointment of a Fiduciary (which may be the Trustee) to represent the Holders of Subordinate Bonds, having powers and duties not inconsistent with the Trust Indenture.

Reports by Trustee to Holders. The Trustee, on or prior to each Distribution Date for a Series of Bonds, shall deliver to the Holders of such Bonds and to each Rating Agency a statement prepared by the Trustee setting forth as of such Distribution Date or for the period since the preceding Distribution Date, as applicable, the following information and such other information as maybe specified in the Series Supplement relating to such Bonds:

(1) the Bond Obligation paid to Holders expressed in dollars per thousand;

(2) the interest paid to Holders expressed in dollars per thousand;

(3) the actual Turbo Redemptions paid on and prior to such Distribution Date versus the projected Turbo Redemptions;

(4) the amount on deposit in each Fund and Account, including the face value of investments described in subsection (c), (e), (f) and (h) of Eligible Investments;

(5) the Liquidity Reserve Requirement; and

(6) whether or not a Lump Sum Payment, Partial Lump Sum Payment or Total Lump Sum Payment has been received.

Action by Holders. Any request, authorization, direction, notice, consent, waiver or other action provided by the Trust Indenture to be given or taken by Holders of Bonds may be contained in and evidenced by one or more writings of substantially the same tenor signed by the requisite number of Holders or their attorneys duly appointed in writing. Proof of the execution of any such instrument, or of an instrument appointing any such attorney, shall be sufficient for any purpose of the Trust Indenture (except as otherwise expressly provided in the Trust Indenture) if made in the following manner, but the Authority or the Trustee may nevertheless in its discretion require further or other proof in cases where it deems the same desirable. The fact and date of the execution by any Bondholder or his attorney of such instrument may be proved by the certificate or signature guarantee, which need not be acknowledged or verified, of an officer of a bank, trust company or securities dealer satisfactory to the Authority or to the Trustee; or of any notary public or other officer authorized to take acknowledgments of deeds to be recorded in the state in which he purports to act, that the person signing such request or other instrument acknowledged to him the execution thereof; or by an affidavit of a witness of such execution, duly sworn to before such notary public or other officer. The authority of the person or persons executing any such instrument on behalf of a corporate Holder may be established

without further proof if such instrument is signed by a person purporting to be the president or a vice president of such corporation with a corporate seal affixed and attested by a person purporting to be its clerk or secretary or an assistant clerk or secretary. Any action of the owner of any Bond shall be irrevocable and bind all future record and beneficial owners thereof.

Events of Default.

"Event of Default" in the Trust Indenture means any one of the following:

(a) Principal of, premium or interest on any Senior Bond has not been paid, when due;

(b) failure to pay when due payments (other than Termination Payments) under an Interest Rate Exchange Agreement;

(c) failure to pay Sinking Fund Installments or Turbo Redemptions when due in accordance with the Trust Indenture, but only if, and to the extent moneys are available therefor.

(d) the Authority fails to observe or perform any other provision of the Trust Indenture, which failure is not remedied within 60 days after written notice thereof is given to the Authority by the Trustee or to the Authority, the State and the Trustee by the Holders of at least 25% of the Aggregate Principal Obligation, except as specified in paragraph (a) hereof, failure to make any Turbo Redemption because of insufficiency of Surplus Collections pursuant to Article V of the Trust Indenture shall not constitute a Default or an Event of Default. In the case of a default specified in this paragraph, if the default cannot be corrected within the said 60-day period, it shall not constitute an Event of Default if corrective action is instituted by the Authority within said 60-day period and diligently pursued until the default is corrected.

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

(f) a material breach by the Authority of its covenants contained in Section 7.03(b) of the Trust Indenture, which breach is not remedied within 60 days after written notice thereof is given to the Authority and the State by the Trustee or to the Authority and the Trustee by the Holders of at least 25% of the Aggregate Principal Obligation. In the case of a default specified in this paragraph, if the default cannot be corrected within the said 60-day period, it shall not constitute an Event of Default if corrective action is instituted by the State or the Authority within said 60-day period and diligently pursued until the default is corrected.

(g) the State fails to pay to the Authority or the Trustee any Pledged TSRs received by it promptly in accordance with the Agreement; or

(h) (i) the State agrees to an amendment of the MSA in any manner that would materially and adversely impair the ability of the Authority to receive the Pledged TSRs, or releases any PM from any of its covenants or obligations to make payment of the

Pledged TSRs under the MSA, or agrees to the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the MSA or waives timely performance or observance by PMs under the MSA, if, in any and each such case, the effect thereof would be materially adverse to the Authority's ability to receive the Pledged TSRs; or

(ii) except as may be authorized and provided for in Sections 6.09(h) or 11.02 of the Trust Indenture, the Agreement is amended, superceded, suspended, revoked or otherwise altered by the Authority in a manner that would materially impair the rights of the Beneficiaries; and

(iii) the action constituting an "event of default" under paragraphs (i) or (ii) of paragraph (f) is not remedied within 60 days after Written Notice, specifying such default and requiring the same to be remedied, shall have been given to the Authority and the State by the Trustee or by the Holders of at least 25% of the Aggregate Principal Obligation. In the case of a default specified in paragraph (f), if the default cannot be corrected within the said 60-day period, it shall not constitute an Event of Default if corrective action is instituted by the State or the Authority within said 60-day period and diligently pursued until the default is corrected.

Registered Holders. Certain provisions applicable to DTC as Holder of immobilized Bonds shall not be construed in limitation of the rights of the Authority and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in the Trust Indenture. Notwithstanding any other provisions of the Trust Indenture, any payment to the registered owner of a Bond shall satisfy the Authority's obligations thereon to the extent of such payment.

Remedies. Pursuant to the Trust Indenture, if an Event of Default occurs and is continuing the Trustee may, and upon written request of the Holders of at least 25% of the Aggregate Principal Obligation of Senior Bonds Outstanding shall, in its own name by action or proceeding in accordance with law:

(A) enforce all rights of the Holders and require the Authority to carry out its agreements with Holders or, to the extent permitted by law and subject to the terms, provisions and limitations in the Agreement, require the State to perform its duties under the Agreement;

(B) sue upon such Bonds;

(C) require the Authority to account as if it were the trustee on an express trust of such Holders;

(D) enjoin any acts or things which may be unlawful or in violation of the rights of such Holders;

The Trustee shall, in addition to the other provisions of the Trust Indenture, have and possess all the powers necessary or appropriate for the exercise of any functions incident to the general representation of Holders in the enforcement and protection of their rights under the Trust Indenture.

Extraordinary Payment. Upon an Event of Default under the Trust Indenture, or a failure to make any other payment required under the Trust Indenture within 7 days after the same becomes due and payable, the Trustee shall give Written Notice thereof to the Authority. The Trustee shall give notice under the Trust Indenture when instructed to do so by the written direction of another Fiduciary or the Holders of at least 25% of the Aggregate Principal Obligation of Senior Bonds Outstanding. Upon the occurrence of an Event of Default, the Trustee shall proceed under the Trust Indenture for the benefit of the Holders in accordance with the written direction of a Majority in Interest of the Outstanding Senior Bonds. The Trustee shall not be required to take any remedial action (other than the giving of notice) unless reasonable indemnity is furnished for any expense or liability to be incurred therein. Upon receipt of Written Notice, direction, and indemnity, and after making such investigation, if any, as it deems appropriate to verify the occurrence of any Event of Default of which it is notified as aforesaid, the Trustee shall promptly pursuant the remedies provided by the Trust Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Holders, and shall act for the protection of the Holders with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

Only upon the occurrence of a Payment Default, shall the Bonds and payments under Interest Rate Exchange Agreements be paid on a pro rata basis as described in the Trust Indenture.

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

Individual Remedies. Subject to the provisions of the next succeeding sentence, no one or more Holders shall by his or their action affect, disturb or prejudice the pledge and assignment created by the Trust Indenture, or enforce any right under the Trust Indenture, except in the manner provided therein; and all proceedings at law or in equity to enforce any provision of the

Trust Indenture shall be instituted, had and maintained solely by the Trustee in the manner provided therein and for the equal and ratable benefit of all Holders of the same class. Nothing in the Trust Indenture shall affect or impair the right of any Holder of any Bond to enforce payment of the principal of, premium, if any, or interest thereon at and after the same comes due pursuant to the Trust Indenture, or the obligation of the Authority to pay such principal, premium, if any, and interest on each of the Bonds to the respective Holders thereof at the time, place, from the source and in the manner expressed in the Trust Indenture and in the Bonds.

Venue. Except as otherwise provided in the Trust Indenture, any legal action against the Authority shall be brought in the Michigan Court of Appeals, which shall have exclusive jurisdiction; provided, however, any legal actions against the Authority seeking money damages shall be brought in the Michigan Court of Claims, which shall have exclusive original jurisdiction with respect to actions against the Authority seeking money damages.

Waiver. If the Trustee determines that a Default has been cured before becoming an Event of Default and before the entry of any final judgment or decree with respect to it, the Trustee may waive the Default and its consequences, by written notice to the Authority, and shall do so upon written instruction of the Holders of at least 25% of the Aggregate Principal Obligation of the Senior Bonds.

Supplements and Amendments to the Trust Indenture. The Trust Indenture may be:

(i) supplemented by delivery to the Trustee of an instrument certified by an Authorized Officer of the Authority to (A) provide for earlier or greater deposits into the Bond Fund, (B) upon direction of an Authorized Officer of the Authority, accompanied by an opinion of Counsel as to the validity thereof under the Act, subject any property to the lien of the Trust Indenture subject to the consent of the State or as authorized by law, (C) add to the covenants and agreements of the Authority or surrender or limit any right or power of the Authority to the extent permitted by the Act or other applicable law, (D) identify particular Bonds for purposes not inconsistent with the Trust Indenture, including credit or liquidity support, remarketing, serialization and defeasance, (E) cure any ambiguity or defect, (F) protect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes, or the exemption from registration of the Bonds under the Securities Act of 1933, as amended, or of the Trust Indenture under the Trust Indenture Act of 1939, as amended, (G) authorize Bonds of a Series and in connection therewith determine the matters referred to in the Trust Indenture, and any other things relative to such Bonds that are not materially adverse to the Holders of Outstanding Bonds, or to modify or rescind any such authorization or determination at any time prior to the first authentication and delivery of such Series of Bonds, or (F) reduce the percentage of Sold Tobacco Receipts constituting Pledged TSRs (and correspondingly increase the percentage of Sold Tobacco Receipts constituting Unencumbered TSRs) or reduce the amount of Sold Tobacco Receipts as provided in Section 2.01(f); or

(ii) amended in any other respect by the Authority and the Trustee, (A) to add provisions that are not materially adverse to the Holders, or (B) to adopt amendments that do not take effect unless and until (1) no Bonds Outstanding prior to the adoption of such

amendment remain Outstanding or (2) such amendment is consented to by the Holders of such Bonds in accordance with the further provisions below; or

(iii) amended only with prior written notice to the Rating Agencies and the written consent of a Majority in Interest of the Aggregate Principal Obligation of Subordinate Bonds and Senior Bonds (acting as separate classes) affected thereby; provided, however, the Trust Indenture shall not be amended so as to (A) extend the maturity of any Bond, (B) reduce the Principal amount or Accreted Value of any Bond, applicable premium or interest rate of any Bond, (C) make any Bond redeemable other than in accordance with its terms, (D) create a preference or priority of any Bond over any other Bond of the same class or (E) reduce the percentage of the Bonds required to be represented by the Holders giving their consent to any amendment unless the Holders of the Bonds affected thereby have consented thereto in writing.

Although not required, the receipt of a Rating Confirmation with respect to any such proposed modification shall be conclusive evidence that such modification does not adversely affect the Authority's ability to receive the Pledged TSRs.

Any amendment of the Trust Indenture shall be accompanied by a Counsel's opinion addressed to the Trustee to the effect that the amendment is permitted by law and by the Trust Indenture and, if there are Tax-Exempt Bonds Outstanding, does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes.

When the Authority determines that the requisite number of consents have been obtained for an amendment hereto or to the Agreement which requires consents, it shall file a certificate to that effect in its records and give written notice to the Trustee and the Holders. The Trustee will promptly certify to the Authority that it has given such notice to all Holders and such certificate will be conclusive evidence that such notice was given in the manner required by the Trust Indenture.

Supplements and Amendments to the Agreement. In the event that the Trustee receives a request from the Authority for a consent or other action with respect to an amendment to the Agreement pursuant to the Trust Indenture, the Trustee shall transmit a notice of such request to each Holder and request directions with respect thereto.

Governing Law. The Trust Indenture shall be governed by State law, without reference to its conflict of law provisions, and the obligations, rights and remedies of the parties under the Trust Indenture shall be determined in accordance with such laws. Any and all litigation or actions commenced in connection with the Trust Indenture and the Bonds shall be brought in the venues designated in the Trust Indenture.

Series 2008 Supplement

The following summary describes certain terms of the Series 2008 Supplement pursuant to which the Series 2008 Bonds will be issued. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Series 2008 Supplement and the Bonds.

Details of the Series 2008 Bonds. The Series 2008 Supplement authorizes two Series of Tax-Exempt Bonds and one Series of Taxable Bonds, as follows: (i) the Authority's Tobacco Settlement Asset-Backed Bonds, Series 2008A in the aggregate principal amount of $114,860,000.00; (ii) the Authority's Taxable Tobacco Settlement Asset-Backed Bonds, Series 2008B in the initial principal amount of $29,874,650.00; and (iii) the Authority's Tobacco Settlement Asset-Backed Bonds, Series 2008C in the initial principal amount of $57,673,814.40.

The Series 2008A Bonds shall be issued as Tax-Exempt Bonds and Fixed Rate Current Interest Bonds in fully registered form and shall be numbered from AR-1, consecutively upwards. The Series 2008A Bonds shall be in book entry only form in Authorized Denominations of $5,000 or any integral multiple thereof. The Series 2008A Bonds shall be dated their date of delivery and shall mature on the dates and bear interest at the rates set forth in the Series 2008 Supplement. Interest on the Series 2008A Bonds shall be payable on each Distribution Date in each year, beginning on December 1, 2008 and such interest will be computed on the basis of a 360-day year consisting of twelve 30-day months. The Series 2008A Bonds will be issued as Turbo Term Bonds. The Series 2008A Bonds will be issued as Additional Bonds and Refunding Bonds under the Trust Indenture and the requirements for the issuance of such Bonds have been satisfied.

The Series 2008B Bonds shall be issued as Taxable Bonds and Capital Appreciation Bonds in fully registered form and shall be numbered BR-1, consecutively upward. The Series 2008B Bonds shall be in book entry only form in Authorized Denominations which accrete to $5,000 or any integral multiple thereof at the end of Accretion Period. The Series 2008B Bonds shall be dated their date of delivery and shall mature on the dates set forth in the Series 2008 Supplement. The Series 2008B Bonds shall accrete at the respective rates which provide the approximate yields to maturity set forth in the Series 2008 Supplement and which, when compounded on each Valuation Date, results in the Accreted Values shown on Schedule B to the Series 2008 Supplement, which Accreted Value shall be payable at maturity or earlier redemption thereof. The Series 2008B Bonds will be issued as Turbo Term Bonds. The Series 2008B Bonds will be issued as Additional Bonds and Refunding Bonds under the Trust Indenture and the requirements for the issuance of such Bonds have been satisfied.

The Series 2008C Bonds shall be issued as Tax Exempt Bonds and Capital Appreciation Bonds in fully registered form and shall be numbered CR-1, consecutively upward. The Series 2008C Bonds shall be in book entry only form in Authorized Denominations which accrete to $5,000 or any integral multiple thereof at the end of the Accretion Period. The Series 2008C Bonds shall be dated their date of delivery and shall mature on the date or dates set forth in the Series 2008 Supplement. The Series 2008C Bonds shall accrete at the respective rates which provide the approximate yields to maturity set forth in Schedule C to the Series 2008 Supplement and which, when compounded on each Valuation Date, results in the Accreted Values shown on Schedule C to the Series 2008 Supplement, which Accreted Value shall be payable at maturity or earlier redemption thereof. The Series 2008C Bonds will be issued as Turbo Term Bonds. The Series 2008C Bonds will be issued as Additional Bonds and Refunding Bonds under the Trust Indenture and the requirements for the issuance of such Bonds have been satisfied.

*Optional Redemption***.** (a) The Series 2008A Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid as set forth in the Projected Turbo Schedule included in Schedule A to the Series 2008 Supplement, but as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2018, from any Maturity Date selected by the Authority in its discretion and in either case (x) if redeemed in part, in accordance with DTC's standard procedures, or if such Bonds are not then held by DTC or another Securities Depository, on such basis as the Trustee deems fair and appropriate, including by lot, within a Maturity Date; and (y) at a redemption price equal to 100% of the Principal being redeemed, plus interest accrued to the date fixed for redemption.

(b) The Series 2008B Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), on a pro rata basis, at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid as set forth in the Projected Turbo Schedule included in Schedule B to the Series 2008 Supplement but, as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2018, at a redemption price equal to 100% of the Accreted Value being redeemed on the date fixed for redemption.

(c) The Series 2008C Bonds are subject to redemption (from the proceeds of Refunding Bonds or any other source other than Collections), at the option of the Authority (i) in whole or in part at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid as set forth in the Projected Turbo Schedule included in Schedule B to the Series 2008 Supplement but, as of the date of such redemption, have not been paid with respect to such Turbo Term Bonds, and (ii) in whole or in part on any date on or after June 1, 2033, from any Maturity Date selected by the Authority in its discretion and in either case (x) if redeemed in part, in accordance with DTC's standard procedures, or if such Bonds are not then held by DTC or another Securities Depository, on such basis as the Trustee deems fair and appropriate, including by lot, within a Maturity Date; and (y) at a redemption price equal to 100% of the Accreted Value being redeemed on the date fixed for redemption.

Mandatory Redemption of Turbo Term Bonds. The Series 2008 Bonds shall be subject to mandatory redemption from Surplus Collections in the Turbo Redemption Account as provided in the Trust Indenture.

Certain Provisions Relating to Convertible Capital Appreciation Bonds and Capital Appreciation Bonds. For purposes of (i) receiving payment of the redemption price of a Convertible Capital Appreciation Bond or a Capital Appreciation Bond if any such Bond is redeemed prior to maturity, (ii) receiving payment pursuant to the Trust Indenture of a Convertible Capital Appreciation Bonds or a Capital Appreciation Bond following the occurrence of an Event of Default or (iii) computing the Principal amount of Bonds held by the Holder of a Convertible Capital Appreciation Bond or a Capital Appreciation Bond in giving to

the Authority or Trustee any notice, consent, request or demand pursuant to the Trust Indenture for any purpose whatsoever, the then current Accreted Value of such Bond shall be deemed to be its Principal amount.

Covenants and Agreements of the Authority

In accordance with the Trust Indenture, the Authority covenants and agrees that while any Series 2008 A Bonds, Series 2008B Bonds or Series 2008C Bonds are Outstanding Bonds under the Trust Indenture, the Authority will not (i) reduce the percentage of Sold Tobacco Receipts constituting Pledged TSRs (and correspondingly increase the percentage of Sold Tobacco Receipts constituting Unencumbered TSRs) authorized under Section 2.01(f) of the Trust Indenture; and (ii) use a Cash Equivalent for deposit to the Liquidity Reserve Account to satisfy the Liquidity Reserve Requirement.

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APPENDIX E

BOOK-ENTRY ONLY SYSTEM

*The information in this Appendix E concerning The Depository Trust Company ("**DTC**"), New York, New York, and DTC's book-entry system has been obtained from DTC and the Authority, the State and the Underwriters take no responsibility for the completeness or accuracy thereof. The Authority, the State and the Underwriters cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of principal of and interest on the Series 2008 Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Series 2008 Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2008 Bonds, or that they will do so on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix F. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.*

DTC will act as securities depository for the Series 2008 Bonds. The Series 2008 Bonds will be issued as fully registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered security certificate will be issued for the Series 2008 Bonds, in the aggregate initial principal amount of such Series 2008 Bonds, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("**Direct Participants**") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("**DTCC**"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, (respectively, "**NSCC**," "**FICC**," and "**EMCC**," also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("**Indirect Participants**"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of the Series 2008 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2008 Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2008 Bonds ("**Beneficial Owner**") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written

confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2008 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2008 Bonds, except in the event that use of the book-entry system for the Series 2008 Bonds is discontinued. To facilitate subsequent transfers, all Series 2008 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2008 Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2008 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2008 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2008 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2008 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the security documents. For example, Beneficial Owners of the Series 2008 Bonds may wish to ascertain that the nominee holding the Series 2008 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2008 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2008 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of and interest evidenced by the Series 2008 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Authority or the Indenture Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Indenture Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal of and interest evidenced by the Series 2008 Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Indenture Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

NONE OF THE AUTHORITY, THE UNDERWRITERS OR THE INDENTURE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT

PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF BONDS FOR PREPAYMENT.

DTC may discontinue providing its services as depository with respect to the Series 2008 Bonds at any time by giving reasonable notice to the Authority or the Indenture Trustee. Under such circumstances, in the event that a successor depository is not obtained, bond certificates are required to be printed and delivered. The Authority may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered. In the event that the book-entry system is discontinued as described above, the requirements of the Indenture will apply.

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APPENDIX F

ACCRETED VALUE TABLE

Table of Accreted Values for the Series 2008B Capital Appreciation Turbo Term Bonds
(Accreted Values Shown Per $5,000 Maturity Amount)

Date	Accreted Value	Date	Accreted Value
7/7/2008	$213.20	6/1/2027	$1,028.20
12/1/2008	220.40	12/1/2027	1,071.90
6/1/2009	229.75	6/1/2028	1,117.45
12/1/2009	239.55	12/1/2028	1,164.95
6/1/2010	249.70	6/1/2029	1,214.45
12/1/2010	260.35	12/1/2029	1,266.05
6/1/2011	271.40	6/1/2030	1,319.85
12/1/2011	282.95	12/1/2030	1,375.95
6/1/2012	294.95	6/1/2031	1,434.45
12/1/2012	307.50	12/1/2031	1,495.40
6/1/2013	320.55	6/1/2032	1,558.95
12/1/2013	334.20	12/1/2032	1,625.20
6/1/2014	348.40	6/1/2033	1,694.30
12/1/2014	363.20	12/1/2033	1,766.30
6/1/2015	378.65	6/1/2034	1,841.35
12/1/2015	394.75	12/1/2034	1,919.60
6/1/2016	411.50	6/1/2035	2,001.20
12/1/2016	429.00	12/1/2035	2,086.25
6/1/2017	447.25	6/1/2036	2,174.90
12/1/2017	466.25	12/1/2036	2,267.35
6/1/2018	486.05	6/1/2037	2,363.70
12/1/2018	506.70	12/1/2037	2,464.20
6/1/2019	528.25	6/1/2038	2,568.90
12/1/2019	550.70	12/1/2038	2,678.10
6/1/2020	574.10	6/1/2039	2,791.90
12/1/2020	598.50	12/1/2039	2,910.55
6/1/2021	623.95	6/1/2040	3,034.25
12/1/2021	650.45	12/1/2040	3,163.20
6/1/2022	678.10	6/1/2041	3,297.65
12/1/2022	706.95	12/1/2041	3,437.80
6/1/2023	737.00	6/1/2042	3,583.90
12/1/2023	768.30	12/1/2042	3,736.25
6/1/2024	800.95	6/1/2043	3,895.05
12/1/2024	835.00	12/1/2043	4,060.55
6/1/2025	870.50	6/1/2044	4,233.15
12/1/2025	907.50	12/1/2044	4,413.05
6/1/2026	946.05	6/1/2045	4,600.60
12/1/2026	986.25	12/1/2045	4,796.15
		6/1/2046	5,000.00

Table of Accreted Values for the
Series 2008C Capital Appreciation Turbo Term Bonds
(Accreted Values Shown Per $5,000 Maturity Amount)

Date	Accreted Value	Date	Accreted Value
7/7/2008	$ 65.60	6/1/2033	$ 570.35
12/1/2008	67.90	12/1/2033	595.65
6/1/2009	70.95	6/1/2034	622.05
12/1/2009	74.10	12/1/2034	649.70
6/1/2010	77.40	6/1/2035	678.50
12/1/2010	80.80	12/1/2035	708.60
6/1/2011	84.40	6/1/2036	740.05
12/1/2011	88.15	12/1/2036	772.90
6/1/2012	92.05	6/1/2037	807.20
12/1/2012	96.15	12/1/2037	843.05
6/1/2013	100.40	6/1/2038	880.45
12/1/2013	104.85	12/1/2038	919.50
6/1/2014	109.50	6/1/2039	960.30
12/1/2014	114.40	12/1/2039	1,002.95
6/1/2015	119.45	6/1/2040	1,047.45
12/1/2015	124.75	12/1/2040	1,093.90
6/1/2016	130.30	6/1/2041	1,142.45
12/1/2016	136.10	12/1/2041	1,193.15
6/1/2017	142.10	6/1/2042	1,246.10
12/1/2017	148.45	12/1/2042	1,301.40
6/1/2018	155.00	6/1/2043	1,359.15
12/1/2018	161.90	12/1/2043	1,419.45
6/1/2019	169.10	6/1/2044	1,482.45
12/1/2019	176.60	12/1/2044	1,548.25
6/1/2020	184.40	6/1/2045	1,616.95
12/1/2020	192.60	12/1/2045	1,688.70
6/1/2021	201.15	6/1/2046	1,763.65
12/1/2021	210.10	12/1/2046	1,841.90
6/1/2022	219.40	6/1/2047	1,923.65
12/1/2022	229.15	12/1/2047	2,009.00
6/1/2023	239.30	6/1/2048	2,098.15
12/1/2023	249.95	12/1/2048	2,191.25
6/1/2024	261.05	6/1/2049	2,288.50
12/1/2024	272.60	12/1/2049	2,390.05
6/1/2025	284.70	6/1/2050	2,496.10
12/1/2025	297.35	12/1/2050	2,606.85
6/1/2026	310.55	6/1/2051	2,722.55
12/1/2026	324.30	12/1/2051	2,843.35
6/1/2027	338.70	6/1/2052	2,969.55
12/1/2027	353.75	12/1/2052	3,101.30
6/1/2028	369.45	6/1/2053	3,238.95
12/1/2028	385.85	12/1/2053	3,382.65
6/1/2029	402.95	6/1/2054	3,532.75
12/1/2029	420.85	12/1/2054	3,689.55
6/1/2030	439.50	6/1/2055	3,853.25
12/1/2030	459.05	12/1/2055	4,024.25
6/1/2031	479.40	6/1/2056	4,202.85
12/1/2031	500.65	12/1/2056	4,389.35
6/1/2032	522.90	6/1/2057	4,584.10
12/1/2032	546.10	12/1/2057	4,787.55
		6/1/2058	5,000.00

APPENDIX G

INDEX OF DEFINED TERMS

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